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

April 16, 2010

Re: Proposals to Strengthen the Resilience of the Banking Sector

Ladies and Gentlemen:

U.S. Bancorp (the "Bank") welcomes the opportunity to comment on the Basel Committee on Banking Supervision's (the "Committee") December 2009 consultative document, "Strengthening the resilience of the banking sector" (the "Proposals"). The Bank also appreciates the dedicated efforts of its domestic banking supervisors to meet with the Bank and with other financial institutions to ensure that the responses to the Proposals are informed and contribute to the process of addressing the causes of the current financial downturn stemming from capital and liquidity concerns in the financial sector.

Background

U.S. Bancorp (NYSE: USB), with $281 billion in assets as of Dec. 31, 2009, is the parent company of U.S. Bank National Association, the fifth largest commercial bank in the United States. The company operates 3,015 banking offices in 25 states and 5,148 ATMs and provides a comprehensive line of banking, brokerage, insurance, investment, mortgage, trust, and payment services products to consumers, businesses, and institutions.

The Bank participated in the U.S. Department of the Treasury's Capital Purchase Program ("CPP") from November, 2008 to June, 2009, even though the Bank's capital ratios, exclusive of the CPP capital issuance would have been well above the prescribed regulatory level for determining whether a financial institution is "well capitalized".

On May 11, 2009, after receiving positive and "passing" results on the SCAP stress tests applied to the top 19 U.S. banking institutions, the Bank announced the issuance of a $2.5 billion common stock offering, the proceeds of which contributed to the repayment in full of the CPP preferred stock. The Bank has consistently generated profits each quarter during the current financial downturn, and enjoys the highest public debt ratings among its peer banks.

The Bank is scheduled to begin its Basel II parallel run in 2011 and expects to begin operating under the Basel II risk-based capital rules in 2012.

This letter focuses on the elements of the Proposals which are of primary importance to the Bank. The Bank is also responding to the Proposals through a comment letter submitted by The Clearing House Association L.L.C.[1], of which the Bank is a member.

Agreement with the Overall Goals of the Proposals

The Bank agrees with the efforts of the Committee and of the Bank's domestic regulators to address the capital and liquidity issues that contributed to the present financial downturn. Strengthening individual financial institutions by requiring increased capital levels and a more conservative approach to liquidity risk management will benefit the Bank and its customers by increasing public confidence in the financial sector, reducing the risk related to its financial counterparties, and strengthening the financial sector as a whole.

The Bank also agrees that the consultative process is the correct approach to developing revisions to the current capital regulations that will create a more resilient banking sector. The Bank sees the Proposals as the first step, and the associated Quantitative Impact Study ("QIS") as the logical second step, of what should be a thoughtful and deliberate process. The far-reaching implications of the Proposals, many of which have not yet been identified, require a thoughtful dialogue between the Committee, domestic regulators, the banks, and consumers of banking services. Other parties that will have a significant impact on successfully addressing issues such as international competitiveness include accounting policy governing bodies and national tax authorities.

Principal Concerns

The Bank has two principal concerns regarding the Proposals and the consultative process itself. First, the Committee intends to produce finalized standards over a time period that is too brief to permit the constructive and informed dialogue required for such complex matters. Because of the compressed time period, the Bank believes that the Committee will find it very difficult, if not impossible, to achieve its stated goal of a truly consultative process. The result of the accelerated schedule will be a) disjointed modifications to the existing capital rules based on an incomplete study of their implications, and b) prescriptive liquidity standards developed with an incomplete understanding of their consequences for the banking sector and the economies that the banking sector serves.

The Bank's second principal concern is that the Proposals contain provisions that will have a significant adverse impact on the banking sector, the extent of which is not fully understood at present. A number of these provisions are not justified from a capital management perspective. Other provisions will lead to additional complications related to capital and liquidity management which do not exist at present. Some of these provisions will have unintended consequences that will adversely impact sectors of the larger economy.

