

PENSION, ENDOWMENT, AND MUTUAL FUND ACCESS TO  
BANKING ACT

---

APRIL 26, 2018.—Committed to the Committee of the Whole House on the State of  
the Union and ordered to be printed

---

Mr. HENSARLING, from the Committee on Financial Services,  
submitted the following

R E P O R T

together with

ADDITIONAL VIEWS

[To accompany H.R. 2121]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 2121) to require the appropriate Federal banking agencies to revise regulations to specify that certain funds shall not be taken into account when calculating any supplementary leverage ratio for custodial banks, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike all after the enacting clause and insert the following:

**SECTION 1. SHORT TITLE.**

This Act may be cited as the “Pension, Endowment, and Mutual Fund Access to Banking Act”.

**SEC. 2. TREATMENT OF FUNDS DEPOSITED WITH A CENTRAL BANK IN CALCULATING THE APPLICABLE SUPPLEMENTARY LEVERAGE RATIO.**

(a) **IN GENERAL.**—The funds of a custody bank that are deposited with a central bank shall not be taken into account when calculating the applicable supplementary leverage ratio for the custody bank.

(b) **LIMITATIONS.**—

(1) **AMOUNTS.**—The amount of funds described under subsection (a) shall be limited to—

(A) the total value of deposits of the custody bank linked to fiduciary or custodial and safekeeping accounts; or

(B) an amount that is greater than a percentage specified by the appropriate Federal banking agency of the total leverage exposure of the custody bank, based on considerations such as the potential impact on the safety and soundness of the custody bank and the ability of the custody bank to continue to accept cash deposits from customers that are linked to fiduciary or custodial and safekeeping accounts.

(2) HIGH-QUALITY CENTRAL BANK REQUIREMENTS.—Subsection (a) only applies to central banks that are high-quality central banks, including—

(A) the Federal Reserve System;  
 (B) the European Central Bank; and  
 (C) central banks of member countries of the Organisation for Economic Co-operation and Development, if—

(i) the central bank of such member country has been assigned a zero percent risk weight under the final rules titled “Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule” (78 Fed. Reg. 62018; published Oct. 11, 2013, and 79 Fed. Reg. 20754; published April 14, 2014); and

(ii) the sovereign debt of such member country is not in default or has not been in default during the previous five years.

(c) REGULATIONS.—Not later than 60 days after the date of the enactment of this Act, the appropriate Federal banking agencies shall revise applicable regulations to carry out this Act.

(d) DEFINITIONS.—For purposes of this section:

(1) APPROPRIATE FEDERAL BANKING AGENCY.—The term “appropriate Federal banking agency” has the meaning given that term under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(2) CUSTODY BANK.—The term “custody bank” means a depository institution holding company predominantly engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution subsidiary of such a holding company.

(3) DEPOSITORY INSTITUTION HOLDING COMPANY.—The term “depository institution holding company” has the meaning given that term under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(4) INSURED DEPOSITORY INSTITUTION.—The term “insured depository institution” has the meaning given that term under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(5) SUPPLEMENTARY LEVERAGE RATIO.—The term “supplementary leverage ratio” means the supplementary leverage ratio, including applicable buffers, surcharges, and well-capitalized requirements relating to such supplementary leverage ratio, as defined by regulation of the appropriate Federal banking agency in title 12, Code of Federal Regulations, as in effect on October 1, 2017.

Amend the title so as to read:

A bill to ensure that certain funds shall not be taken into account when calculating any supplementary leverage ratio for custody banks, and for other purposes.

#### PURPOSE AND SUMMARY

Introduced by Congressman Keith Rothfus on April 25, 2017, H.R. 2121, the “Pension, Endowment, and Mutual Fund Access to Banking Act”, would permit a custodial bank to exclude from the calculations of its applicable supplementary leverage ratio, subject to limitations, the funds deposited with a “high-quality” central bank. Within sixty days of enactment of H.R. 2121, the federal banking regulators must update “applicable regulations” to account for the changes made by the legislation.

#### BACKGROUND AND NEED FOR LEGISLATION

In response to the 2008 financial crisis, the Basel Committee on Banking Supervision (Basel Committee) agreed to modify inter-

nationally negotiated bank regulatory standards known as the Basel Accords, to increase bank capital requirements.

Basel III increased the minimum leverage ratio from 3 percent to 4 percent for certain banks, including those with a strong supervisory rating. The leverage ratio is calculated based on the value of a bank's assets without the use of risk-weighting. On July 9, 2013, the federal banking regulators, including the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, issued a final rule to implement many of the Basel III recommendations.

