

July 6, 2016

**BY ELECTRONIC SUBMISSION:** [www.bis.org/commentupload.htm](http://www.bis.org/commentupload.htm)

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

Re: Consultative Document, Revisions to the Basel III Leverage Ratio Framework

Ladies and Gentlemen:

The Bank of New York Mellon Corporation (“**BNY Mellon**”) welcomes the opportunity to comment on the Consultative Document issued by the Basel Committee on Banking Supervision (“**Basel Committee**”) regarding revisions to the Basel III leverage ratio framework (“**Consultative Document**”).<sup>1</sup>

BNY Mellon supports the Basel Committee’s stated objective to maintain the leverage ratio as a “backstop” that complements the risk-based capital framework.<sup>2</sup> Despite this stated objective, the leverage ratio has become the *binding* capital constraint for many firms on a business-as-usual basis. The leverage ratio has a particularly distortive effect on BNY Mellon and other custody banks due to the large amount of cash on deposit with central banks and in the broader financial system—a structural issue that is unlikely to disappear any time soon. National jurisdictions have exacerbated this issue by implementing even higher requirements that are super-equivalent to the 3 percent Basel III leverage standard.

Against this background, BNY Mellon strongly supports the Basel Committee’s efforts to review the design and calibration of the leverage ratio. In fact, BNY Mellon strongly recommends that the Basel Committee go even further and review the impact of the leverage ratio on cash placements at central banks.

Part I of this letter provides an overview of the BNY Mellon business model, and Part II explains how the leverage ratio impacts a custody bank like BNY Mellon. Part III responds to questions in the Consultative Document regarding additional requirements for global systemically important banking organizations (“**G-SIBs**”). Finally, Part IV suggests additional ways to solve for the problem of cash placements at central banks.

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<sup>1</sup> Basel Committee on Banking Supervision, Consultative Document, *Revisions to the Basel III Leverage Ratio Framework* (April 2016).

<sup>2</sup> *Id.* at 1.

## **I. Overview of BNY Mellon**

BNY Mellon is a global custody and trust bank with approximately \$393 billion in total consolidated assets and \$28.9 trillion in assets under custody or administration as of 2015.<sup>3</sup> The BNY Mellon business model is focused on providing safekeeping, payment, settlement, asset administration, cash management, and other operational services primarily to institutional clients. Fees for these services constitute the large majority of BNY Mellon's revenue.<sup>4</sup> The services BNY Mellon provides to institutional clients, including pension plans, mutual funds, endowments, and a variety of government entities, allow these clients to execute financial transactions across the globe.

Clients must be able to deposit cash at BNY Mellon to support these day-to-day activities.<sup>5</sup> Cash is needed, for example, to facilitate client payments, avoid payments bottlenecks, and manage intraday liquidity in the payments system. As a result, client deposits drive the BNY Mellon balance sheet.<sup>6</sup>

BNY Mellon also receives additional or "excess" cash deposits as a result of these same client servicing relationships—both in business-as-usual and in stress scenarios. Under ordinary, business-as-usual conditions, for example, deposit balances may increase at the end of each month as clients reallocate their investments. A client also could place a large cash deposit with BNY Mellon due to a recently closed deal. During times of market stress or even market uncertainty, clients typically increase cash deposits at their custody bank in the "flight to safety." BNY Mellon primarily places these one-time, variable, or excess cash deposits at central banks to make sure the cash is available when clients need it. BNY Mellon believes this conservative asset-liability management strategy is the best way to serve our clients and is prudent as a matter of liquidity risk management.

## **II. Impact of the Leverage Ratio**

Increased client deposits—and the corresponding increase in central bank placements—expand the balance sheet. Because the leverage ratio is not risk sensitive, banks must hold the same amount of tier 1 capital for these essentially risk-less assets as for higher risk assets such as derivatives, securitizations, or equities.

In recent years, BNY Mellon and other banks have seen a steady increase in cash deposits from clients. For example, BNY Mellon held approximately \$145 billion in deposits in 2010, \$219 billion in 2011, \$246 billion in 2012, \$261 billion in 2013, \$265 billion in 2014, and

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<sup>3</sup> See The Bank of New York Mellon Corporation 2015 Annual Report, at 2.