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[1] The Clearing House provides payment services for check, electronic check, ACH and wire transfer. It also includes industry forums to discuss and take action in issues critical to its owners. The Clearing House is owned by the following banks: Bank of America, N.A., The Bank of New York Mellon, Branch Banking and Trust Company, Capital One, Citibank, N.A., City National Bank, Comerica Bank, Deutsche Bank Trust Company Americas, Fifth Third Bank, First Citizens Bank & Trust Company, HSBC Bank USA, N.A., JPMorgan Chase Bank, N.A., KeyBank, N.A., Manufacturers and Traders Trust Company, PNC Bank, N.A., RBS Citizens, N.A., UBS AG, Union Bank, N.A. ,**U.S. Bank, N.A.**, Wells Fargo Bank, N.A.

The Bank believes that taken as a whole in its present state the Proposals will have the effect of increasing the cost of capital and liquidity for banks that elect to continue offering their present banking services to their customers. Over time, these costs will be high enough to drive customers to service providers that are not currently subject to regulatory supervision. The Bank believes that alternative,unregulated, providers of banking services will appear in response to the fundamental changes included in the Proposal.

Another outcome may be that banks elect to close out balance sheet positions and exit financial services markets that attract higher levels of capital and generate higher liquidity costs, curtailing banking services to their traditional customers. The Bank believes that in this case as well, banking customers will move to service providers that are not subject to these costs.

The Committee should be mindful of the risk that the Proposals could increase the capital and liquidity requirements of banks to the point where banks will be virtually insulated from failure. Such an outcome would lead to a material increase the cost of credit and banking services to customers and could reduce the level and diversity of services provided by the banking sector. This outcome would increase the risk of promoting the development of a shadow banking sector and of dampening the level of activity in the broader economy.

The Bank does not intend to be alarmist. The Committee may dispute this view; however, the point is that no one understands the full impact of the Proposals on the banking sector, the shadow banking sector, and the global as well as domestic economies. The Bank urges that the Committee proceed deliberately and examine the potential collateral effects of this process.

Consultative Process is Too Brief

A true consultative process comparable to that which led to the successful finalization of the Basel II regulations is required to achieve the Committee's goal. The timetable cited for finalizing the rules does not allow for thoughtful consideration of the concepts contained in the Proposal.

The Bank urges the Committee to publish a proposal for additional comment after the results of the current QIS are analyzed and made available to the banks. The additional comment period should be for a minimum of 90 days. If this additional consultative period makes clear that a second, more focused QIS is required, particularly on the subject of liquidity, the Committee should extend the consultative process appropriately and seriously consider the need for additional dialogue at that point.

The Proposals include a long and varied list of individual changes to the rules. The Bank understands that this is a starting point for identifying the most significant changes for further consideration. A second consultative round is required to permit the banks to focus on the most important changes and so be in a position to respond constructively with estimates of the impact of a coherent set of proposed changes.

The banks also need the opportunity to evaluate the Proposals while taking into consideration the Committee's analysis related to calibrating the minimum capital ratios. The Bank considers the Committee's silence on calibration to be one of the chief obstacles to providing substantive comment on this Proposal. The Bank can only estimate in isolation the impact of individual components of the Proposal on its capital without a) understanding what the final list of proposed changes under consideration is and, b) the Committee's approach to calibration.

In short, the Bank believes that the present timetable is too rushed. We understand that the magnitude of the financial disruption has created a sense of urgency around addressing problems in the financial sector sooner rather than later. However, the large number of changes proposed in the consultative document touch upon fundamental questions of bank capital and liquidity requirements and if revisions to the banking regulations are not considered dispassionately and objectively, changes fostered by this Proposal could easily become the direct cause of deeper problems in an already weakened banking system.

Comment on Specific Capital Proposals
The Bank has comments related to four areas of the capital proposals:

- the exclusion of trust preferred securities and other cumulative, dated hybrid securities from regulatory capital;
- the expanded definition of "lesser assets" to be deducted from regulatory capital;
- measures included in the Proposal that would significantly increase the volatility of capital;
- the Leverage Ratio;
- Capital Buffer; and,
- Capital Composition.

