**February 23, 2021**

Via Electronic Submission

The Honorable Randal K. Quarles
The Honorable Lael Brainard,
The Honorable Michelle Bowman

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC, 20551

Dear Honorable Randal K. Quarles, Honorable Lael Brainard and Honorable Michelle Bowman

In May 2020, SIFMA responded to the Board of Governors of the Federal Reserve System's (the "Federal Reserve's") interim final rule[1] (the "IFR") for bank holding companies, which provides a temporary exclusion of U.S. Treasury securities and deposits at the Federal Reserve Banks from the Supplementary Leverage Ratio ("SLR"). SIFMA, The American Bankers Association and the Financial Services Forum members strongly supported the Agencies' modification to this risk-insensitive, size-based capital requirement to at least partially accommodate for the unprecedented speed and size of monetary expansion that was on the horizon. The exclusion of these near-risk-free assets, however, is set to expire on March 31, 2021, despite Federal Reserve Chairman Jerome Powell's comment that the Federal Reserve's balance sheet will continue to expand, and that any future exit by the Federal Reserve (the "Fed") will be publicly communicated "well in advance of active consideration of beginning a gradual taper of asset purchases.[2]"

The purpose of this letter is to encourage the Federal Reserve to extend the IFR consistent with the expected continued expansion of the Federal Reserve's balance sheet and significant U.S. Treasury issuance for 2021. We also believe that the IFR extension must be made as soon as possible to better enable banks to engage in efficient capital planning and allocation processes. We believe it is imperative that the continuation of the IFR include both excess reserves and U.S. Treasury securities to preserve the Federal Reserve's long-standing policy stance that these asset classes are fungible.

As cited in the preamble of the IFR, the U.S. response to the COVID-19 pandemic has resulted in a significant expansion of banking organizations' balance sheets. Moreover, as noted in the IFR preamble, it was envisioned that the Federal Reserve's expanded balance sheet would persist for as long as the

[1] Docket No. R-1707; RIN 7100-AF81
[2] Virtual chat with Chair Powell hosted by the Princeton University Bendheim Center for Finance, January 14, 2021

U.S. government and the Federal Reserve were actively responding to the economic impact of the COVID-19 pandemic. This strongly suggests that the IFR should be extended to correlate with the U.S. government's and the Federal Reserve's continuing actions to mitigate the economic impact of the COVID-19 pandemic. In fact, elimination of the IFR would be contrary to the Federal Reserve's and U.S. Government's present economic objectives and would have negative implications on current efforts.

The March 31, 2021 expiration of the IFR does not lead to an SLR shortfall for SIFMA members. However, projections for the growth of the Federal Reserve's balance sheet, future fiscal stimulus, and forward Treasury issuance will result in firms' SLR requirements becoming more binding. This reduced balance sheet capacity may impact future bank decision making regarding accepting deposits and acting as intermediaries in the U.S. Treasury market. This risks migration of some of this activity to the unregulated non-bank sector and may impact the smooth function and stability of the Treasury markets.

**The Federal Reserve's Balance Sheet and Implications to Banking Organizations**

*QE, deposit growth and low loan demand*

The size of the Federal Reserve's balance sheet has material implications on the banking system, which is evidenced by the extraordinary growth in excess reserves coinciding with the rapid and sizeable purchase of assets by the Federal Reserve. While we support this economic response to the COVID-19 pandemic, the expansion is materially larger and grew faster than any prior QE in recent history. To put this in perspective, the Federal Reserve's balance sheet has expanded 85% from YE2019, reaching $7.6 trillion on February 10, 2021. Moreover, the current balance sheet is more than three times larger than at YE2010 and close to 70% higher than the previous highwater mark in April 2017.

It is expected that the Federal Reserve's balance sheet will continue to grow at least for the next couple of years and is likely to stay elevated for some time. Indeed, the Federal Reserve has stated it will continue to purchase U.S. Treasuries and agency mortgage-backed securities ("MBS") at a rate of at least $120 billion per month for the foreseeable future. Further, it is very likely the Federal Reserve will ramp up its U.S. Treasury purchases beyond current levels to cushion the impact of anticipated increased Treasury issuance and the implications of monetary policy. Currently, it is projected that the Federal Reserve's balance sheet will easily top $10 trillion by year-end 2021, depending on the size of the U.S. deficit.

