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April 16, 2010

Via E-Mail

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: *International framework for liquidity risk measurement, standards and monitoring*

Ladies and Gentlemen:

American Express Company ("*American Express*") is pleased to have the opportunity to comment on the consultative document issued by the Basel Committee on Banking Supervision (the "*Committee*") entitled *International framework for liquidity risk measurement, standards and monitoring* (the "*Liquidity Proposal*").[1]

Although American Express has a long history as a financial institution, it has only recently become a bank holding company under U.S. law in September 2008. Unlike many other traditional bank holding companies, American Express is primarily engaged in the business of issuing credit and charge cards and prepaid products to a

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1 American Express will submit a separate comment letter addressing the Committee's proposals on bank capital, the consultative document entitled *Strengthening the resilience of the banking sector*.

diverse group of retail consumers, small businesses and corporate clients and operating a network to process transactions made by these customers using American Express products. We are a global company, operating in over 130 countries, with over 87 million cards in force and with a network of merchants that accept American Express cards world-wide.

We support the Committee's efforts to strengthen the international banking sector in light of the recent global financial crisis. We are concerned, however, that the Liquidity Proposal in its current form is a "one size fits all" approach that, in many instances, does not account for the unique nature of many bank operations. Liquidity risk management depends in large part on factors that tend to be specific to a particular bank, such as business model and mix of business. In our case, although we are a bank holding company, our core business is issuing charge and credit cards and card transactions processing, which makes our business model unique among major financial institutions. For American Express, as well as other financial institutions that do not have a traditional banking business model and are affected by the Liquidity Proposal, such a "broad brush" approach may result in unintended consequences for both banks and consumers.

Because of the wide variety of institutions and business models that would be subject to this framework, we believe more flexibility needs to be built into the implementation of the liquidity coverage ratio ("*LCR*") and net stable funding ratio ("*NSFR*"). While we understand the need for some standardization, we believe that the ratios would be more workable and better achieve their respective goals if the framework provided a role for banks, in consultation with their supervisors, to determine the appropriate scope of the assets and liabilities to be included in the numerators and denominators as well as in applying adjustment factors to those assets and liabilities. We believe that this would lead to more rigorous liquidity management and would be less

likely to result in unintended consequences, such as contraction of available funding for small businesses and consumers.

In this letter, we address the concerns that relate specifically to American Express and its unique business model. We have other concerns with respect to the proposal, but we expect that many of those concerns will be addressed by the banking industry as they apply broadly and are shared by others. For example, we believe that while the LCR and NSFR may be useful tools if appropriately structured, they are not the only way to measure liquidity and would therefore more appropriately be treated as supervisory tools rather than as measures subject to public disclosure. If the ratios are to be made public, it is critical that more flexibility be incorporated into the framework, as discussed below, so that the ratios provide an accurate assessment of a bank's actual liquidity position.

I. Liquidity Coverage Ratio

Like the Committee, we believe it is important that banks have adequate liquidity to support their obligations under stress conditions. We understand that the class of assets that qualify as high quality liquid assets for purposes of the LCR needs to be narrowly defined to adequately test an institution's short-term liquidity. We believe, however, that obligations of government-sponsored enterprises that have been explicitly guaranteed by the relevant sovereign should be included in the stock of liquid assets without a haircut.[2]

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[2] In the United States, for example, this would include debt of Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which was explicitly guaranteed by the U.S. government after the U.S. Treasury took Fannie Mae and Freddie Mac into conservatorship in 2008.

Similarly, we think it is appropriate to evaluate short-term liabilities based on their potential run-off in stress situations. The LCR as defined in the Liquidity Proposal, however, is unduly conservative in light of our experience during the financial crisis, particularly with respect to actual run-off of insured deposits.

A. <u>Classification and Stability of Deposits</u>

We agree with the Committee's goal of recognizing that the stability of liabilities, such as deposits, should be evaluated based on the likelihood that they will be drawn down during a period of stress. The factors set forth in the Liquidity Proposal for determining which deposits are stable, however, do not align with the observed stability of these liabilities.

