BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date:	April 4, 2014
To:	Board of Governors
From:	Governor Tarullo DKT
Subject:	Board vote on a final rule on enhanced supplementary leverage ratio (SLR) standards; a proposed rule to revise the SLR; and a proposed rule to revise the definition of eligible guarantee

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Attached are (1) a memorandum to the Board on two leverage ratio-related rulemakings and a technical change to the advanced approaches risk-based capital rule; (2) the draft *Federal Register* notice of final rulemaking that would implement enhanced SLR standards; (3) the draft *Federal Register* notice that proposes to revise the calculation of the SLR; and (4) the draft *Federal Register* notice that would revise the definition of eligible guarantee under the advanced approaches risk-based capital rule in the Board's revised regulatory capital framework.

- The final rule on enhanced SLR standards would effectively apply to the eight U.S. top-tier bank holding companies identified as global systemically-important banks by the Financial Stability Board and to their insured depository institution (IDI) subsidiaries. Covered BHCs would be required to maintain an SLR of more than 5 percent in order to avoid limitations on capital distributions and discretionary bonus payments. Subsidiary IDIs would be required to maintain an SLR of at least 6 percent to be "well-capitalized" under the agencies' prompt corrective action framework.
- The SLR NPR would revise the definition of total leverage exposure, which is the denominator of the SLR, to be consistent with the BCBS's January 2014 revised leverage ratio (Basel III leverage ratio).
- The eligible guarantee NPR would correct an error in the 2013 rule that inappropriately limited recognition of guarantees of wholesale exposures under the advanced approaches.

The final rule and the notices of proposed rulemakings would be published jointly by the Board, FDIC, and OCC in the *Federal Register* after all agencies have completed internal review and approval procedures.

The Committee on Bank Supervision has reviewed the final rule and notices of proposed rulemaking and I believe they are ready for the Board's consideration.

Attachments

Date: April 4, 2014

To: Board of Governors

From: Staff[1]

Subjects: Final rule on enhanced supplementary leverage ratio (SLR) standards; proposed rule on the SLR; and proposed rule on the definition of eligible guarantee in the advanced approaches risk-based capital rule

ACTIONS REQUESTED

Staff seeks the Board's approval of (1) a final rule implementing enhanced SLR standards for large, interconnected U.S. banking organizations (final rule); (2) a notice of proposed rulemaking (NPR) that would modify the definition of total leverage exposure (SLR NPR) in the agencies' 2013 revised capital rule (2013 rule);[2] and (3) an NPR that would revise the definition of eligible guarantee (eligible guarantee NPR) under the agencies' advanced approaches risk-based capital requirements in the 2013 rule (advanced approaches). In connection with these rulemakings, staff requests authority to make technical, non-substantive changes to the attached materials prior to publication in the *Federal Register* in order to respond to comments from the *Federal Register* or to incorporate non-substantive changes requested by other federal banking agencies as part of the approval process. The final rule, the SLR NPR, and the eligible guarantee NPR would be issued jointly by the Board, FDIC, and OCC (collectively, the agencies) after the agencies have completed their internal review and approval procedures.

[1] Messrs. Gibson, Van Der Weide, Boemio, Climent and Willis, and Mmes. Hewko, Horsley, Kirkpatrick, Phelan, Milewski (Division of Banking Supervision and Regulation), and Messrs. Alvarez, McDonough, and Buresh and Mme. Snyder (Legal Division).