In addition to the simple leverage ratio, Basel III established a "supplementary leverage ratio" (SLR) that requires certain larger banking organizations to maintain a 3 percent ratio of tier 1 capital to total leverage exposure. The SLR includes leverage exposures that are both on and off asset the bank's balance sheet. All banks with at least \$250 billion in total assets and \$10 billion in foreign assets must meet a 3 percent SLR. In addition, banks with more than \$700 billion in assets or \$10 trillion in assets under custody must maintain a 5 percent SLR to avoid restrictions on capital distributions and discretionary bonuses, and 6 percent for depository subsidiaries to be considered well capitalized.

In April 2014, federal banking regulators proposed and adopted an "enhanced supplementary leverage ratio" (eSLR) for the U.S. global systemically important banking organizations, or "U.S. G-SIBs," of 5 percent at the bank holding company and 6 percent at each insured depository institution subsidiary. Beginning in January 2018, banks subject to the rules will be required to meet both the SLR and eSLR.

In June 2017, the Treasury Department released its first report in response to the President's February 3, 2017 Executive Order entitled "Core Principles for Regulating the United States Financial System" to inform the Administration's perspective to regulate the financial system. The report entitled, "A Financial System That Creates Economic Opportunities—Banks and Credit Unions" provided recommendations to improve market liquidity and rationalize capital requirements. The report states that "[s]ignificant adjustments should be made to the calculation of the SLR. In particular, deductions from the leverage exposure denominator should be made, including . . . [c]ash on deposit with central banks."

H.R. 2121, as amended by an amendment offered by Representative Bill Foster, allows a depository institution holding company "predominantly engaged in custody, safekeeping, and asset servicing activities" to exclude from the calculations of its applicable supplementary leverage ratio funds deposited with a "high-quality" central bank. So called custodial banks provide asset safekeeping for large institutional investors, asset managers, official institutions and private wealth clients. Custody services involve the holding and servicing of assets for others and custodians provide administrative services for their clients such as the processing of income and interest payments, proxy voting, transfer agency services, securities lending and the redemption of securities, among other activities.

Banks that have a predominant amount of businesses derived from custodial services are different from banks that engage in a wide variety of banking activities, as their revenues are primarily

derived from fees for custodial services as opposed to net interest revenue generated from lending and other interest-earning activities. In addition, custodial banks that meet the definition of “predominantly engaged in custody, safekeeping, and asset servicing activities” as required under H.R. 2121 often deposit funds with high-quality central banks or invest funds in other very low-risk assets. Based on the publicly available data, and discussions with market participants and with banks that provide custodial services, the Committee believes that only the three traditional custodial banks meet H.R. 2121’s definition.

The difference in balance sheets associated custody banks predominantly engaged in custodial services and those of commercial banks was highlighted in a July 2016 white paper published by the Clearing House, and entitled “The Custody Services of Banks”:

According to a report published by Autonomous, on an asset-weighted average basis, net interest income accounted for just under 60% of U.S. banks’ revenues in 2014, with the percentage ranging from over 75% for smaller regional banks (with total assets between \$1 billion and \$50 billion) and approximately 60% for large regional banks (with total assets between \$50 billion and \$500 billion) to approximately 50% for large banks (with total assets above \$500 billion) . . .

. . . In the four-year period from 2012 through 2015, the percentage of total revenues accounted for by revenues from custody services ranged from 64.1% to 69.2% for BNY Mellon, 51.4% to 53.8% for Northern Trust, and 87.7% to 88.4% for State Street. The majority of the revenues from custody services consist of fees rather than net interest income, although, as described below, custodians do earn net interest income, which contributes to their overall profitability.<sup>1</sup>

In a letter of support for H.R. 2121 dated October 10, 2017, the Financial Services Roundtable wrote:

Pension funds, mutual funds, and endowments depend on custody banks for the day-to-day services that allow individuals to build wealth and invest. The services include record-keeping to ensure that retirement accounts, pension funds, and other assets are safe and secure, and processing customers’ asset sales and purchases. The Supplementary Leverage Ratio (SLR) required by banking regulators has a disproportionate effect on custody banks because of their higher proportion of safe assets, particularly cash at central banks. H.R. 2121 will modify the SLR requirements for these institutions and preserve their ability to place customer cash on deposit at central banks.

In a letter of support for H.R. 2121 dated October 10, 2017, the Securities Industry and Financial Markets Association wrote:

This technical correction is an important step to improve the SLR to ensure that custody banks have enough balance sheet capacity to provide clients with a safe haven during stressed market conditions. Accordingly, this legislative fix would improve custody banks’ abilities to service clients, reduce market stress, and enhance financial stability.

