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*Via Electronic Mail*

Mr. Robert V. Frierson, Esq.  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street & Constitution Avenue, N.W.  
Washington, D.C. 20551

Re: Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer (Docket No. R-1529; RIN 7100 AE-43)

Ladies and Gentlemen:

The Clearing House<sup>1</sup> appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System's proposed policy statement describing the framework for imposing a countercyclical capital buffer for U.S. advanced approaches bank holding companies, savings and loan holding companies and state member banks.<sup>2</sup> By regulation, the countercyclical buffer, while currently set at zero percent, could reach a maximum of 2.5 percent of risk-weighted assets, in the form of common equity tier 1 capital.

The Clearing House strongly supports the maintenance of robust capital by all banking organizations as an essential tool for promoting the safety and soundness of individual organizations and, more broadly, enhancing the stability of the financial system as a whole. The proposed countercyclical buffer, however, suffers from severe legal and conceptual problems, and its numerous and significant costs would greatly exceed any potential benefits.

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<sup>1</sup> The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

<sup>2</sup> Federal Reserve System, Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Buffer, 81 Fed. Reg. 5,661 (Feb. 3, 2016); 12 C.F.R. Part 217.

In particular, the proposal would establish a framework for future determinations about the countercyclical buffer that is procedurally deficient and conceptually flawed. The Clearing House strongly believes that any future decision to apply the countercyclical buffer should be subject to notice-and-comment rulemaking, *and* subject to a framework that is clear, specific, and tailored in a way that recognizes the serious weaknesses and limitations of the countercyclical buffer relative to its stated policy objectives. The proposed framework misses each of these marks. Thus, we urge the Federal Reserve to revise and re-propose for further public comment a countercyclical buffer policy statement that addresses each of these concerns, including a statement that future decisions to apply the countercyclical capital buffer will be subject to notice-and-comment rulemaking.

Part I of this letter provides an executive summary of our comments. Part II describes how the proposal contemplates a countercyclical buffer framework that is inconsistent with the Administrative Procedure Act (the “APA”).<sup>3</sup> Part III raises a series of conceptual and practical problems with the proposal that a re-proposal should attempt to correct. Part IV highlights concerns with the proposal’s “trigger” for future increases in the countercyclical buffer and suggests an alternative standard. Part V describes a variety of other concerns with the proposal.

## **I. Executive Summary**

- The proposal should be revised to ensure that any future decision to establish a countercyclical capital buffer is subject to notice-and-comment rulemaking, as required by the APA.
- The proposal should be revised to provide clearer, more specific, and empirically anchored standards by which future decisions to establish the buffer will be made. These standards should be much more tailored than the proposal so as to reflect both (i) the inherent weaknesses and limitations of the countercyclical buffer as a prudential policy tool and (ii) the wide range of other prudential regulations that already and better address the concerns that might underlie the countercyclical buffer.
- The proposal’s specific “trigger” for determining when to increase the countercyclical buffer— that is, circumstances where potential systemic vulnerabilities are somewhat above normal – is inappropriate, not empirically grounded, and should be revised.
- Other aspects of the proposal should be amended to ensure that the reciprocity and other operational elements work as intended.

## **II. The proposal should be revised to ensure that any future decision to impose a countercyclical buffer capital charge is subject to notice-and-comment rulemaking, as required by the APA.**

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<sup>3</sup> 5 U.S.C. § 551 *et seq.*

As proposed, the Federal Reserve's framework for setting a countercyclical capital buffer under its capital rules, which are set forth in Regulation Q, absent further process would be inconsistent with the requirements of the APA. In imposing specific capital requirements, the Federal Reserve must comply with the requirements of administrative rulemaking—that is, it must provide notice and allow parties an opportunity to meaningfully comment on the proposal.

Under the APA, the Federal Reserve cannot impose specific capital requirements on the basis of its Regulation Q and the proposed policy statement. As we describe in detail below, the imposition of specific capital requirements is legislative rulemaking as defined in the APA. The current rules and proposed policy statement, however, are so vague and open-ended that they do not provide a meaningful opportunity for interested parties to comment on the criteria that will be used by the Federal Reserve to impose specific capital requirements. Thus, if and when the Federal Reserve later seeks to impose a specific countercyclical capital requirement, it will be required to use notice-and-comment rulemaking and thereby allow the public a meaningful opportunity to comment on the specific models, criteria, and data used by the Federal Reserve to make its determination. The Federal Reserve cannot rely on an open-ended policy statement, such as the proposal, to grant itself wide discretion to set the countercyclical capital buffer. For these reasons, we believe it is crucial that the proposal be revised to explicitly affirm that any and all future decisions to increase capital requirements by increasing the level of the countercyclical buffer will be subject to notice-and-comment rulemaking as required by the APA.<sup>4</sup>

**A. The Federal Reserve's imposition of a specific countercyclical capital requirement would constitute a legislative rule, and thus would require notice-and-comment rulemaking under the APA.**

The APA requires that industry participants must be afforded a meaningful opportunity to comment on the specific framework that will be used by the Federal Reserve when it sets countercyclical capital requirements. This requirement cannot be avoided: the Federal Reserve must provide its specific rationale, through notice-and-comment rulemaking, each time that it requires additional capital using the countercyclical capital buffer.<sup>5</sup>

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<sup>4</sup> As noted below, it is important that the process for any imposition of the countercyclical buffer be established in a final rule, and not be left for future determination (for example, at the time of imposition) pursuant to vague and unclear standards. Investors are likely to be reluctant to invest in banking organizations if they cannot know whether they face severe restrictions or prohibitions on dividends or other capital distributions or dilution to meet a future countercyclical buffer requirement, without prior notice, and would discount the value of bank stock accordingly. Thus, banking organizations would likely suffer a concrete and particularized injury, immediately and directly attributable to adoption of the proposal, even before any countercyclical buffer is activated.

<sup>5</sup> Theoretically, it might also be possible under the APA for the Federal Reserve to specify a detailed framework that it adopts now, pursuant to notice-and-comment, that it would then follow mechanically in the future without further agency discretion, but in light of all of the inherent limitations and weaknesses of the countercyclical buffer that we highlight in Parts III-V, we believe that doing so would be both unworkable and enormously imprudent in practice.

An agency must use the formal rulemaking process whenever it issues a “substantive” or “legislative” rule.<sup>6</sup> The D.C. Circuit has previously stated that whether or not a rule is a “legislative” rule is ascertained by determining if there is an affirmative response to *any* of the following four questions: “(1) whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties, (2) whether the agency has published the rule in the Code of Federal Regulations, (3) whether the agency has explicitly invoked its general legislative authority, or (4) whether the rule effectively amends a prior legislative rule.”<sup>7</sup> Under that standard, the imposition of specific capital requirements is a legislative rule, and it is necessary for the Federal Reserve to use notice-and-comment rulemaking when it sets capital requirements.