[2] The Board and the OCC published a joint final rule in the *Federal Register* on October 11, 2013 (78 FR 62018) and the FDIC published a substantially identical interim final rule on September 10, 2013 (78 FR 55340). The 2013 rule, which effectively implements the international Basel III framework, can be found at http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

EXECUTIVE SUMMARY

- The **final rule** on enhanced SLR standards would be finalized substantially as proposed. The final rule would effectively apply to the eight U.S. top-tier bank holding companies (covered BHCs) identified as global systemically-important banks (G-SIBs) by the Financial Stability Board and to their insured depository institution (IDI) subsidiaries (together, covered organizations).[3] Covered BHCs would be required to maintain an SLR of more than 5 percent in order to avoid limitations on capital distributions and discretionary bonus payments. Subsidiary IDIs of covered BHCs would be required to maintain an SLR of at least 6 percent to be "well-capitalized" under the agencies' prompt corrective action (PCA) framework. *(See pages 3-5 of this memorandum for further information on the final rule, and see Appendix I for a summary of comments received on the enhanced SLR standards NPR.)*

- The **SLR NPR** would revise the definition of total leverage exposure, which is the denominator of the SLR, to be consistent with the BCBS's January 2014 revised leverage ratio (Basel III leverage ratio). The principal changes that would be effected by the SLR NPR are including the notional amount of sold credit protection (with some hedge recognition) and including lines of credit, letters of credit and other similar off-balance sheet items using standardized credit conversion factors (CCFs). Repo-style transactions and cash variation margin for derivative contracts would continue to be measured in a manner largely consistent with U.S. generally accepted accounting principles (GAAP) but some banking organizations may be required to increase exposure amounts for these transactions, compared to GAAP assets. The proposal would also require institutions to calculate total leverage exposure using daily averages. *(See pages 5-10 of this memorandum for further information on the SLR NPR.)*

- **Impact analysis:** Board staff estimates that total leverage exposure for the eight covered BHCs would increase an estimated 8 percent under the SLR NPR. Using supervisory estimates as of fourth quarter 2013, the estimated aggregate tier 1 capital shortfall for covered BHCs to meet a 5 percent SLR would be $68 billion (compared to $22 billion using the total leverage exposure definition in the 2013 rule). *(See pages 10-12 of this memorandum for further information on the impact analysis.)*

- The **eligible guarantee NPR** would correct an error in the 2013 rule that inappropriately limited recognition of guarantees of wholesale exposures under the advanced approaches.

[3] The U.S. top-tier bank holding companies that are currently identified as G-SIBs according to the Basel Committee on Banking Supervision (BCBS) methodology are Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

(See pages 12-13 of this memorandum for further information on the eligible guarantee NPR.)

DISCUSSION

A. The Final Rule on Enhanced SLR Standards

The final rule would become effective on January 1, 2018, and apply to any U.S. top-tier bank holding company with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody (covered BHC) and its insured depository institution (IDI) subsidiaries (together, covered organizations). The 2013 rule defines the SLR as the ratio of tier 1 capital to total leverage exposure and requires each advanced approaches banking organization to calculate and report its SLR beginning in 2015 and to maintain a minimum SLR of 3 percent beginning in 2018. The SLR, which was finalized in 2013 in a manner largely consistent with the Basel III leverage ratio then in effect, was designed to incorporate both on- and off-balance sheet exposures to more accurately measure an internationally active banking organization's leverage exposure.

To mitigate the threat to financial stability posed by systemically-important financial companies, which is one of the objectives of the Dodd-Frank Act, the agencies published a joint NPR seeking public comment on enhanced SLR standards for covered organizations (2013 enhanced SLR standards NPR) that would build on the 3 percent minimum SLR beginning in 2018. The 2013 enhanced SLR standards NPR was intended to incentivize companies that are so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability to maintain capital well above the thresholds required for other firms. By further enhancing the capital strength of systemically-important U.S. banking organizations, the enhanced SLR standards could help to counterbalance possible funding cost advantages that these organizations may enjoy as a result of the perception that they may be "too big to fail."