The Liquidity Proposal would classify bank deposits in terms of the channel through which they are received (Paragraphs 41, 45, 51, 54 and 55), and this categorization largely determines the applicable run-off factor for each type of deposit. This framework for categorizing deposits favors a "bricks-and-mortar" retail banking environment that has become less prevalent over time. Customers frequently conduct their entire banking relationship online and do not have the sort of relationship with the bank that accepts their deposits as a retail customer historically would have had. Despite this change in banking model, insured retail deposits in the United States have generally remained quite stable, even in times of financial stress. As a result, we do not believe that the categorization of deposits in the Liquidity Proposal correlates with actual persistence of deposits in times of stress.

In the Liquidity Proposal, retail deposits are defined as those deposits placed in a bank by a natural person and receive a run-off factor of either 7.5% or 15% (depending on perceived stability) (Paragraph 41). Included in "stable retail deposits" are only those deposits that are covered by deposit insurance and where (i) the depositors have other established relationships with the same bank which make deposit withdrawal

highly unlikely or (ii) the deposits are in transactional accounts (Paragraph 41). By contrast, deposits placed by a financial institution intermediary regardless of the underlying source of those deposits would appear to be classified as "unsecured wholesale funding" subjecting them to a very conservative 100% run-off factor (Paragraph 55).

In terms of our banking model, we have a significant amount of deposits from natural persons that would be considered retail deposits but for a broker-intermediary that assists in the placement of the deposit with American Express. In many cases, even though these deposits are placed by an intermediary, the underlying retail customer has specifically selected American Express as the bank at which its deposits will be placed. Importantly, American Express offers market rates for these deposits, and we believe that this is a more important distinguishing factor among brokered deposits, which tend to experience greater run-off when above-market rates are offered, than the channel through which the deposits are placed at the bank. Furthermore, the deposits we accept are almost universally insured by the Federal Deposit Insurance Corporation. This insurance enhances stability and should decrease the likelihood that a bank would experience a high degree of run off of such deposits, even when they are placed through an intermediary. Despite the stable nature of these deposits, they could be assigned a punitive run-off factor of 100 %.

The Committee has indicated that deposit insurance is one factor that makes deposits more stable but also indicates that it is insufficient, by itself, to make a deposit "stable." Deposit insurance systems differ across jurisdictions, and these differences may have a substantial impact on the stability of the deposits protected by insurance, even in times of crisis. However, the experience of the recent financial crisis indicates that, at least in some jurisdictions, deposit insurance alone may be sufficient to protect deposits against run-off, even in the absence of another established relationship with the depositor.

We believe that the Committee should allow sufficient flexibility with respect to the classification of deposits and assignment of run-off factors to align more closely with observed stability of deposits. One way to achieve this would be to classify all insured deposits as potentially "stable" and then allow individual jurisdictions to identify additional factors to distinguish between more and less stable deposits. This approach would allow for the recognition of differences in legislation and business practices across jurisdictions. We believe that this would result in more accurate determinations of which deposits are, in fact, stable and would avoid treating deposits with similar risk factors differently.

II. Net Stable Funding Ratio

We support the NSFR's goals of providing a structural assessment of liquidity risk across all on- and off-balance sheet items, but we have serious concerns regarding the prescriptive approach taken in the Proposal. The approach should be flexible enough to take into account the circumstances and diverse sources of funding of individual institutions as well as the liquidity characteristics of diverse sets of assets.

A. ASF and RSF Factors

1. *ASF Factor*

American Express, like many financial institutions, has available funding sources other than those specifically categorized by the Liquidity Proposal as "available stable funding." Our operations provide examples of funding sources that are inherently stable but that may be assigned an ASF factor of 0% ("all other liabilities") because they are not specifically included in any of the other ASF categories. This is a clear downside of the NSFR's prescriptive approach to measuring liquidity.