The imposition of specific capital requirements is the binding mechanism by which the Federal Reserve implements its Congressionally derived authority to establish capital requirements for banking organizations.<sup>8</sup> As courts have explained, “a binding rule promulgated pursuant to a delegation of legislative authority is the clearest possible example of a legislative rule.”<sup>9</sup> The countercyclical buffer provisions of Regulation Q and the proposed policy statement set forth a statement of permissible ranges and a general statement of non-binding considerations, but do not actually impose any binding capital requirements on institutions or provide any real clarity as to the circumstances that would produce implementation of the countercyclical buffer. Rather, each future capital requirement increase via the countercyclical buffer will “effect a substantive regulatory change to the statutory or regulatory regime” because it will alter the substantive requirement (i.e., the *actual* capital requirement) that applies under the regulation.<sup>10</sup> Notice-and-comment rulemaking will therefore be required each time the countercyclical buffer is increased.<sup>11</sup>

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<sup>6</sup> *U.S. Telecom Ass’n v. FCC*, 400 F.3d 29 (D.C. Cir. 2005); 5 U.S.C. § 553. Legislative rules are those that “grant rights, impose obligations, or produce other significant effects on private interests.” *Batterton v. Marshall*, 648 F.2d 694, 701–02 (D.C. Cir. 1980); *La Casa Del Convaleciente v. Sullivan*, 965 F.2d 1175, 1178 (1st Cir. 1992) (“If a rule creates rights, assigns duties, or imposes obligations, the basic tenor of which is not already outlined in the law itself, then it is substantive.”).

<sup>7</sup> *Am. Min. Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

<sup>8</sup> *See, e.g.*, International Lending Supervision Act of 1983 (“**ILSA**”), Pub. L. No. 98-181, 97 Stat. 1278, codified at 12 U.S.C. § 3901, *et seq.*; 12 U.S.C. § 5365.

<sup>9</sup> *Mendoza v. Perez*, 754 F.3d 1002, 1022 (D.C. Cir. 2014).

<sup>10</sup> *Elec. Privacy Info. Ctr. (EPIC) v. U.S. Dep’t of Homeland Sec.*, 653 F.3d 1, 6–7 (D.C. Cir. 2011). This conclusion is required by recent D.C. Circuit precedent. For example, in *Mendoza*, the D.C. Circuit held that rules that set specific wages for foreign workers were legislative because they imposed specific wage requirements pursuant to a more general grant of authority. 754 F.3d at 230. Where administrative agencies issue rules that set forth specific standards based on broad discretionary language, such as “fair and equitable” or “just and reasonable,” the agency’s action is legislative rulemaking. Likewise, in *Sebelius*, for example, the D.C. Circuit held that a specific numerical requirement related to Medicare reimbursement was not an interpretation of the phrase “reasonable cost” in the Medicare regulations because that term did “not supply substance from which the propositions can be derived.” *Catholic Health Initiatives v. Sebelius*, 617 F.3d 490, 495–96 (D.C. Cir. 2010) (“The short of the matter is that there is no way an interpretation of ‘reasonable costs’ can produce the sort of detailed—and rigid—investment code set forth in [the rule].”). The issue here is analogous. The relevant statutory authority merely provides that the Federal Reserve will require that banks maintain “adequate” and “appropriate” capital levels. *See* 12

The proposition that specific capital requirements are legislative is also supported by the Federal Reserve's practice for other regulations. The Federal Reserve has used the notice-and-comment process for regulations (issued under the same legislative authority) that set forth the capital requirements in Basel III, including those at issue here. 78 Fed. Reg. 62,018 (Oct. 11, 2013). Similarly, the Federal Reserve has also used notice-and-comment previously for a variety of other rules related to capital requirements. *See, e.g.*, 80 Fed. Reg. 74,839 (Nov. 30, 2015) (adopting minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants); 72 Fed. Reg. 69,287 (Dec. 7, 2007) (adopting risk-based capital adequacy framework for banking organizations). There is nothing in the Federal Reserve's statutory authority to implement a countercyclical buffer that supports a different approach here.

**B. The Federal Reserve's countercyclical capital buffer rule and proposed policy statement do not provide adequate notice to allow meaningful comment on the specific models, criteria, and data that will be used by the Federal Reserve when determining countercyclical capital levels.**

As noted, the APA requires that federal agencies provide public notice and an opportunity for comment on proposed substantive or legislative rules.<sup>12</sup> To meet these requirements, an agency "must provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully."<sup>13</sup> As courts have noted, "the notice requirement improves the quality of agency rulemaking by exposing regulations to diverse public comment, ensures fairness to affected parties, and provides a well-developed record that enhances the quality of judicial review."<sup>14</sup> Key to the notice requirement is "the agency's duty to identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules," and "[a]n agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary."<sup>15</sup>

The countercyclical capital buffer rules and policy statement issued by the Federal Reserve are so vague and open-ended that they do not provide a meaningful opportunity for interested parties to substantively comment on the Federal Reserve's proposed approach. In

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U.S.C. § 3907(a)(1); 12 U.S.C. § 5365. The implementing regulation and policy statement provide only general information about the Federal Reserve's approach, stating that the Federal Reserve will consider a broad range of economic and market factors when setting countercyclical capital requirements. As in *Sebelius*, the Federal Reserve's imposition of a specific capital requirement based on these authorities would be itself a legislative rule subject to notice-and-comment requirements.

<sup>11</sup> We also note that a supervisory increase in capital requirements for a banking organization on an individual basis would generally require that the banking organization be provided with notice and a formal opportunity to respond, including a hearing in some circumstances. *See, e.g.*, 12 U.S.C. § 1818(b); 12 C.F.R. § 217.1(e).

<sup>12</sup> *See* 5 U.S.C. § 553.

<sup>13</sup> *Fla. Power & Light Co. v. United States*, 846 F.2d 765, 771 (D.C. Cir. 1988).

<sup>14</sup> *Sprint Corp. v. FCC*, 315 F.3d 369, 373 (D.C. Cir. 2003).

<sup>15</sup> *Solite Corp. v. EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991).

particular, the proposal and Regulation Q fail to provide notice of any of the specific models, formulas, data, or other tools that the Federal Reserve will use when determining appropriate capital levels. The APA requires the Federal Reserve to reveal those specific details before it may impose specific capital requirements.