Under the final rule, consistent with the 2013 enhanced SLR standards NPR, a covered BHC that maintains a leverage buffer of tier 1 capital in an amount greater than 2 percent of its total leverage exposure, in addition to the 3 percent minimum SLR, would not be subject to limitations on capital distributions and discretionary bonus payments. If a covered BHC maintains a leverage buffer of 2 percent or less, it would become subject to increasingly strict limitations on capital distributions and discretionary bonus payments. The mechanics of the final rule's leverage buffer would be aligned with those used for the 2013 rule's risk-based capital conservation buffer. Furthermore, under the final rule, an IDI that is a subsidiary of a covered BHC would need to satisfy a 6 percent SLR to be considered well-capitalized for PCA purposes.[4]

The agencies received nearly 30 comments on the 2013 enhanced SLR standards NPR from banking organizations, trade associations representing the banking or financial services industry, supervisory authorities, public interest advocacy groups, private individuals, members of Congress, and other interested parties. In general, comments from financial services firms, banking organizations, banking trade associations and other industry groups were critical of the 2013 enhanced SLR standards NPR, while comments from organizations representing smaller banking organizations or their supervisors, public interest advocacy groups and the public generally were supportive. Commenters expressed concerns with respect to several issues, including timing, scope of application, and impact on certain covered organizations (for example, custody banks). Several commenters were critical of the proposed calibration, which

[4] The 2013 rule incorporated the 3 percent minimum SLR into the PCA framework as an adequately capitalized threshold for IDIs subject to the advanced approaches risk-based capital rules, but did not establish a well-capitalized threshold for this ratio.

could potentially make the SLR the binding regulatory capital constraint for some covered banking organizations. Some commenters also highlighted that using an average of three month-end balances to calculate the total leverage exposure could lead to an artificial and temporary increase of the SLR at the end of the month, an issue that is addressed for all banking organizations in the SLR NPR as described below.[5]

For the reasons described above, and in light of the impact analysis of the interaction between the final rule and the SLR NPR described on pages 10 through 12 of this memorandum, the final rule would adopt the enhanced SLR standards substantially as proposed.

B. The SLR NPR

The proposed revisions to the SLR in the SLR NPR are aligned with the Basel III leverage ratio as finalized by the BCBS in January 2014 and are designed to ensure that total leverage exposure reflects the economic exposure of certain off-balance sheet activities more closely. They would also ensure consistency in the calculation of on- and off-balance sheet exposures for determining total leverage exposure across jurisdictions with different accounting regimes. Additionally, the SLR NPR would also make changes to the methodology for calculating the SLR and to the public disclosure requirements for this ratio. The proposed changes in the SLR NPR would affect all advanced approaches banking organizations.[6]

1. Proposed changes to the definition of total leverage exposure

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[5] See Appendix I for a thematic summary of comments received on the 2013 enhanced SLR standards NPR. See section II of the preamble to the attached draft final rule for a more detailed overview of these comments and the agencies' responses to them.

[6] Advanced approaches banking organizations generally are those with consolidated total assets of at least $250 billion or consolidated total on-balance sheet foreign exposures of at least $10 billion.

Consistent with the 2013 rule, total leverage ratio exposure would continue to include substantially all on-balance sheet assets, less amounts deducted from tier 1 capital under the 2013 rule; the potential future exposure (PFE) amount for each derivative contract, including for certain cleared transactions, to which the banking organization is a counterparty; and 10 percent of the notional amount of unconditionally cancellable commitments. Under the SLR NPR, total leverage exposure would be revised to also include the items discussed below.

i. Sold credit protection

Under the 2013 rule, sold credit protection in the form of a credit derivative or similar instrument (for example, a total return swap on a bond) is treated like other derivative contracts for purposes of determining the exposure amount for inclusion in total leverage exposure. The SLR NPR would require that sold credit protection's notional amount (adjusted for any leverage built into the transaction) be included in total leverage exposure because the banking organization assumes the credit risk of the reference exposure, in addition to the counterparty credit risk arising from the creditworthiness of the counterparty.

