Statement by Martin J. Gruenberg

Member, Board of Directors, FDIC

Revisions to the Supplementary Leverage Ratio Capital Rule for Custody Banks

March 29, 2019

The notice of proposed rulemaking (NPR) under consideration by the FDIC Board today would implement Section 402 of the Economic Growth, Regulatory Relief and Consumer Protection Act (EGRRCPA). Section 402 directs the appropriate Federal banking agencies to amend their rules for custodial banks to exclude certain assets from the supplementary leverage capital ratio:

> "Funds of a custodial bank that are deposited with a central bank shall not be taken into account when calculating the supplementary leverage ratio as applied to the custodial bank."

Section 402 defines the term "custodial bank" as "any depository institution holding company predominantly engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution subsidiary of such a holding company."

Under the proposed rule, a depository institution holding company would be considered "predominantly engaged" under the terms of the statute if the U.S. top-tier depository institution holding company has a ratio of assets under custody-to-total assets of at least 30 to 1. As the preamble to the NPR points out, this proposed standard demonstrates a clear separation between the three well-known U.S. custody banks – Bank of New York Mellon, State Street Corporation, and Northern Trust Corporation – and other banking organizations that might have a large absolute dollar volume of custody assets but for which such assets are a much smaller proportion of their total assets and thus could not reasonably be considered as "predominantly engaged" in such activities.

The proposed rule's implementation of the statute appears to be consistent with the clear language of the law. For this reason, I will vote to approve this proposed rule.

Prior to the enactment of EGRRPCA, I expressed strong reservations about this provision because it would substantially reduce capital requirements for at least two of the largest, most systemically important banking organizations in the United States. That is still the case, and I would like to take this opportunity to reiterate those reservations.

Funds deposited with a central bank have long been included in leverage ratio requirements in the United States. Making this change to the supplementary leverage ratio for custodial banks, which service and manage trillions of dollars of assets on behalf of clients, would greatly reduce their capital requirements. As is pointed out in the preamble to the proposed rule, this provision could result in an estimated $7 billion, or roughly 23 percent, reduction in the tier 1 capital requirements for the insured depository institutions of State Street Corporation and Bank of New York Mellon, two of the eight U.S. global systemically important banks (GSIBs).

State Street Corporation and Bank of New York Mellon have been identified as GSIBs and are subject to higher capital requirements in large part because they serve as counterparties to virtually every major financial market participant. The financial services and products provided by these global custody banks are an essential part of the financial markets' infrastructure, and are not easily substituted by other market participants should these firms be subject to material financial distress.

Strengthening the leverage capital requirement of the largest, most systemically important banks was an essential post-crisis reform that promotes market confidence in times of stress and reduces the likelihood of failure. The leverage capital ratio provides a simple and transparent constraint on financial leverage that is a critically important complement to the more complex risk-based capital requirement. Because of the inherent difficulty of measuring risks in banking exposures, risk-based capital rules can permit institutions to operate with capital cushions that do not provide confidence to counterparties in times of stress.

Both custodial banks, as well as the other U.S. GSIBs, meet the supplementary leverage capital requirements today and remain quite profitable. It is important to remember that the two custodial banks, like their GSIB peers, experienced severe financial distress during the 2008 crisis, requiring unprecedented government support. For example, State Street and Bank of New York Mellon between them utilized more than $80 billion of public support from the FDIC's Temporary Liquidity Guarantee Program. A reduction in their supplementary leverage ratio capital requirement would make them more vulnerable to financial stress in the future.

The argument is made that during periods of financial stress, large deposit inflows at custodial banks may place them at risk of breaching their supplementary leverage ratio capital standards. Such a concern, however, can be addressed through the supervisory process as provided for under the existing regulatory capital rules. Preemptively weakening leverage capital requirements applicable to the custodial banks, or any of the U.S. GSIBs, unnecessarily places financial stability and the Deposit Insurance Fund at risk.

For these reasons, I had strong reservations about this provision prior to its enactment into law, and I felt obliged to reiterate them today. Given that the proposed rule appears to implement the law consistent with the law's clear language, I am prepared to vote for the proposed rule.