As the Federal Reserve's balance sheet continues this unprecedented expansion, deposit growth is substantial for large domestically charted banks. The latest H.8 release (2/17/21) reports that deposits have grown approximately 25% since YE 2019. Importantly, this deposit surge has occurred without meaningful loan demand. Loan demand absent government programs and residential mortgages have been lackluster as reflected in the Senior Loan Officer Opinion Survey[3] and the Beige Book[4]. For large domestically chartered banking organizations, the ratio of loans to deposits fell from approximately 70% at YE 2019 to approximately 56% as of February 10, 2021. The mismatch in deposits and asset generation has contributed to the growth of reserves over a relatively short period of time.

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[3] https://www.federalreserve.gov/data/sloos/sloos-202101.htm
[4] https://www.federalreserve.gov/monetarypolicy/files/BeigeBook_20210113.pdf

The continuation of the IFR is crucial for banking organizations to fully execute their necessary deposit-taking role in our nation's economy. SIFMA believes that the IFR's relief for deposits placed at Federal Reserve Banks is consistent with safety and soundness because these placements are effectively riskless.

U.S. Treasury Holdings

Current projections for 2021 U.S. Treasury security issuance are approximately $2.8 trillion (using current deficit projections) with the Federal Reserve likely absorbing close to $1 trillion of total issuance. As such, the market will need to absorb $1.8 trillion in U.S. Treasury securities. To date, 2020 U.S. Treasury issuance has yet to be fully absorbed as evidenced by the elevated holdings of U.S. Treasury securities across the banking system. The most recent H.8 release noted that U.S. Treasury holdings increased over 250% between year-end 2019 and February 10, 2021. While the most recent release shows a nearly 20% decline from their highs in July 2020, most recent trends indicate a return to an upward trajectory in U.S. Treasury holdings, despite the Federal Reserve's monthly U.S. Treasury purchases. This suggests that the dip in U.S. Treasury holdings by banks is only temporary, and in 2021, holdings will likely exceed the 2020 high water mark. It is critical that IFR relief is extended so that banking organizations retain the utmost capacity to manage this unprecedented issuance. This is very important in the functioning of the Treasury market as primary dealers play a critical role in the financing and distribution of U.S. Treasury debt and are primarily bank owned. Accordingly, the IFR's exclusion of U.S. Treasury securities removes a potential impediment that might otherwise impair primary dealers' market-making capacity, and in turn, the efficiency of the U.S. Treasury markets.

**Leverage Ratios should remain a backstop capital requirement, not a binding constraint**

The SLR, like the Tier 1 leverage ratio, was designed to restrict the build-up of leverage in the banking sector and to backstop the existing risk-weighted asset ("RWA") capital requirements with a simple, non-risk-weighted measure. Nevertheless, because of the construction of the denominator as well as its calibration, it could become the binding constraint for many banking organizations solely because of the actions of the Federal Reserve and the U.S. Treasury.

**Conclusion**

In closing, we wish to underscore how unique and challenging the last year has been for the Federal Reserve, the markets, and its participants, including banking organizations. Thus far, the leadership and foresight of the Federal Reserve has permitted the U.S. to aptly navigate the economic challenges sparked by the pandemic. We also agree with recent statements by Vice Chair for Supervision Quarles that "the banking system has been a source of strength during the past year."[5] Banking organizations have played a pivotal role in market stability by extending credit, accepting deposits, and intermediating the capital markets throughout the cycle. Members believe that the extension of the IFR is critical to the continued ability of banking organizations to continue accepting deposits and acting as intermediaries in the U.S. Treasury market. Additionally, it is crucially important that the Federal Reserve communicate its intensions regarding the IFR in the very near future to prevent any unnecessary disruptions.

[5] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201218b.htm

We believe the continuation of the IFR would also permit further study as to the appropriate design and role of leverage-based metrics in the prudential framework, taking into account the experience and evidence of this crisis as well as broader, long-term policy objectives of both the SLR and Tier 1 leverage ratios. Indeed, the same comments and rationale contained in this letter apply to the Tier 1 leverage ratio and its potentially unnecessary impact on bank intermediation.

To this end, we encourage the Federal Reserve to consider the long-term role of the SLR in the capital framework, including by taking further action on the Federal Reserve's 2018 proposal to recalibrate eSLR requirements with a buffer equal to 50 percent of a firm's G-SIB Surcharge.[6] A recalibration along these lines would harmonize the SLR with related regulatory standards and potentially reduce the need in the future for interventions in leverage standards during periods of heightened economic uncertainty. Importantly, the joint federal banking agencies' finalization of the eSLR recalibration proposed in 2018 would bring the U.S. rule into compliance with the Basel Committee agreement.

Sincerely,

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[6] 83 Fed. Reg. 17,317 (Apr. 19, 2018).