Exclusion of cumulative, dated hybrid securities from regulatory capital
The Bank recommends that the Committee continue to permit the inclusion of cumulative, dated hybrid securities such as trust preferred securities ("TRUPS") in Tier 1 capital. The Bank believes that the 15% limit (effective March 31, 2011) on the inclusion of these securities in core capital is sufficient assurance that common equity will remain the dominant form of core capital. The Bank acknowledges that the loss absorbing capacity of these instruments is not identical to that of common equity; however, the Bank notes that over the current financial disruption 6 of the 19 banks that participated in the U.S. SCAP exchanged $6 billion of TRUPS for common equity, effectively absorbing losses in their non-common equity core capital elements.

The Bank understands that the tax regimes in Europe and the United States differ on the point of the tax deductibility of undated capital securities. One avenue for achieving a level playing field on this point is for the Committee to recommend that dated cumulative capital securities such as TRUPS be included in core capital subject to the present limitations until such time as the tax rules for eligible capital securities are harmonized, eliminating any competitive disparity. As of that time, any new TRUPS would not be eligible for core capital and existing TRUPS would be grandfathered and phased out over a 10 or 15 year period.

Expanded definition of "lesser assets" to be deducted from regulatory Capital
The Bank agrees that intangible assets such as goodwill net of related deferred tax liabilities and other intangibles have less value on a gone concern basis than that of other assets such as financial assets. However, the Bank believes that the current regulatory treatment of servicing assets, including mortgage servicing rights ("MSR"s) and purchased credit card rights ("PCCRs") is correct and does not require adjustment.

The value of MSRs is predicated on discounted contractual servicing cash flows stemming from residential mortgage servicing agreements. In addition to the conservative discount rates applied to the cash flows, based on the regulatory capital rules the Bank deducts 10% of the market value of these cash flows from its Tier 1 capital. These contracts are transferrable at an ascertainable value. Beyond the fact that the value of MSRs has economic basis, the implications of deducting 100% of the value of these rights could cause banks to exit the mortgage servicing business. This would result in servicing companies operating outside of the regulatory capital rules, displacing banks as servicers and increasing the risk associated with investing in residential mortgages.

The capital rules applied to PCCRs is identical to that of MSRs. If the book value of the PCCRs exceeds 90% of its estimated market value, the difference is deducted from Tier 1 capital. The market value of the PCCRs is calculated quarterly and reviewed annually. The value of the PCCRs is based on discounted cash flows stemming from credit card contracts associated with purchased portfolios. In addition to the regulatory limitations on the inclusion of PCCRs in capital, GAAP provides that if the market value of the PCCRs is less than the book value of the PCCRs, then the PCCRs are reduced through impairment and the loss taken through the income statement.

The Bank believes that the regulatory limitations on MSRs and PCCRs as well as the GAAP rules regarding impairment of intangibles are sufficient to assure the market and the supervisors of the continuing value of these assets even under gone concern conditions. The Bank recommends that the regulations regarding these assets remain unchanged.

Volatility of Capital: adjusting regulatory capital for unrealized losses on debt securities
The Bank shares the Committee's concern regarding the market's confidence in the integrity of the calculation of Tier 1 capital. The Bank was cognizant of the sudden interest the market developed in the classic definition of tangible common equity ("TCE") in the first quarter of 2009. We understand that the TCE ratio is predicated on book common equity and does not filter out the unrealized gains or losses on debt securities.

The Bank believes that the reasons considered when the Committee made its original decision to filter out unrealized gains and losses on debt securities continue to apply. The reason why unrealized gains and losses have been filtered out was to reduce the volatility of regulatory capital related to movement in the yield curve and in credit spreads in banks' security portfolios.