<sup>4</sup> Fee revenues constituted 79% of total revenue, excluding net securities gains, in 2015. See The Bank of New York Mellon Corporation 2015 Annual Report, at 3 & 11.

<sup>5</sup> See, e.g., Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* ¶ 93 (Jan. 2013) (recognizing that institutional customers "need[] to place, or leave, deposits with a bank in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments").

<sup>6</sup> Total interest-bearing deposits and total noninterest-bearing deposits accounted for 75% of total liabilities in 2015. See The Bank of New York Mellon Corporation 2015 Annual Report, at 15.

\$279 billion in 2015.<sup>7</sup> These cash deposits and the corresponding increase in central bank placements put pressure on the leverage ratio as the binding constraint.

The large amount of cash deposits is not isolated phenomenon, and it is not simply due to the interest rate environment. Investors are more risk averse—and holding more cash—given market uncertainty and the increasing frequency of market volatility events, such as technological disruptions, terrorism, natural disasters, and economic outlook reports.<sup>8</sup> The fear of potential tail events, such as “Brexit,” further aggravates this trend.<sup>9</sup>

The need for institutional clients to deposit cash with their custody banks is only increasing. For example, new regulatory frameworks require low-risk, highly liquid collateral for non-centrally cleared derivatives<sup>10</sup> and have been proposed for non-centrally cleared securities financing transactions.<sup>11</sup> Regulators also have increased liquidity requirements<sup>12</sup> and placed greater emphasis on intraday liquidity management.<sup>13</sup> In all of these new regulatory frameworks, there is a bias for cash due to the significant haircuts for non-cash collateral.

Exacerbating the excess cash issue is the shrinking supply of attractive cash alternatives.<sup>14</sup> The increased demand for low-risk assets (due to collateral and liquidity requirements, for example) has diminished the difference in returns between cash and low-risk, highly liquid securities, so that clients often favor holding cash. Money market fund (“MMF”) reform has reduced the supply of fixed net asset value MMFs. As a result, excess cash that clients would have invested elsewhere are likely to remain as cash deposits with custody banks.

While BNY Mellon can and is taking steps to effectively manage its capital position to comply with the leverage ratio, such steps may not be desirable from a commercial or a macroprudential, financial stability perspective. The primary way to reduce total leverage exposure is to reduce client deposits and the corresponding cash placements at central banks.

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<sup>7</sup> See The Bank of New York Mellon Annual Reports for 2010–2015.

<sup>8</sup> See, e.g., Josie Cox, *Fund Managers Pile Into Cash Amid Market Volatility*, Wall Street Journal (June 16, 2015) (quoting an asset manager, “We seem to have entered an environment where cash is king and will likely be king for the foreseeable future.”); Julie Verhage, *Bank of America: Markets Are In a ‘Twilight Zone’ and It’s Time to Hold More Cash and Gold*, Bloomberg (May 18, 2015).

<sup>9</sup> See, e.g., Michael S. Fischer, *Global Investors Sitting on ‘Mountain of Cash’: BofA Merrill Survey*, ThinkAdvisor (June 14, 2016) (citing “Brexit” as the biggest ‘tail risk’ for world markets).

<sup>10</sup> See, e.g., Basel Committee on Banking Supervision & Board of the International Organization of Securities Commission, *Margin Requirements for Non-Centrally Cleared Derivatives* (March 2015).

<sup>11</sup> See Basel Committee on Banking Supervision, *Consultative Document: Haircut Floors for Non-Centrally Cleared Securities Financing Transactions* (Nov. 2015).

<sup>12</sup> See, e.g., Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013).

<sup>13</sup> See, e.g., Basel Committee on Banking Supervision, *Monitoring Tools for Intraday Liquidity Management* (April 2013).

<sup>14</sup> See, e.g., Juliet Chung & Sarah Krouse, *Big Banks to America’s Firms: We Don’t Want Your Cash*, Wall Street Journal (Oct. 18, 2015) (“Many businesses have large sums [of cash] on hand and opportunities to profitably invest it appears scarce.”).