Under the SLR NPR, a banking organization may reduce the notional amount of sold credit protection by the amount of any reduction in the fair value of the sold credit protection if the reduction is recognized in common equity tier 1 capital. In addition, a banking organization may reduce the notional amount of sold credit protection by the notional amount of purchased credit protection on the same reference name if the remaining maturity of the purchased credit protection is equal to or greater than the remaining maturity of the sold credit protection, and certain other conditions are met. The SLR NPR also would permit a banking organization to adjust the PFE amount associated with sold credit protection to avoid double counting of the exposure amount.

ii. Off-balance sheet exposures

Under the 2013 rule, banking organizations must apply a 100 percent CCF to all off-balance sheet items (other than off-balance sheet exposures of derivatives and repo-style transactions, that is, securities lending and borrowing and repurchase and reverse repurchase transactions) included in total leverage exposure, except for unconditionally cancellable commitments, which receive a 10 percent CCF. The SLR NPR would revise this treatment, consistent with the Basel III leverage ratio, by retaining the 10 percent CCF for unconditionally cancellable commitments, but replacing the uniform 100 percent CCF for other off-balance sheet items with the standardized risk-based capital CCFs in the 2013 rule. For example, under the SLR NPR, a banking organization would apply a 20 percent CCF to a commitment with an original maturity of one year or less that is not unconditionally cancellable.

The proposed revisions to the CCFs are designed to incorporate off-balance sheet exposures in the total leverage exposure without overstating effective exposure amounts because the uniform 100 percent CCF may, in aggregate, overstate the relative magnitude of off-balance sheet exposures as compared to on-balance sheet exposures.

iii. Cash variation margin

Under the 2013 rule, total leverage exposure includes a banking organization's on-balance sheet assets, including the GAAP carrying value, if any, of derivative contracts on the banking organization's balance sheet. In some cases the GAAP carrying value reflects a netting of cash variation margin received against gross derivative assets. The SLR NPR would specify the conditions that a banking organization's cash collateral received from, or posted to, counterparties in derivative transactions would need to meet so that the banking organization may reduce its gross derivative asset amounts (in case of cash collateral received) or its cash assets (in case of cash collateral posted) for inclusion in total leverage exposure. Similar to the 2013 rule, cash variation margin would only reduce the current exposure amount of a derivative contract, not the PFE amount.

The proposed conditions may result in a stricter treatment of some derivative transactions as compared to GAAP because the SLR NPR's criteria for cash variation margin have been developed to ensure that only cash that, in substance, is a form of pre-settlement payment on a derivative contract may reduce the asset amount for purposes of total leverage exposure.

iv. Repo-style transactions

Under the 2013 rule, total leverage exposure includes the on-balance sheet carrying value of a repo-style transaction, but not any related off-balance sheet exposure for such transactions. The on-balance sheet amount of a repo-style transaction may reflect the GAAP option to offset certain gross accounting assets (that is, amounts recognized as receivables under reverse repurchase agreements) by the amount of the payments due to the counterparty (that is, amounts recognized as payables under repurchase agreements) under a bilateral netting agreement provided that certain conditions are met.

The SLR NPR would refine this requirement by providing that a banking organization may not reflect the GAAP offset option if the criteria specified in the SLR NPR are not met. While the SLR NPR's specified criteria are expected to be largely consistent with the GAAP offset option, some banking organizations may be required to add back some repo-style transaction assets that qualify for the GAAP offset option.

In addition, the SLR NPR would permit a securities lender to adjust its on-balance sheet assets in security-for-security repo-style transactions in cases where the securities lender does not use the securities received as collateral to further leverage itself (i.e., it does not re-hypothecate or resell the securities). This proposed change is designed to ensure a consistent measure of exposure among institutions subject to different accounting frameworks.

The SLR NPR also would add to total leverage exposure a measure of counterparty credit risk for repo-style transactions, measured as the difference between cash, gold, and securities lent and cash, gold and securities received in repo-style transactions. Further, the SLR NPR would specify the measure of exposure for repo-style transactions where a banking organization acts as an agent and has a limited exposure to the counterparties.