The Committee must balance the risk of a negative public perception of the definition of regulatory common equity against the implications associated with a volatile regulatory capital measure. The Bank believes that if financial institutions with large Available For Sale ("AFS") securities portfolios elect to maintain their present portfolio duration (and are required to increase their securities holdings to satisfy the liquid assets requirements of the proposed liquidity ratios), they will be subject to potentially severe swings in unrealized gains and losses. These movements in capital could be highly procyclical as, given recent experience, securities values will tend to decline sharply in the face of a financial disruption. This assumption is central to the asset haircuts in the proposed liquidity ratios. This additional consideration will require that banks add yet more capital to the capital levels held for other risks, effectively creating a buffer that will have to be maintained against further swings in securities prices. Including unrealized gains and losses in regulatory capital would not completely resolve market (or supervisory) discounting of common equity as large AFS investment portfolios (whether carried at a gain or loss) are always at risk for declining prices, reducing both book and regulatory common equity.

If, on the other hand, the banking sector responds to this proposed change by materially shortening the duration of its investment portfolios so as to eliminate material swings in regulatory capital, and reduces the absolute level of securities held to that required by the liquidity rules, there will be negative consequences for the market for mortgage-backed securities ("MBS") and banks' ability to generate earnings.

In the case of the Bank, the bulk of the securities that are held in the AFS portfolio are MBS guaranteed by entities sponsored by the U.S. government ("GSEs" or "Agencies"). These securities are held to meet the Bank's liquidity requirements and to provide collateral to our public entity customers (states, counties and municipalities) whose deposits legally require collateralization. If the Bank shortens duration, it will have to sell the MBS. This will have two results: first, there will be a glut of agency MBS on the market as most banks have similar AFS investment portfolio compositions; and, the Bank's public entity customers will have to find less attractive alternatives for investing their excess funds.

The impact of banks divesting themselves of agency MBS could cause negative repercussions in the U.S. housing market that will adversely affect mortgage originations and housing values.

Leverage Ratio

The Bank believes that whatever the ultimate form of the increase in capital requirements, whether through calibration or increased deductions from Tier 1 capital, the new capital requirement plus increased required liquidity levels combined with enhanced levels of supervision will deal with whatever risks the proposed leverage ratio is expected to address.

If the Committee adopts the leverage ratio in its present form, namely with a fully loaded denominator, then the Committee will likely have to set the minimum ratio at such a low percentage that the market may conclude that the ratio was set at that point to accommodate the banks. This is not the signal that Bank or the Committee wish to communicate to the public.

The Bank recommends that the Committee drop the concept of a leverage ratio or, if absolutely necessary, adopt a leverage ratio based on that currently in place in the U.S.

Capital Buffer

The concept of a capital buffer is an attractive theoretical solution to the problem of procyclicality. In practice, however, the Bank believes that the requirement of a capital buffer in addition to the minimum capital ratios will create an expectation in the market that will effectively make the new minimum ratios equal to the sum of the regulatory minimums plus the buffer. Absent more information from the Committee on the matter of calibrating the ratios, the Bank finds it difficult to comment more specifically on the proposed buffer. Introducing the buffer concept will complicate Committee's primary objective of setting new minimum capital ratios.

The Bank recommends that the matter of capital conservation should be addressed as a supervisory matter by domestic regulators. In the U.S. supervisors already have a variety of laws and regulations granting them discretion over earnings retention.

Deductions from Common Equity/Capital Composition

The Committee proposes a number of incremental changes to the composition of capital, either through tighter restrictions on core capital components, new deductions from common equity or Tier 1 capital, or moving deductions from Tier 1 capital to common equity.

Because of the lack of information in the Proposals regarding calibration of the three existing capital ratios as well as the Tier 1 common ratio, coupled with the variety of individual proposals related to capital composition, the Bank finds it difficult to comment on what the impact of the capital subtotals implies for the incremental need for additional common equity suggested by the Proposals. The Bank looks forward to reviewing the results of the QIS and the next round of comment as the focus of the Proposals is refined.