The statutory authority for the countercyclical buffer appears to be (i) ILSA, the relevant provisions of which merely provide that the “appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital” and that such standard shall be countercyclical,<sup>16</sup> and/or (ii) § 616 of the Dodd-Frank Act.<sup>17</sup> The regulation issued in 2013 to establish Regulation Q provides almost no additional information on how the Federal Reserve will determine whether to increase capital requirements via the countercyclical buffer.<sup>18</sup> The regulation provides that the Federal Reserve may “adjust the countercyclical capital buffer amount for credit exposures in the United States between zero percent and 2.5 percent of risk-weighted assets” based “on a range of macroeconomic, financial, and supervisory information indicating an increase in systemic risk including, but not limited to, the ratio of credit to gross domestic product, a variety of asset prices, other factors indicative of relative credit and liquidity expansion or contraction, funding spreads, credit condition surveys, indices based on credit default swap spreads, options implied volatility, and measures of systemic risk”<sup>19</sup> – in short, anything and everything related to the economy.

Similarly, while the proposed policy statement provides greater detail on how the Federal Reserve views the buffer, it is also vague and open-ended: no information is provided about the specific models, criteria, or data that the Federal Reserve intends to use – instead, it only indicates general types and categories of measurement tools the Federal Reserve may use – along with a clear reservation of authority to use other tools not described in the proposal. For example, the policy statement provides that the Federal Reserve expects to apply the

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<sup>16</sup> 12 U.S.C. § 3907(a)(1).

<sup>17</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, § 616, Pub. L. 111-203 (July 21, 2010) [*hereinafter* “Dodd-Frank”]. We note that Section 616 of Dodd-Frank effectively defines countercyclical standards so that there is to be both an upwards and downwards revision in capital requirements, with the former being in times of economic expansion and the latter in times of economic contraction. The proposed policy statement would be inconsistent with this statutory requirement in two respects. First, it would provide for capital increases based on a number of factors that do not correlate to economic expansion. Second, there is no effective provision in the proposed policy statement for reduction of the buffer. We note further, however, that the putative benefit of a countercyclical buffer is not in its imposition *but rather in its removal at a time of systemic stress*. The benefit of a buffer is purportedly the ability it gives banking organizations to absorb outsized losses and still continue to provide credit under stress, as capital requirements are eased. We believe it is very unlikely that such a benefit would ever be realized in the United States. Political pressure would weigh heavily against easing capital requirements on large banking organizations, and in fact would urge still higher capital requirements, in the interest of protecting taxpayers in periods of stress from any looming crisis. Certainly the experience of the financial crisis – where banking organizations were required not only to increase capital (with justification) but also pay approximately \$5.5 billion in assessments to the deposit insurance fund (which could have been done post-crisis) is not encouraging.

<sup>18</sup> 12 C.F.R. § 217.11(b)(2); 78 Fed. Reg. 62,038 (Oct. 11, 2013).

<sup>19</sup> 12 C.F.R. § 217.11(b)(2)(iii)-(iv).

countercyclical buffer any time that “potential systemic vulnerabilities” are “somewhat above normal.”<sup>20</sup> But it does not discuss (i) what it considers “normal” for these purposes or (ii) what level of deviation would be considered “somewhat above” that baseline. The proposal also notes that “assessments of financial-system vulnerabilities” will be made by a “broad array of quantitative indicators of financial and economic performance and a set of empirical models.”<sup>21</sup> But it declines to specify which indicators and which models will be used, or to explain how they will affect the Federal Reserve’s decision to impose additional capital requirements. Further, the proposal rejects the notion that more detailed models need to be provided and states that the determinations will necessarily be ad hoc, stating: “adjustments . . . tightly linked to a specific model or set of models would be imprecise . . . As a result, the types of indicators and models considered in assessments of the appropriate level of the [countercyclical buffer] are likely to change over time based on advances in research and the experience of the Federal Reserve with this new macroprudential tool.”<sup>22</sup>

The Clearing House understands that a static approach may not be appropriate when assessing the overall state of the economy, which is why we believe that a notice-and-comment period at the time would be appropriate. The absence of meaningful criteria in the proposed policy statement leaves banking organizations – and investors –with little understanding of the circumstances in which the Federal Reserve would be likely to require additional capital. As such, it is not possible for industry participants to provide meaningful comment on the approach that will be used by the Federal Reserve, as required under the APA.

When making a determination in the future of whether the countercyclical capital requirements should be adjusted, the Federal Reserve presumably will rely upon specific market data, and it will use analytic tools to determine why it sees, under the policy statement, “an elevated risk of above-normal losses” or “rapid asset price appreciation or credit growth that are [sic] not well supported by underlying economic fundamentals.” But the specific data, tools, and models have not have been made available to the industry for comment and review in any meaningful form. This is simply not permitted under the APA. Agencies violate the APA when they rely upon “critical factual information” that was not disclosed during the rulemaking process.<sup>23</sup> Here, the proposal provides almost no detail regarding any of the specific data,

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<sup>20</sup> 81 Fed. Reg. 5,663 (Feb. 3, 2016).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Penobscot Indian Nation v. U.S. Dep’t of Hous. & Urban Dev.*, 539 F. Supp. 2d 40, 49 (D.D.C. 2008) (holding that internal analysis of HUD loan portfolio “constitutes critical factual information”). *See also Owner-Operator Ind. Drivers Ass’n v. Fed. Motor Carrier Safety Adm.*, 494 F.3d 188, 203–06 (D.C. Cir. 2007) (finding error where agency failed to provide an opportunity to comment on the methodology used to justify an increase in maximum number of hours truck drivers may drive); *Chamber of Commerce of U.S. v. SEC*, 443 F.3d 890, 903 (D.C. Cir. 2006) (holding that SEC violated APA by using survey data that had not been included in rulemaking); *Idaho Farm Bureau Fed. v. Babbitt*, 58 F.3d 1392, 1403 (9th Cir. 1995) (agency committed error by failing to include data that was central to decision in rulemaking).



frameworks, models, or other concrete information about how the Federal Reserve will make capital requirement determinations.<sup>24</sup>

**C. It is not permissible for the Federal Reserve to treat its 2013 rulemaking and proposed policy statement as delegating to itself wide discretion to set specific capital requirements in the future.**

Courts have flatly rejected the proposition that a regulator may avoid the notice-and-comment requirements by promulgating a rule that grants itself discretion to impose substantive regulatory requirements later. *See United States v. Picciotto*, 875 F.2d 345, 347 (D.C. Cir. 1989).<sup>25</sup> In essence, that is what the proposed policy statement purports to do here, by reserving for the Federal Reserve the right to modify capital requirements in the future for effectively almost any reason. As noted above, the existing regulation states the Federal Reserve will have discretion to adjust the “countercyclical capital buffer amount for credit exposures” according to the Federal Reserve’s assessment of market conditions based “on a range of macroeconomic, financial, and supervisory information.” 12 C.F.R. § 217.11(b)(2). Indeed, the proposal specifically rejects the notion that determinations will be tied to specific standards or models. 81 Fed. Reg. 5,663 (Feb. 3, 2016).