2. Proposed changes to the timing of the calculation of the SLR

Under the 2013 rule, the SLR is calculated as an average of three month-end balances of the SLR. Under the SLR NPR, the calculation of the SLR would be revised, consistent with the Basel III leverage ratio, to address some of the comments received on the 2013 enhanced SLR standards NPR.

Specifically, under the SLR NPR, the tier 1 capital numerator of the SLR would be calculated as of the last day of each reporting quarter, consistent with how it is calculated for the generally applicable leverage ratio.[7] The total leverage exposure would be calculated as the arithmetic mean of the total leverage exposure calculated each day of the reporting quarter. The proposed calculation would mitigate the concern with potential balance sheet "window dressing" at the end of the quarter, as well as address commenter concerns with regard to sudden and substantial deposit inflows at the end of reporting periods or during times of financial stress. Banking organizations already perform the calculation of daily averages for on-balance sheet items; the SLR NPR would propose the same calculation for off-balance sheet exposures.

[7] The generally applicable leverage ratio under the 2013 rule is the ratio of a banking organization's tier 1 capital to its average total consolidated assets as reported on the banking organization's regulatory report (minus amounts deducted from tier 1 capital).

3. Disclosure requirements

Banking organizations subject to the SLR would be required to disclose the calculation of the SLR using a new common disclosure template adopted by the BCBS for purposes of the Basel III leverage ratio, starting January 1, 2015. The agencies' regulatory reports already incorporate reporting of the SLR ratio, effective January 1, 2015, but not in the format adopted by the BCBS. Agency staffs plan to review in the future the regulatory reporting requirements of the SLR components on FFIEC 101, Schedule A, if the proposed changes in the SLR NPR are ultimately adopted and recommend any necessary changes to the agencies for approval.

C. Impact Analysis of the Final Rule and SLR NPR[8]

As mentioned above, covered organizations under the final rule would be affected by the proposed changes to total leverage exposure in the SLR NPR. Using data as of fourth quarter 2013, staff estimates that for covered organizations, the total leverage exposure as defined in the SLR NPR would be approximately 8 percent larger on a weighted average basis than total leverage exposure as defined in the 2013 rule. This increase is substantially due to the inclusion of the notional amount of sold credit protection in total leverage exposure under the SLR NPR.

Based on the definition of total leverage exposure in the 2013 rule, staff estimates that all eight covered BHCs would meet the 3 percent SLR using data as of fourth quarter 2013 and that the tier 1 capital shortfall of these BHCs with respect to a 5 percent SLR would be $22 billion.[9]

[8] The quantitative estimates of the agencies are based on 4Q2013 Comprehensive Capital Analysis and Review (CCAR) data for purposes of calculating impact on the total leverage exposure under the 2013 rule. The estimates are based on 4Q2013 CCAR data and on 2Q2013 BCBS quantitative impact study data for purposes of calculating impact on the total leverage exposure under the SLR NPR.

[9] As of 3Q2012, and using the definition of total leverage exposure in the 2013 rule, the estimated aggregate tier 1 capital shortfall for covered BHCs to meet a 5 percent SLR would

In comparison, by using the definition of total leverage exposure as revised by the SLR NPR, staff estimates that all 8 would meet the minimum 3 percent SLR and the tier 1 capital shortfall of these BHCs with respect to a 5 percent SLR would be $68 billion.

Under the SLR NPR's definition of total leverage exposure, staff estimated the amount of tier 1 capital required to meet the risk-based and supplementary leverage ratios on a pre- and post-stress basis.[10] The estimates indicated that the amount of tier 1 capital required for covered BHCs to meet a 3 percent SLR on a post-stress basis and to meet a 5 percent SLR on a pre-stress basis is roughly comparable. On a non-stressed basis, the capital required by a 5 percent SLR would exceed the capital required by the minimum tier 1 risk-based capital ratio plus the risk-based capital buffers (that is, capital conservation buffer plus the applicable GSIB surcharge) for most covered BHCs. If the Board were to subject covered BHCs to a risk-based capital surcharge additional to the BCBS risk-based capital surcharges, based on short-term wholesale funding levels, the relative bindingness of the SLR could be materially diminished.