American Express offers travelers checks and prepaid cards to businesses and consumers as an alternative method for storing value and making purchases. In

many respects, these prepaid liabilities function in much the same way as a checking account does. Customers pay up front to have access (or to give a third party access) to the funds at a later date on redemption. Based on historical data, including during the recent financial crisis, these liabilities have had a predictable redemption rate that has generally remained consistent through all economic cycles. For example, over the past 15 years, American Express's outstanding travelers checks liabilities have remained relatively stable at around $5 billion. We believe the NSFR should be flexible enough to include alternative sources of funding, such as prepaid liabilities, where an institution can demonstrate historic stability through all economic cycles. If prepaid liabilities were specifically included as an available source of funding, we believe they should be treated as "stable" sources of funding and assigned an ASF factor comparable to stable deposits.

American Express also maintains a customer incentive program, which we refer to as Membership Rewards, under which cardmembers accumulate points for purchases made with their charge cards and credit cards for later redemption. As of December 31, 2009, our liability for Membership Rewards was approximately $4.3 billion and has grown from $2.5 billion in 2004. We currently maintain a reserve to offset the future liabilities associated with our reward program. Historically, the rate of redemption of Membership Rewards has been predictable over time and has not been sensitive to stress events. Based on the predictability of their depletion rates, if reserves set aside for customer incentive programs were specifically included as an available source of funding in the liquidity framework, it should be assigned the same ASF factor as stable deposits.

As discussed above, we believe that the NSFR should be flexible enough to permit banks to identify alternative sources of funding that are not specifically addressed in the proposal and, in consultation with the bank's supervisor, determine an appropriate factor to assign to the ASF. Through this process, a bank and its supervisor

could take into account the bank's actual experience with these alternative sources of funding, which would ensure an appropriate ASF factor would be applied.

2. *RSF Factor*

We believe that the types of assets specifically included in categories that have an RSF factor of less than 100% are too limited. "All other assets" are automatically assigned a 100% RSF factor even though they may be substantially similar to assets in categories with lower RSF factors. In general, the NSFR should either exclude from the ratio, or assign low RSF factors to, products that do not present great liquidity risk to a bank.

Credit card receivables are an example of an asset that does not present significant liquidity risk to the bank but would be treated like assets that do because they are not specifically addressed by the Liquidity Proposal. Although credit cards loans generally do not have to be repaid in full at the end of each billing cycle, American Express, based on its models and experience, is able to estimate repayment rates with a good degree of accuracy. Under the Liquidity Proposal, however, it appears that credit card receivables would be placed in the category "all other assets," which means that they would be assigned a 100% RSF factor. A high RSF factor is not appropriate for credit card receivables because it does not recognize their predictability of repayment and the fact that they generally can be easily monetized. Although cardholders are not contractually obligated to pay their entire credit card balances within one year, in our experience, cardholder payment rates have historically been highly predictable and in recent years have reflected average monthly payment rates of over 20%. This indicates that, on average, a charge incurred at any given time generally would be extinguished well within one year.

Including credit card receivables in a category that requires a high percentage of funding could significantly reduce the amount of funding available to retail consumers and small businesses for whom credit cards are frequently a primary source of funding. We believe that, at a minimum, credit card receivables should be treated in the same manner as loans to retail clients because of the predictability of repayment rates.

Again, a more flexible framework that would allow a bank and its supervisor to take into account the bank's actual experience managing the liquidity risks associated with assets that may require stable funding would likely result in an RSF factor that more appropriately gauges the level of funding actually required. It also would avoid situations where an asset is automatically assigned a 100% RSF factor simply because it does not fall into one of the prescribed categories. A more tailored approach could help avoid inadvertently affecting a bank's ability to extend credit.

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In closing, we would like to reiterate our support of the Committee's goal to achieve a more stable financial system and appreciate the efforts the Committee has made in that regard. We hope that the views we have outlined above are helpful to the Committee's considerations. If we may be of any assistance, please contact us at (212) 640-2000.

Sincerely yours,

Daniel T Henry

Daniel T. Henry
Executive Vice President, Chief Financial Officer
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