This approach is not permissible under the APA. Rather, any future imposition of specific capital requirements through application of the countercyclical buffer must be subject to the constraints of notice-and-comment rulemaking.<sup>26</sup>

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<sup>24</sup> The proposed policy statement states that the Federal Reserve will rely upon a variety of models and data representing conditions in all key sectors of the economy. 81 Fed. Reg. 5,663 (Feb. 3, 2016). The Federal Reserve must disclose these models and data to the extent it intends to use them to guide its discretion in setting capital requirements. *See McLouth Steel Products Corp. v. Thomas*, 838 F.2d 1317, 1322 (D.C. Cir. 1988) (agency must provide notice and meaningfully opportunity to comment on model that “substantially curtails [its] discretion”).

<sup>25</sup> For example, in *Picciotto*, the Park Service sought to reserve the right to impose substantive requirements without using formal rulemaking. The court rejected the Park Service’s reliance on an “open-ended” regulation, stating an agency cannot “grant itself a valid exemption to the APA for all future regulations, and be free of APA’s troublesome rulemaking procedures forever after, simply by announcing its independence in a general rule.” *Picciotto*, 875 F.2d at 347. *See also EPIC*, 653 F.3d at 7 (“[T]he purpose of the APA would be disserved if an agency with a broad statutory command . . . could avoid notice-and-comment rulemaking simply by promulgating a comparably broad regulation . . . and then invoking its power to interpret that statute and regulation in binding the public to a strict and specific set of obligations.”).

<sup>26</sup> Indeed, if the Federal Reserve *could* impose specific countercyclical requirements as “interpretive rules” under this framework, it arguably could evade using notice-and-comment rulemaking altogether in setting capital requirements. Instead, it could simply promulgate a capital requirement range and an unspecific “framework” for setting requirements within the range—and then in the future impose specific capital requirements without using notice-and-comment at all. That result would be plainly inconsistent with the APA.



**III. The proposal should be revised to provide clearer, more specific, and empirically anchored standards by which future decisions to establish the countercyclical buffer will be made. These standards should be much more tailored than the proposal so as to reflect both (i) the inherent weaknesses and limitations of the countercyclical buffer as a prudential policy tool and (ii) the wide range of other prudential regulations that already and better address the countercyclical concerns underlying the proposal.**

Although it is difficult to comment extensively on the substance of the proposed policy statement given the few details it provides regarding how and when the countercyclical buffer will be set, we highlight below the significant weaknesses of the countercyclical buffer relative to its potential policy purposes, the significant practical limitations of the buffer that stem from its imprecision and bluntness as a policy tool, and potential costs of its application. In light of these substantial drawbacks, we strongly urge the Federal Reserve to reconsider the proposal to provide more specific, empirically anchored standards for countercyclical buffer decisions that make clear that application of the buffer can and will be viewed as a suboptimal policy tool of last resort.

**A. The countercyclical buffer should have a clear purpose and be tailored to achieving it.**

Congress has urged the Federal Reserve to “seek to make [bank regulatory capital] requirements countercyclical,”<sup>27</sup> but never expressly authorized a countercyclical buffer, and thus never specified its purpose or set a standard for establishing its size.<sup>28</sup> Regulation Q provides no purpose or standard. The proposal at different points appears to suggest several potential purposes. Because each of these potential purposes raises conceptual problems that highlight the inherent weaknesses and limitations of the countercyclical buffer as a policy tool, we discuss each in further detail below.

*Macroeconomic Purposes.* One of the stated goals of the proposal is to “moderate fluctuations in the supply of credit over time,” which suggests a macroeconomic purpose. However, because the U.S. financial system is far less bank-centric than the vast majority of the financial systems of other large economies, the countercyclical buffer is unlikely to be effective (and could well be counterproductive) for moderating fluctuations in the supply of credit in the U.S. over time. Specifically, the Financial Stability Board’s “Global Shadow Banking Monitoring Report 2015” indicates that, in the United States, banking organizations comprise only about 25 percent of total U.S. financial assets.<sup>29</sup> The large banking organizations subject to the countercyclical buffer would comprise only approximately 18 percent.<sup>30</sup> Consequently, while applying the countercyclical buffer for large U.S. banking organizations might reduce the

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<sup>27</sup> Dodd-Frank § 616.

<sup>28</sup> 12 U.S.C. § 3907.

<sup>29</sup> Financial Stability Board, “Global Shadow Banking Monitoring Report 2015”, p. 59 (Nov. 12, 2015).

<sup>30</sup> It is worth noting that a countercyclical buffer may make more sense as a macroeconomic tool for other nations in which the largest banks represent a greater percentage of total bank assets in those countries.

supply of credit by a subset of large U.S. banking organizations, this narrow focus means that it is less likely to be effective at reducing the overall supply of credit than in jurisdictions in which banking organizations comprise a greater proportion of the total financial assets.

Furthermore, if the reason that vulnerabilities are building or just that credit is rapidly expanding is a loosening of the terms of or standards for credit from non-bank sources, tightening capital requirements on a subset of large banking organizations may only *increase* the share of credit being supplied on imprudent terms by non-bank entities, contrary to the Federal Reserve's objectives. While the proposal provides that "[i]ncreasing the resilience of large banking organizations should, in turn, improve the resilience of the broader financial system," experience was quite to the contrary during the run-up to the most recent financial crisis, as subprime lending was rapidly expanding to thrifts, non-banks and government-sponsored entities. It is not clear how imposing a capital charge on a subset of already highly capitalized banking organizations improves the overall resilience of the broader U.S. financial system when other banking organizations, financial services companies and shadow banking entities will continue to operate as-is.

More fundamentally, we note that the proposal and its Basel Committee antecedent are based on the assumption that bank regulators (often central banks) have the ability to identify asset bubbles or other types of systemic risk *ex ante* – in the words of the policy statement, identify “an elevated risk of above-normal losses” or identify “asset price appreciation or credit growth that are [sic] not well supported by underlying economic fundamentals.” However, as noted in Part II, the proposal does not explain how such a finding will be made. This is of concern given the historical difficulty that central banks and others have experienced in identifying asset bubbles or predicting market events.<sup>31</sup>

*Large Bank Safety and Soundness Purpose.* The proposal also states that the countercyclical buffer “is designed to take into account the broad macroeconomic and financial environment in which banking organizations function and the degree to which that environment impacts the resilience of the group of advanced approaches institutions.”<sup>32</sup> This suggests that the purpose of the buffer is to enhance the resiliency of large banking organizations as a group.