Comments on the Liquidity Proposals

The Bank agrees with the Committee's efforts to strengthen the level of liquidity and the quality of liquidity risk management in the banking sector. However, the Bank has concerns regarding the liquidity proposals put forth by the Committee:

- first, the ratios do not allow for the effect of significant differences between national financial markets;

- second, the liquidity ratios are not a sufficiently sensitive tool on which to base fundamental risk management actions;

- third, the liquidity ratios contain assumptions in the form of asset haircuts, rate of deposit retention, and draw percentages on unused commitments that are excessively conservative; and,

- finally, the Bank believes that the time frame in which the Committee wishes to implement the liquidity ratios does not allow for the review and analysis required of proposals that represent such a material departure from previous supervisory activities related to liquidity risk review.

Unique characteristics of national financial markets
The Bank understands that the intent of the liquidity ratios is to establish regulations that unequivocally assure the public that banks will no longer rely on governmental agencies such as central banks (the Federal Reserve Bank in the case of the U.S.) for liquidity support when the next financial disruption occurs.

Regardless of the virtue or fault of this approach, this objective contradicts the implicit assumption in the U.S. that, as a result of the banking reforms in the 1930's, domestic banks could safely take deposits without regard to maturity, and provide liquidity to borrowers by extending credit without being required to match the maturity of their assets against that of their deposits. The caveat was that banks had to hold performing assets, whether securities or loans, acceptable to the Federal Reserve so that in the event of an unexpected need for funds, the banks could go to the Discount Window to borrow. Prior to the banking reforms, the banks would have had to call in demand loans to cover short term funding needs.

The composition of the liquidity ratios, particularly the Liquidity Coverage Ratio ("LCR") disqualifies the Discount Window as a source of funding, replacing it with high quality assets. This is a major transformation of the definition of liquidity in domestic banking. The Bank understands that arguing for the restoration of the Federal Reserve Bank as a short term funding source in the LCR is not an option. However, it is important to note the fundamental change implied in the LCR, and to seriously consider the potential ramifications of this change.

The Bank does recommend to the Committee that it permit U.S. banks to take into account their unused borrowing capacity at the Federal Home Loan Bank ("FHLB") when calculating their LCR. The role of the FHLB as a lender to the banking sector is a feature unique to U.S. financial markets. The FHLB was created by Congress expressly to provide liquidity to real estate loans originated by banks in the U.S. The FHLB's advances to the banking sector peaked in the 3rd quarter of 2008, at the height of the recent financial disruption, when the FHLB proved to be a reliable source of ready funding for domestic banks.

The Bank also recommends that the Committee consider another unique feature of the U.S. financial system by including in the definition of high quality assets obligations issued directly by and obligations guaranteed by GSEs such as the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"), as discussed above in the section on capital. At present, agency MBS comprise a significant part of the domestic banks' securities portfolios. The market for these securities is deep and exhibits liquidity characteristics comparable to that of sovereign obligations.

The Liquidity Ratios
The Bank believes that the construction of the liquidity ratios, and in particular that of the Net Stable Funding Ratio ("NSFR"), is flawed. For example, the NSFR's concept of providing liquidity credit to customer loans on the basis that they mature in less than one year rather than on the nature and the quality of all customer loans regardless of maturity is too blunt an assumption. The more significant assumption that over the course of a 1-year time horizon there is no liquidity in the sum of customer loans with maturities in excess of 1 year has no basis in liquidity risk management practices.

The Committee states that the ratios are based on traditional bank cash capital ratios and short term liquidity ratios. The Bank understands that the conceptual simplicity of these ratios are a convenient point of departure for assessing a bank's liquidity; however, most analysts will generally proceed with a detailed review of other bank-specific factors including the bank's liquidity risk management practices and its capital adequacy. Actions that will precipitate a fundamental restructuring of the banking sector's balance sheet cannot be motivated by such a cursory review of a bank's liquidity.

The ratios are not sensitive to significant liquidity risk management factors that distinguish one bank from another. For example, the Bank is unique among its peers in that it distributes its commercial paper and Eurodollar deposits through an internal sales force, exclusively to customers with an account relationship at the bank. The Bank considers these liabilities to be the functional equivalent of core deposits although they are reported as wholesale liabilities. The liquidity ratios would significantly understate the real liquidity value of these liabilities.