Staff believes that the affected covered BHCs and their subsidiary IDIs would be able to retain earnings and effectively manage their capital structures to meet the enhanced SLR standards in the final rule, which does not become effective until January 1, 2018. Covered organizations could take systemic risk-reducing actions without much economic cost to mitigate the impact of a stricter definition of total leverage exposure, including (i) reducing the net notional amount of sold credit protection by matching maturity more closely with purchased credit protection and (ii) further compressing their over-the-counter derivative trades.

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have been $63 billion. The shortfall decline from 2012 to 2013 reflects in part an aggregate increase in the tier 1 capital of covered BHCs of approximately $60 billion during that period.

[10] The Federal Reserve Board's Capital Plan rule requires BHCs to meet minimum capital requirements, but not regulatory capital buffers, post-stress.

Staff believes that the effects of the SLR NPR and final rule on the ability of the Federal Reserve to implement monetary policy likely would be limited. Because the supplementary leverage ratio is insensitive to risk, it is possible that covered organizations' cost of holding low-risk, low-return assets could increase if it becomes the binding regulatory capital constraint. This development could affect the equilibrium level of interest rates or reduce liquidity in short-term funding markets. However, the Federal Reserve has a flexible and diverse policy toolkit that can offset most, if not all, unwanted pressures that may develop as a result of the supplementary leverage ratio, and so any effect likely would be limited.

D. The Eligible Guarantee NPR

The 2013 rule revised the methodologies for calculating risk-weighted assets for all banking organizations and revised the advanced approaches to incorporate agreements reached by the BCBS. In doing so, the 2013 rule amended the definition of eligible guarantee for purposes of both the standardized and the advanced approaches and introduced the definition of "eligible guarantor." In particular, the agencies revised the definition of eligible guarantee to add the requirement that an eligible guarantee be provided by an eligible guarantor.

Under the advanced approaches, there should be no restriction on the type of guarantor recognized for wholesale exposures because the methodology incorporates a banking organization's risk assessment of the guarantor. Banking organizations commonly obtain guarantees from guarantors that do not qualify as eligible guarantors for exposures in their commercial real estate and other wholesale portfolios. Staff believes it would be appropriate to allow these guarantees to continue to qualify as credit risk mitigants for purposes of the advanced approaches capital rule. Therefore, staff recommends the Board approve the proposal in the eligible guarantee NPR that would modify the definition of eligible guarantee for purposes of the advanced approaches capital rules by removing the requirement that an eligible guarantee be provided by an eligible guarantor for purposes of exposures that are not securitizations. The definition of eligible guarantee for purposes of calculating risk-weighted assets under the standardized approach would remain unchanged as these rules provide a standardized treatment for guarantees that is, by nature, less risk sensitive than the methodologies for credit risk mitigation under the advanced approaches.

RECOMMENDATIONS

For the reasons discussed above, staff recommends that the Board approve the attached (1) final rule, (2) SLR NPR for public comment, and (3) eligible guarantee NPR for public comment. Staff also recommends that the Board grant staff the requested authority to make technical and minor changes to the attached materials prior to publication in the *Federal Register*, including responding to comments from the *Federal Register*, or to incorporate changes requested by other agencies as part of the approval process.

Attachments

Appendix I

Overview of comments on the 2013 enhanced SLR standards NPR

The federal banking agencies received nearly 30 comment letters on the July 2013 proposal for enhanced supplementary leverage ratio standards. Commenters included banking organizations, trade associations, supervisory authorities, consumer advocacy groups, pubic officials (including members of the U.S. Congress), private individuals, and other interested parties.