Here, though, one must ask what risks are not currently captured through current rules, including rules that have been identified explicitly as macroprudential in nature. We note that the Basel Committee's concern with procyclicality primarily stemmed from the “certain degree of cyclicity” introduced by the “greater risk sensitivity” of the Basel II internal-ratings-based approach, and in particular because of the tendency of model-based approaches to measuring

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<sup>31</sup> See, e.g., Janet L. Yellen, Presentation to the 18<sup>th</sup> Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies—Meeting the Challenges of the Financial Crisis (Apr. 16, 2009), available at <http://www.frbsf.org/our-district/press/presidents-speeches/yellen-speeches/2009/april/yellen-minsky-meltdown-central-bankers> (“In summary, when it comes to using monetary policy to deflate asset bubbles, we must acknowledge the difficulty of identifying bubbles, and uncertainties in the relationship between monetary policy and financial stability.”).

<sup>32</sup> 81 Fed. Reg. at 5,663.

default risk to understate that risk in good times.<sup>33</sup> However, these concerns are substantially addressed in the U.S. through the introduction of *inter alia*: (i) financial accounting changes that are anticipated to be adopted, (ii) the more stringent implementation of the Basel III capital rules in the U.S., of which the capital surcharge for global systemically important bank holding companies (the “**G-SIB surcharge**”) is one prominent example, (iii) liquidity rules, (iv) the Federal Reserve’s Comprehensive Capital Analysis and Review process (“**CCAR**”), and (v) the standardized floor for calculating minimum capital requirements pursuant to the Collins Amendment.<sup>34</sup>

- Anticipated accounting changes by the Financial Accounting Standards Board that would shift to a “current expected credit loss” model for loan loss provisions will require significantly more forward-looking provisioning for credit losses, likely resulting in a more countercyclical treatment than the previous approach under U.S. generally accepted accounting principles (“**GAAP**”). The Basel Committee recognized in Basel III that the introduction of an expected loss approach would reduce procyclicality.<sup>35</sup> This revised approach will, among other things, likely increase the allowance for loan losses and likely will make the loan loss allowance more countercyclical by extending the loan loss forecast period currently provided for under GAAP. Moreover, banking organizations that follow GAAP will likely have a more countercyclical allowance for loan losses than institutions that use International Financial Reporting Standards because the IFRS 9 rules<sup>36</sup> continue to use a 12-month loan loss forecast period.
- The largest U.S. banking organizations are already required to hold higher amounts of loss-absorbing capital through the Federal Reserve’s significantly more stringent implementation of the Basel III capital rules in the United States, which require U.S. banking organizations to hold higher quality capital in greater amounts, including a capital conservation buffer and, in the context of G-SIBs, a surcharge.<sup>37</sup> The policy statement itself recognizes that “the minimum capital requirements and other capital buffers included in Regulation Q . . . themselves . . . provide substantial resilience to unexpected losses created by normal fluctuations in economic and financial conditions.”<sup>38</sup>
- The U.S. bank regulatory agencies have also implemented more stringent liquidity rules than the Basel Committee has through the U.S. liquidity coverage ratio.<sup>39</sup> Relative to their international peers, U.S. banking organizations hold a far more significant part of their total assets as high quality liquid assets, allowing for even more resiliency in times of stress.

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<sup>33</sup> See Basel Committee on Banking Supervision, “Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems”, ¶ 20 (rev. June 2011) [*hereinafter* “Basel III”].

<sup>34</sup> Dodd-Frank § 171, 12 U.S.C. § 5371.

<sup>35</sup> Basel III, ¶ 23.

<sup>36</sup> IFRS 9, *Financial Instruments* (2014).

<sup>37</sup> 12 C.F.R. Part 217, Subpart H.

<sup>38</sup> 81 Fed. Reg. 5,662.

<sup>39</sup> See Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61,440 (Oct. 10, 2014).

- CCAR and the Federal Reserve’s capital planning process are also clearly countercyclical; if excess credit growth and systemic vulnerabilities are building, those large vulnerabilities should be reflected in the Federal Reserve’s choice of the CCAR severely adverse macroeconomic scenario. And while CCAR is thus inherently countercyclical, the Federal Reserve’s Dodd-Frank stress test rules expressly state that the design of supervisory scenarios incorporates countercyclical elements.<sup>40</sup> Furthermore, CCAR assesses the effects of those systemic vulnerabilities on specific individual banking organizations, rather than requiring all advanced approaches institutions to maintain a larger capital conservation buffer against risks to which individual institutions may not actually be exposed, which would be the effect of the Federal Reserve activating the countercyclical buffer.
  
- Finally, the Collins Amendment enacted by Dodd-Frank sets a floor on the leverage capital and risk-based capital requirements that apply to insured depository institutions and bank and savings and loan holding companies, such that these requirements cannot be less than the generally applicable requirements established pursuant to the “prompt corrective action” framework under the Federal Deposit Insurance Act.<sup>41</sup>

*The proposal does not consider any of these rules as a factor in deciding whether a countercyclical buffer is necessary.*

Lastly, the proposal indicates that “the [Federal Reserve]’s determination of the appropriate level of the countercyclical buffer for U.S.-based credit exposures would be most directly linked to the condition of the overall financial environment rather than the condition of any individual banking organization.”<sup>42</sup> It is unclear why the countercyclical buffer determination would be linked to the overall economic and financial environment when the countercyclical buffer will target only a small subset of banking organizations. This narrow focus means that the proposal is unlikely to achieve its stated objectives and would instead impose a blunt regulatory capital requirement on all advanced approaches institutions.

*Macroprudential Purpose.* We also note that at various points, the proposal states that its purpose is “macroprudential” in nature. We are concerned that the invocation of “macroprudential” could become a talisman used to avoid the need for rigorous analysis and appropriate process. The objective of macroprudential policies is to contain the buildup of systemic risks and achieve greater financial stability, and in that way reduce any adverse consequences—including through crisis—for the real economy. They are meant to complement micro-prudential regulations and traditional macroeconomic management tools, notably monetary and fiscal policies. In theory, macroprudential policies have both a dynamic and a static dimension. The dynamic dimension is designed to mitigate procyclicality, which is the self-reinforcing feedback within the financial system and between the financial system and the real economy. The static dimension is designed to affect the way risk is distributed in the financial system. In practice, macroprudential policies can be activated in instances when there is excessive real credit growth in specific sectors, or the failure of a large institution has

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<sup>40</sup> 12 C.F.R. Part 252, Appendix A.