As a commercial matter, discouraging client deposits is complex and could harm business-as-usual client servicing relationships. And as a policy matter, discouraging client deposits seems counterintuitive to the very purpose of a bank—especially during times of stress or market uncertainty as clients rely on their custody bank as the one safe place to keep cash.<sup>15</sup>

### **III. Additional Requirements for G-SIBs**

The challenges posed by the leverage ratio become more acute as the calibration increases above the 3 percent minimum. The Consultative Document suggests introducing a higher Basel III leverage ratio requirement for G-SIBs to “maintain the relative roles of the risk-based ratio and the leverage ratio in the regulatory capital framework.”<sup>16</sup>

While BNY Mellon opposes higher leverage ratio requirements generally, BNY Mellon believes that any additional leverage ratio requirement should be scaled according to a G-SIB’s relative systemic importance. This symmetry with the risk-based G-SIB surcharge framework would better maintain the leverage ratio as a “backstop” that complements the risk-based capital framework. Moreover, a tiered leverage standard would better reflect the fact that different G-SIBs have different risk profiles driven by different business models and balance sheet management practices.

There are at least two ways to recognize this risk differentiation through a tiered leverage ratio. First, any additional requirement could increase in “tiers” or “bands” that track the G-SIB surcharge. Second, any additional leverage ratio requirement could be set as a percentage of the G-SIB surcharge. The United Kingdom, for example, recently finalized an additional leverage ratio buffer that sets the buffer at 35 percent of the applicable G-SIB surcharge.<sup>17</sup> In both cases, the additional leverage ratio requirement would be proportionate to the systemic importance of the firm and recognize the differences among G-SIBs.

Any additional G-SIB leverage requirement should not be fixed or uniform. The G-SIB designation process recognizes the significant differences among G-SIBs in size, cross-jurisdictional activity, interconnectedness, financial institution infrastructure and substitutability, and complexity.<sup>18</sup> BNY Mellon, for example, is a G-SIB primarily due to the substitutability factor; it is much smaller in size and far less complex than many of its G-SIB counterparts. A uniform G-SIB leverage ratio requirement would eschew these very significant differences among G-SIBs, as a result, likely bind a greater number of G-SIBs.

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<sup>15</sup> Even if BNY Mellon successfully turned away cash deposits, this cash could find its way back onto BNY Mellon’s balance sheet because BNY Mellon serves as the custodian for many of the investment fund cash alternatives.

<sup>16</sup> Consultative Document, at 8.

<sup>17</sup> See Bank of England, Prudential Regulatory Authority, *Implementing a UK Leverage Ratio Framework – PS 27/15* (Dec. 7, 2015).

<sup>18</sup> See Basel Committee on Banking Supervision, *Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement* (July 2013).

#### **IV. Alternative Ways to Address Excess Cash**

Although not addressed in this Consultative Document, BNY Mellon suggests that a simpler way to solve the problem of excess cash in the banking system is to limit the amount of central bank placements included in the leverage ratio denominator. One way to do this would be to exclude central bank placements that fall over a certain percentage of a custody bank's total leverage exposure—a “cap.” Such a cap would directly address the root of the problem—excess client cash deposits that is then placed at central banks—in a targeted manner. A cap would be a simple, easily administrable standard. And a cap based on a percentage of total leverage exposure (the Basel III leverage ratio denominator), rather than total assets, would provide a more holistic picture of a bank's central bank placements in the context of its on- and off-balance sheet activities.

BNY Mellon recognizes that this cap would need to be set high enough to avoid regulatory arbitrage. A properly calibrated cap would ensure that most central bank placements continue to be counted in the total leverage exposure while addressing the specific problem of excess cash placed at custody banks. BNY Mellon would be pleased to work with the Basel Committee to provide data or other information on this issue.

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BNY Mellon appreciates this opportunity to comment on the Basel Committee's Consultative Document to revise the Basel III leverage ratio framework. Should you have any questions, please contact Eli Peterson at [eli.peterson@bnymellon.com](mailto:eli.peterson@bnymellon.com) or (202) 624-7925, or Jennifer Xi at [jennifer.xi@bnymellon.com](mailto:jennifer.xi@bnymellon.com) or (202) 624-7926.