General comments

Most commenters supported the 2013 enhanced SLR NPR and the agencies' goal to improve the resiliency of the banking system by introducing higher SLR levels. While some commenters expressed support for the 2013 enhanced SLR NPR, other commenters supported some changes. Many commenters suggested the proposed levels were too high and expressed concern with the strictness of the definition of total leverage exposure. Several commenters were concerned about the relationship between the risk-based capital (RBC) and leverage capital standards. Some commenters encouraged the agencies to postpone finalizing the 2013 enhanced SLR NPR until after the BCBS finalized its definition of total leverage exposure and after the appropriate quantitative analyses have been completed.

Relationship between RBC and leverage capital standards

Many commenters expressed concern that the 2013 enhanced SLR NPR could reverse the intended relationship between RBC and leverage capital standards. Specifically, some commenters noted that the SLR could become the binding regulatory capital constraint rather than the backstop to the RBC ratios. This would result in the RBC requirement becoming the backstop, which could lead to distorted incentives for regulatory capital purposes and could encourage banking organizations to take on more risky assets in favor of lower risk assets. However, a few commenters supported the 2013 enhanced SLR NPR, and noted that the SLR is a more accurate measure of regulatory capital than RBC ratios, is easier to understand, is comparable across firms, is less prone to manipulation, and, therefore, should be the binding capital requirement.

Other commenters maintained that the 2013 enhanced SLR NPR could incentivize banking organizations to hold the lowest quality assets possible within the constraints of the other credit quality regulations and, thus, would be fundamentally at odds with the agencies' proposed liquidity coverage ratio (LCR) by encouraging banking organizations to shed low-risk assets above the minimum that would be required by the proposed LCR.

A few commenters suggested that the proposed levels in the 2013 enhanced SLR NPR for covered organizations should be set higher, and some commenters opined that the levels should be the same for both covered BHCs and their subsidiary IDIs.

A few commenters suggested that the numerator of the SLR ratio should be common equity tier 1 capital rather than tier 1 capital. One commenter recommended using the tangible equity measure (as opposed to any regulatory capital measure) because it is the simplest, most transparent, and most useful measure of capital available to absorb losses.

Scope of institutions affected

Several commenters expressed concern that the one-size-fits-all approach in the 2013 enhanced SLR NPR is unduly punitive for banking organizations with significant amounts of highly liquid, low-risk assets. They suggested a remedy whereby the proposed levels should be in line with the bucketed RBC surcharge that is being considered for global systemically-important banking organizations (G-SIBs). Alternatively, the commenters suggested that the applicability of the 2013 enhanced SLR NPR should be tied not only to an institution's size, but to overall risk to financial stability, as captured in the G-SIB criteria.

Other commenters noted that the 2013 enhanced SLR NPR should apply not only to G-SIBs, but to all advanced approaches banking organizations, thereby helping to restore confidence in the U.S. banking system.

Timing of proposal and need for quantitative review

Many commenters suggested postponing the adoption of the enhanced SLR standards until after the BCBS has finalized its definition of total leverage exposure and conducted a Quantitative Impact Study (QIS) to assess the impact of the final definition on the covered organizations.

Other commenters suggested delaying adopting the 2013 enhanced SLR NPR until the domestic regulatory initiatives based on the Basel III capital simplification paper and the rule implementing section 165 prudential standards of the Dodd-Frank Act pertaining to SIFIs are finalized, to prevent a divergence from international standards.

Additionally, commenters recommended that the agencies conduct an empirical study to assess the cumulative impact of regulatory capital requirements and other financial reform regulations on the ability of U.S. banking organizations to provide financial services to consumers and businesses at this stage of economic recovery and going forward. Commenters also encouraged the agencies to develop a comprehensive approach in the determination and calibration of regulatory capital standards, including those related to the leverage ratio, RBC, liquidity, debt, G-SIB surcharges, and wholesale funding, to ensure that incentives are not distorted and that the cumulative impact of the requirements is considered as a package.