<sup>41</sup> 12 U.S.C. § 1831o.

<sup>42</sup> 81 Fed. Reg. at 5,663.

implications for the rest of the financial system. However, the effectiveness of the various macroprudential policies varies significantly across types of policies and jurisdictions. For instance, borrower-based macroprudential policies (such as caps on loan-to-value ratios and debt-to-income limits) can be effective in dampening household leverage, especially in advanced economies. In contrast, a wide range of macroprudential policies have much weaker effects on containing leverage in the corporate sector, likely because firms in advanced economies have much better access to capital markets. Moreover, there is very little empirical support that varying capital requirements countercyclically is an effective way to lean against building imbalances. While there may be cases where certain systemic risks arise that are not resolved adequately through traditional bank supervision and regulation, we believe that those risks need to be identified clearly, and any “macroprudential” regulation appropriately tailored to reduce them.

**B. The inherent bluntness and imprecision of the countercyclical buffer makes it highly unlikely that it will be effective in reducing the risks that would motivate its activation.**

*Imprecision as to Effect.* The proposal does not consider the diversified nature of the largest banking organizations and how that complicates the determination of whether to activate the countercyclical buffer. For example, if the Federal Reserve found that systemic risk were “somewhat above normal” in the mortgage market, it appears that, as constructed, the countercyclical buffer would not be assessed solely against mortgage assets. Therefore, the capital charge would also apply to all of the assets of all of the institutions subject to the capital charge. Thus, while imposed in response to concerns about a bubble in the mortgage market, a countercyclical capital charge would likely result in an increase in the cost of originating not only mortgage loans but also other types of loans to consumers, small businesses, municipalities and corporate customers. Moreover, the increase in required capital would also likely lead to an increase in the cost of making markets in securities due to the increased cost of capital market assets and therefore would lower market liquidity and credit supply across all markets.

While banking organizations generally, as a matter of capital planning, tend to identify the source of a higher capital charge and push that cost down to the relevant affected business – either forcing the banking organization to reduce activity, raise pricing or exit the activity altogether – it is not clear how this would work with a countercyclical buffer charge that is ostensibly temporary and cannot be reasonably anticipated through capital planning. The size of the capital charge also presumably would not decrease even if the banking organization exited the business the risks of which motivated an increase in the countercyclical buffer, so it is quite unclear what the effects of activation of the countercyclical buffer would be on banking organization activities and financial markets generally. We are concerned that the proposal does not appear to have considered this important, and potentially intractable, issue at all.

*Imprecision as to Cause.* The broad and non-specific nature of the systemic vulnerabilities that the proposal notes the Federal Reserve will look to in making countercyclical buffer decisions further underscores its inherent weaknesses and limitations as a policy tool. The proposal references the Federal Reserve’s biannual *Monetary Policy Report* to Congress and states that the section of the *Monetary Policy Report* relating to financial stability developments

“will be an important vehicle for updating the public” regarding the vulnerabilities that will affect the level of the countercyclical buffer. The types of vulnerabilities provided in the *Monetary Policy Report*, however, are not bank-specific. This means that activation of the countercyclical buffer may not address these vulnerabilities and may well exacerbate them.<sup>43</sup>

The systemic vulnerabilities listed in the *Monetary Policy Report* and the proposal generally fall into four primary categories: (i) asset valuation pressures, (ii) leverage in the nonfinancial sector, (iii) leverage in the financial sector, and (iv) liquidity and maturity transformation.<sup>44</sup> The *Monetary Policy Report* discusses these categories of vulnerabilities principally in the context of specific asset classes, such as corporate and government debt, equities and commercial real estate (“**CRE**”). However, these vulnerabilities may arise due to activity by non-bank actors (such as hedge funds, REITs, or finance companies), particularly in light of the comparatively small share of U.S. financial assets held by banking organizations. Therefore, activating the countercyclical buffer under these circumstances may not address these vulnerabilities and could aggravate them if activation of the buffer leads to further migration of activities to non-bank financial institutions through increased capital requirements on banking organizations.

We note also that, even with respect to the vulnerability category relating to leverage in the financial sector, this category includes bank leverage and leverage of other non-bank financial institutions, such as broker-dealers and hedge funds.<sup>45</sup> Even if leverage in the financial sector is a source of systemic vulnerabilities, this may be caused primarily by non-bank financial institutions, such that an activation of the countercyclical buffer could cause increased risk-taking by these institutions.

*Alternative Tools.* In contrast to the bluntness and imprecision of the countercyclical buffer, we note that the Federal Reserve has the authority to implement a wide range of more tailored (and likely more effective) policy tools that would be more likely to limit credit losses resulting from excess credit growth. As one example, the U.S. banking regulators issued guidance in 2006 relating to CRE following an increase in concentrations of loans in CRE portfolios.<sup>46</sup> The CRE Guidance noted that “concentrations in CRE lending coupled with weak loan underwriting and depressed CRE markets have contributed to significant credit losses in the past” and sought to decrease these concentrations by establishing guidelines for sound risk management practices with respect to CRE lending, including outlining certain supervisory thresholds that the U.S. banking agencies would analyze to identify banking organizations that were “potentially exposed to significant CRE concentration risk.”<sup>47</sup> Therefore, the 2006 CRE guidance had the objective of limiting concentrations of loans by banking organizations in a

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<sup>43</sup> See *Monetary Policy Report*, Federal Reserve, at 20-21 (Feb. 10, 2016).

<sup>44</sup> See *id.* See also David Aikman, et al., “Mapping Heat in the U.S. Financial System”, Federal Reserve (June 24, 2015), available at <http://www.federalreserve.gov/econresdata/feds/2015/files/2015059pap.pdf>.

<sup>45</sup> See David Aikman, et al., “Mapping Heat in the U.S. Financial System,” Federal Reserve, at 14 (June 24, 2015).

<sup>46</sup> OCC, Federal Reserve, FDIC, “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices,” at 1 (Dec. 12, 2006).

<sup>47</sup> *Id.* at p. 7.

specific sector in order to mitigate significant credit losses, which objective, other than its narrow focus on the CRE sector, is substantially similar to the stated objectives of the countercyclical buffer. A subsequent paper written by Federal Reserve staff found “evidence that the growth rate of CRE loans at banking organizations above the specified thresholds slowed considerably, both relative to banking organizations below the thresholds and relative to how those banking organizations had adjusted to high concentrations before the guidance was issued.”<sup>48</sup> This paper illustrates how more tailored efforts—such as supervisory guidance directed at the lending practices at issue—can effectively address concerns about excessive credit growth to the extent that growth is emanating from the banking sector.