For these reason the Bank recommends that the Committee reconsider the one-size fits all approach to assessing liquidity risk and establish principles, through the consultative process, that banks will apply, under domestic supervision, to their unique liquidity profiles.

Liquidity Ratio Assumptions
The Bank has the following observations related to the details of the ratio calculations, subject to our general concern with the inadequacy of the LCR and the NSFR.

The Bank has referred to the FHLB funding that has been a stable source of funds for domestic banks in the U.S. The NSFR calculation does not permit banks to assume that they will be able to roll maturing FHLB debt, even though the debt is conservatively collateralized. The Bank recommends that the Committee include FHLB advances in its liquidity risk management strategy and in these calculations.

The Bank supports the inclusion of qualifying corporate bonds in the LCR and expects that when the Committee has concluded their analysis of the stressed price behavior of these securities it will find that the factors cited in the LCR for this security class understate the liquidity of these assets.

The Bank believes that the assumptions related to runoff and the stable component of deposits assumed in the LCR and the NSFR, respectively, are too conservative. In particular, the Bank believes that the runoff assumptions related to insured deposits do not credit sufficiently the demonstrable effectiveness of the U.S. FDIC insurance. 7.5% is too high a runoff rate for insured deposits. The Bank also believes that the assumption that 100% of maturing secured funding collateralized by other than high quality assets does not renew is not a reasonable assumption.

In addition to the runoff assumptions related to deposits and customer liabilities, the Bank believes that the assumption that 10% of all unfunded committed commercial facilities will be drawn is too conservative. Neither does the Bank see the basis for the assumption in the LCR that 10% of unfunded retail lines would be drawn in the first 30 days of a liquidity event.

The Bank regrets that it cannot document its assertions regarding the conservatism of the runoff rate assumptions at this time. During the height of the economic downturn and yet today, the Bank has benefited from deposit growth related to the flight to quality effect. Because of this, we do not have first-hand data related to runoff rates driven by either a sharp market disruption such as that posited by the LCR or an extended liquidity drain such as that suggested by the NSFR. As the Committee knows, this data is generally very difficult to find. This is likely why the Committee elects to take a conservative position as a point of departure. The Bank considers this lack of data to be yet more evidence of the importance of extending the consultative process to permit the collection and analysis of relevant data on which banks and supervisors may construct an empirically based set of assumptions related to depositor behavior under stress assumptions.

Need Time to Develop and Implement Effective Liquidity Measures
The Bank applauds the Committee's initiative to address the problem of insufficient liquidity in the banking sector. The Bank urges the Committee to resist the pressure to apply a simple, transparent, and quick fix to a problem that is best addressed on a bank-specific basis, acknowledging the real differences that exist in the structure and depth of national capital markets and banking sectors.

Relevant data related to depositor behavior under stress has always been in short supply. The Bank believes that a deliberate and cooperative approach to gathering, analyzing, and interpreting data by and across national jurisdictions in the wake of the recent financial turmoil should be a cornerstone of the process to develop useful, relevant, and effective liquidity risk management practices and supervisory oversight.

The Bank recommends that the Committee extend the consultative process, including consideration of additional QIS while at the same time encouraging banks to upgrade the quality of their data gathering and reporting processes and to strengthen their liquidity risk management processes.

Summary

The Bank supports the efforts of the Committee to address the weaknesses in the banking sector that contributed to the financial disruption. We trust that the Committee will resist demands that the banking system be "patched up" and that it will look to the long run and engage with the banking sector in a thoughtful and constructive effort to develop revisions to the capital rules and encourage improvements to liquidity risk management that will promote public confidence in a banking system that better serves the economy and the people that participate in it.

As we have stated earlier, we completely agree with the Committee that steps need to be taken to address capital and liquidity insufficiency. However, we have also stressed that this goal should not be achieved by insulating banks from the consequences of risk-taking. Economists may argue about the degree by which such a result would slow economic growth, or limit the availability of credit. We prefer to work with the Committee and our domestic supervisors and dedicate ourselves to getting it right.

Sincerely,

Andrew Cecere