Competitiveness concerns

Commenters expressed concern that the proposed enhanced SLR standards would result in capital levels that are significantly higher than those established in the BCBS framework for the international leverage ratio, and this would be a competitive disadvantage to the largest U.S. banking organizations as they attempt to compete in the global markets. Commenters noted that any potential inconsistencies between the U.S. rules and the BCBS framework may introduce operational and enforcement uncertainties and systemic inefficiencies, which could lead to greater systemic risks, could negatively impact economic growth, and could impede cross-border capital flows needed for businesses to operate on a global basis.

Impact on financial markets

Commenters noted that the enhanced SLR standards would create an incentive to hold the minimum required amount of low-risk assets and reduce participation in activities that generate such assets. According to these commenters, the 2013 enhanced SLR NPR could reduce banking organization demand for high-quality U.S. Treasuries, thereby constricting their liquidity and increasing their volatility and cost. Commenters also said that the enhanced SLR standards could reduce the demand for other forms of low-risk debt, shrink the availability of lines of credit, and constrain the pool of credit available to support economic growth, especially if the SLR becomes the binding constraint for a larger number of banking organizations.

A few commenters noted that if the SLR became the binding constraint for a banking organization, it could cause banking organizations to turn to return on assets (ROA) as the primary driver to allocate scarce capital in order to maximize profits. This could result in irrational decision-making from a safety and soundness perspective and increase the systemic risk posed by large banking organizations. These commenters suggested that an incremental increase in a firm's leverage ratio will decrease its assets-to-equity ratio, thus decreasing its return on equity. To prevent such a decline, the firm would be incentivized to increase its ROA by investing in assets with a higher risk and potential return.

Commenters also noted that if the enhanced SLR became the binding regulatory capital constraint for certain banking organizations, it would require those organizations to increase pricing for certain products or reduce product offerings. Commenters asserted that covered organizations would be encouraged to hold assets that are more risky. In addition, commenters maintained that if firms were to exit the business lines that they find no longer viable, market concentration would increase, exacerbating "too big to fail" issues and promoting the migration of critical financial services to the shadow banking sector. Commenters suggested that this could have a direct impact on the provision of trade finance, cause contagion risk, accelerate fire sales, increase the cost of hedging market risk through the use of derivatives, and reduce covered organizations' participation in securities financing transactions.

On the other hand, some commenters, in support of the enhanced SLR standards, noted that the proposed standards could improve market and asset diversity while helping to counter arbitrage incentives inherent in the RBC approach.

Total leverage exposure

Commenters suggested several modifications to the calculation of total leverage exposure. They recommended excluding low-risk and highly liquid securities (e.g., U.S. Treasuries), cash, cash claims on central banks, central bank deposits, and other high quality liquid assets from total leverage exposure. Commenters noted that including these would create a disincentive for providing client-based services, such as deposit taking. Other recommendations included excluding derivatives cleared on behalf of clients and replacing the 100 percent credit conversion factor (CCF) with the more granular standardized approaches CCFs.

Some commenters supported expanding the definition of total leverage exposure to target off-balance sheet instruments, derivatives, and cash or cash equivalents.

One commenter recommended using International Financial Reporting Standards as a basis for including off-balance sheet derivatives exposures into total leverage exposure, Arguing that this would lead to greater consistency internationally and provide a more transparent view of a firm's position.

A few commenters requested the option to use daily averages for on-balance sheet components of the SLR rather than three end-of-month spot measurements for quarterly calculations. Covered organizations with significant custodial operations noted that they would be especially impacted if this option were not permitted, as their customers engage in periodic yet non-standard activities at the end of each month that cause cash to flow onto the balance sheet, which could yield inaccurate results.

Cost-benefit analysis

One commenter expressed concern with the absence of a cost-benefit analysis in the 2013 enhanced SLR NPR, noting that the federal banking agencies are obligated to include a cost-benefit analysis with the proposed enhanced SLR under the Riegle Community Development and Regulatory Improvement Act.