**C. How the countercyclical buffer would be calibrated is entirely unexplained.**

Even if one presupposes that asset bubbles can be identified well in advance, and can be effectively mitigated through a higher capital charge on 13 banking organizations (i.e., the banking organizations that would be subject to the countercyclical buffer’s application), there remains the question of how large a capital charge is necessary and sufficient to achieve that goal. Here, neither Regulation Q nor the proposed policy statement provide any explanation whatsoever for how the actual amount of any future increase in the level of the countercyclical buffer would be calibrated. This leaves an enormous gap in the public’s understanding of how the quantum of any buffer determination will be determined. We urge the Federal Reserve to close this gap by providing a clear explanation, for public review and comment, of how it intends to calibrate any determination to increase the countercyclical buffer.

**D. Collectively, the inherent substantive weaknesses and limitations of the countercyclical buffer require an approach to buffer determinations that is substantially more specific and tailored than the approach described in the proposal.**

Given the uncertainty regarding (i) when the countercyclical buffer may be activated and (ii) whether activation of the buffer will achieve its stated objectives, together with the inherent weaknesses of the countercyclical buffer relative to its stated purposes, we believe that the countercyclical buffer should be viewed as a suboptimal policy tool of last resort, activated only once all other tools for limiting excess credit growth (or other identified and clearly explained purpose of the buffer) have been fully considered and exhausted. We therefore urge the Federal Reserve to revise its proposal to:

- Provide clearer, more specific, and empirically grounded standards for buffer determinations, which will not only support the procedural fairness of the buffer, but also provide all stakeholders with a more meaningful framework for assessing the potential effectiveness (or lack thereof) of the buffer relative to different circumstances over time;

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<sup>48</sup> William F. Bassett and W. Blake Marsh, “Assessing Targeted Macroprudential Financial Regulation: The Case of the 2006 Commercial Real Estate Guidance for Banks”, Federal Reserve, p. 42 (June 12, 2014), available at <http://www.federalreserve.gov/pubs/feds/2014/201449/201449pap.pdf>.



- Acknowledge the inherent conceptual and practical weaknesses and limitations of the buffer and affirm that the Federal Reserve will carefully consider, before any decision to apply or increase the buffer, the extent to which they are likely to frustrate the buffer’s purpose or effect; and
- Acknowledge the wide range of alternative policy tools available to the Federal Reserve to achieve similar purposes and expressly affirm that the Federal Reserve will consider and exhaust all other alternatives before determining to increase the buffer.

**IV. The proposal’s specific “trigger” for determining when to increase the countercyclical buffer – periods when potential systemic vulnerabilities are “somewhat above normal” – is vague and inappropriate.**

The proposal provides that the Federal Reserve expects to apply the countercyclical buffer any time that “potential systemic vulnerabilities” are “somewhat above normal.” This proposed “trigger” is quite inappropriate, as it is subjective, extraordinarily broad, not empirically grounded and inconsistent with the standard articulated in the final capital rules implementing the countercyclical buffer in the United States.<sup>49</sup>

As a starting point, we believe that the appropriate “trigger” for application of the countercyclical buffer should be very high. We note that the Basel Committee framework’s trigger applies only “when there is evidence that the stock of credit has grown to excessive levels relative to the benchmarks of past experience.”<sup>50</sup> The Basel Committee framework also notes that the countercyclical buffer is intended to protect banking organizations against losses that may be “extremely large when a downturn is preceded by a period of excess credit growth.”<sup>51</sup> Similarly, the Basel Committee also observed that, under this standard, “jurisdictions are likely to only need to deploy the buffer on an infrequent basis.”<sup>52</sup> Importantly, the text of the preamble to the U.S. Basel III Rules stated that the countercyclical buffer is designed “to protect the banking system from the systemic vulnerabilities that may build-up during periods of excessive credit growth.”<sup>53</sup>

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<sup>49</sup> We also note that the proposal’s trigger is inconsistent with the standard applicable under the Basel Committee framework and appears inconsistent with the standard suggested in the Federal Reserve’s most recent *Monetary Policy Report*, which indicated that a zero buffer level remained appropriate in light of the “continued moderate level of financial vulnerabilities.” *Monetary Policy Report*, at 21 (emphasis added).

<sup>50</sup> See Basel Committee on Banking Supervision, “Guidance for National Authorities Operating the countercyclical buffer”, p. 1 (Dec. 2010) (emphasis added).

<sup>51</sup> Basel III, ¶136 (emphasis added).

<sup>52</sup> Basel III, ¶137 (emphasis added).

<sup>53</sup> Office of the Comptroller of the Currency, Federal Reserve System, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule 78 Fed. Reg. at 62,018, 62,038 (Oct. 11, 2013) (emphasis added).*

The proposal is clearly inconsistent with this standard. Unlike the prudent “excessive credit growth” standard that we believe should apply on an infrequent basis, as described above, the proposal describes an approach to the countercyclical buffer that would apply the buffer when “potential systemic vulnerabilities are somewhat above normal.”<sup>54</sup> This trigger is qualitatively different than the trigger we believe should apply and that is reflected in the U.S. Basel III rulemaking, as the “potential systemic vulnerabilities” formulation used in the proposal is a much broader concept than the more appropriate “excessive credit growth” standard we recommend. The latter is more specifically focused on the relative supply of credit, whereas the former is broader, capturing a wide range of financial stability risk that is more difficult to apply and measure in practice.

Also problematic is the proposal’s relative threshold for determinations. As a general matter, this threshold is difficult to assess, as the proposal contains no discussion of (i) what is to be considered “normal” for these purposes or (ii) what level of deviation would be considered “somewhat above” that baseline. The absence of meaningful benchmarks in this respect leaves banking organizations and market participants with little understanding of the circumstances in which the Federal Reserve would be likely to apply (or remove) the buffer. Furthermore, it seems likely that however the Federal Reserve construes its standard, this standard for activation of the countercyclical buffer will be significantly lower than the standard we recommend. Rather than “infrequent” application of the buffer only during “excessive credit growth” periods to protect against “extremely large” losses, the linguistic construction of the Federal Reserve standard would appear to result in application of the countercyclical buffer much more frequently and based on unexplained triggers and benchmarks.

These concerns can be directly addressed by eliminating the proposal’s trigger and replacing it with a trigger that is consistent with the final Basel III capital rules and the standard we believe is appropriate, including with respect to the latter’s focus on both (i) credit growth as the object and (ii) excess as the standard. We strongly urge the Federal Reserve to do so because this standard is more appropriate.<sup>55</sup>

## **V. Other Concerns with the Proposal and the Countercyclical Buffer Generally**

### **A. Failure to consider costs.**

The proposal fails to identify or allow for consideration of its costs – whether tied to imposition of the countercyclical buffer or to the uncertainty it will cause bank investors even prior to its imposition. The proposal does not address at all the potential impact of its proposed countercyclical buffer framework, future decisions to apply the countercyclical buffer, and potential alternatives thereto. In particular, it does not appear that the Federal Reserve has considered (i) what the marginal impact of the countercyclical buffer would be on the supply of credit provided by advanced approaches institutions or (ii) how a non-zero and time-varying countercyclical buffer would affect the share of total U.S. credit needs of the U.S. economy met

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<sup>54</sup> 81 Fed. Reg. at 5,664.

<sup>55</sup> We also note that this more appropriate standard makes a jurisdictional reciprocity approach more workable, as discussed in Part V.

by advanced approaches institutions or by the banking system as a whole and the resulting implications for total credit supply and financial stability. If the putative benefit of the countercyclical buffer is the greater credit availability that is derived when it is *released* during a time of stress, then by definition there is lesser credit availability when it is *imposed*. Even if the goal is less credit availability in what the Federal Reserve identifies as an asset class experiencing a bubble, the effects of the charge have firm-wide consequences, and thus could impact the cost of credit to all consumer and business customers of affected banking organizations, as described above.

**B. The proposal should expressly limit the geographic scope of the measures that are considered to trigger the countercyclical buffer to the U.S. economy.**

We believe that an appropriate countercyclical buffer framework requires national authorities to monitor excessive credit growth for purposes of the countercyclical buffer with specific focus on the stock of credit in their national economies. This focus on domestic credit is important to the jurisdictional reciprocity approach described in Regulation Q (and consistent with the Basel Committee framework), with its focus on private sector credit exposures to borrowers in specific jurisdictions. Accordingly, U.S. authorities should monitor excessive credit growth (and any associated increase in systemic risks) in the United States.

Unlike the approach contemplated by Regulation Q and the Basel Committee framework, the proposal does not appear to tailor application of the countercyclical buffer to U.S.-specific circumstances. Instead, the proposal provides that the Federal Reserve would consider, among other financial system vulnerabilities, “asset valuation pressures and risk appetite, leverage in the nonfinancial sector, leverage in the financial sector, and maturity and liquidity transformation in the financial sector.” All of these appear to be broad, financial-stability-based measures of the global financial system generally, rather than conditions and circumstances in the United States financial system in particular. Such a broad, global scope is inappropriate given that, under Regulation Q, the U.S. countercyclical buffer would apply only to the U.S.-based credit exposures of the banking organizations to which it applies. Accordingly, we urge the Federal Reserve to clearly and explicitly affirm that any future countercyclical buffer determinations will be made based on U.S.-specific circumstances that are informed by measurement tools specifically focused on the U.S. economy. Doing so would also help ensure that the jurisdictional reciprocity approach described in Regulation Q (and consistent with the Basel Committee framework) would be workable in practice.

**C. Coordination among U.S. Banking Agencies.**

The proposal provides that the Federal Reserve merely “expects” to make decisions regarding the level of the countercyclical buffer for U.S. private sector credit exposures jointly with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation and “expects” that the countercyclical buffer level will be the same for covered depository institution holding companies and insured depository institutions. By leaving at least potential scope for unilateral or uncoordinated action on countercyclical buffer decisions, the proposal leaves open the possibility of divergent treatment among the Federal Reserve, the OCC and the FDIC in setting the level of the countercyclical buffer, which would result in significant compliance burdens for banking organizations that have institutions regulated by multiple

U.S. banking regulators. We urge the Federal Reserve to explicitly affirm that it will make countercyclical buffer decisions jointly with the other U.S. banking agencies and will ensure that required countercyclical buffer levels for covered depository institution holding companies and insured depository institutions will be appropriately coordinated.

**D. Reciprocal application of the countercyclical buffer for non-U.S. jurisdictions.**

In addition to our concerns regarding the proposal, we are concerned that the jurisdictional reciprocity provisions of the countercyclical buffer are operationally cumbersome and will result in little regulatory benefit in many instances. If the Federal Reserve determines to adjust the countercyclical capital buffer amount to reflect decisions made by foreign jurisdictions, advanced approaches institutions will be required to calculate the countercyclical buffer for non-U.S. credit exposures in such foreign jurisdictions. The rules for determining where certain credit exposures are located are complex, unwieldy and difficult to apply in practice. Specifically, the FFIEC 009 reporting form, which provides information on the distribution by country of claims on, and liabilities to, foreign residents held by U.S. banking organizations, reports the accounting values for such claims and liabilities and does not report values for purposes of regulatory capital.<sup>56</sup> It would be operationally difficult and costly to translate the accounting values reported on the FFIEC 009 form into regulatory capital requirements for purposes of applying the jurisdictional reciprocity provisions. There are also a number of discrepancies between the U.S. Basel III Rules and the FFIEC 009 form relating to, among other things, the treatment of credit derivatives, collateral, guarantees and investment funds. These differences mean that banking organizations would be required to calculate non-U.S. credit exposures by applying completely separate frameworks for (i) reporting purposes on the FFIEC 009 form and for (ii) regulatory capital purposes for purposes of any activation of the countercyclical buffer by a non-U.S. jurisdiction. This would be difficult and costly for banking organizations to implement and the likely insignificant regulatory benefits would be overshadowed by the operational costs and related burdens.

As such, we believe that before activating the buffer in the U.S. with respect to one or more foreign jurisdictions to which U.S. advanced approaches institutions have little credit exposure, the Federal Reserve should set a de minimis level for credit exposures in a non-U.S. jurisdiction below which advanced approaches institutions would not need to calculate the countercyclical buffer when non-U.S. jurisdictions activate the buffer, considering and taking into account the significant administrative costs and burdens of these calculations. From a public policy perspective, we believe that in many instances these costs will far outweigh the benefits of potentially miniscule increases in capital requirements.

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<sup>56</sup> See FFIEC 009 Reporting Form, available at [https://www.ffiec.gov/forms009\\_009a.htm](https://www.ffiec.gov/forms009_009a.htm).

The Clearing House appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'G. Baer', with a long horizontal flourish extending to the right.

Gregory A. Baer  
President  
*The Clearing House Association L.L.C.*

cc: Scott Alvarez  
William Basset  
Mark Buresh  
Sean Campbell  
Rochelle Edge  
Michael Gibson  
Benjamin McDonough  
Mary Watkins  
(Board of Governors of the Federal Reserve System)

Amy Friend  
Martin Pfinsgraff  
(Office of the Comptroller of the Currency)

Doreen Eberly  
Charles Yi  
(Federal Deposit Insurance Corporation)