<sup>1</sup>“The Custody Services of Banks,” The Clearing House (July 2016), available at [https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/07/20160728\\_tch\\_white\\_paper\\_the\\_custody\\_services\\_of\\_banks.pdf?la=en](https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/07/20160728_tch_white_paper_the_custody_services_of_banks.pdf?la=en).

## HEARINGS

The Committee on Financial Services held hearings discussing matters relating to H.R. 2121 on February 15, 2017 and July 12, 2017.

## COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on October 12, 2017 and ordered H.R. 2121 to be reported favorably to the House as amended by a recorded vote of 60 yeas to 0 nays (Record vote no. FC-76), a quorum being present. Before the motion to report was offered, the Committee adopted an amendment in the nature of a substitute offered by Mr. Rothfus, and the Committee adopted by voice vote an amendment to the amendment in the nature of a substitute by Mr. Foster.

## COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House as amended. The motion was agreed to by a recorded vote of 60 yeas to 0 nays (Record vote no. FC-76), a quorum being present.

## Record vote no. FC-76

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling .....	X			Ms. Maxine Waters (CA) .....	X		
Mr. McHenry .....	X			Mrs. Carolyn B. Maloney (NY) ..	X		
Mr. King .....	X			Ms. Velázquez .....	X		
Mr. Royce (CA) .....	X			Mr. Sherman .....	X		
Mr. Lucas .....	X			Mr. Meeks .....	X		
Mr. Pearce .....	X			Mr. Capuano .....	X		
Mr. Posey .....	X			Mr. Clay .....	X		
Mr. Luetkemeyer .....	X			Mr. Lynch .....	X		
Mr. Huizenga .....	X			Mr. David Scott (GA) .....	X		
Mr. Duffy .....	X			Mr. Al Green (TX) .....	X		
Mr. Stivers .....	X			Mr. Cleaver .....	X		
Mr. Hultgren .....	X			Ms. Moore .....	X		
Mr. Ross .....	X			Mr. Ellison .....	X		
Mr. Pittenger .....	X			Mr. Perlmutter .....	X		
Mrs. Wagner .....	X			Mr. Himes .....	X		
Mr. Barr .....	X			Mr. Foster .....	X		
Mr. Rothfus .....	X			Mr. Kildee .....	X		
Mr. Messer .....	X			Mr. Delaney .....	X		
Mr. Tipton .....	X			Ms. Sinema .....	X		
Mr. Williams .....	X			Mrs. Beatty .....	X		
Mr. Poliquin .....	X			Mr. Heck .....	X		
Mrs. Love .....	X			Mr. Vargas .....	X		
Mr. Hill .....	X			Mr. Gottheimer .....	X		
Mr. Emmer .....	X			Mr. Gonzalez (TX) .....	X		
Mr. Zeldin .....	X			Mr. Crist .....	X		
Mr. Trott .....	X			Mr. Kihuen .....	X		
Mr. Loudermilk .....	X						
Mr. Mooney (WV) .....	X						
Mr. MacArthur .....	X						
Mr. Davidson .....	X						
Mr. Budd .....	X						
Mr. Kustoff (TN) .....	X						
Ms. Tenney .....	X						
Mr. Hollingsworth .....	X						

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 2121 will remove burdensome, costly and unnecessary regulations from custodial banks that were not originally intended for them by providing for the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) to specify that central bank placements are excluded when calculating the applicable supplementary leverage ratio for a custodial bank.

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, February 23, 2018.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2121, the Pension, Endowment, and Mutual Fund Access to Banking Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Kathleen Gramp and Sarah Puro.

Sincerely,

KEITH HALL,  
*Director.*

Enclosure.

*H.R. 2121—Pension, Endowment, and Mutual Fund Access to Banking Act*

Summary: H.R. 2121 would adjust the calculation of a financial ratio called the supplementary leverage ratio (SLR), for certain banks that engage predominately in banking activities that the bill defines as custody, safekeeping, and asset serving.<sup>1</sup> The bill would permit certain large financial institutions to omit cash balances held at the Federal Reserve and other central banks from their SLR calculations. Currently, all assets must be included in the denominator of that ratio.

CBO estimates that enacting H.R. 2121 would increase deficits by \$45 million over the 2018–2027 period. That amount includes a net increase in direct spending of \$50 million and an increase in revenues of \$5 million. Most of those costs would be recovered from financial institutions in years after 2027. Because enacting the bill would affect direct spending and revenues, pay-as-you-go procedures apply.

CBO estimates that enacting H.R. 2121 would not increase net direct spending or on-budget deficits by more than \$2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

H.R. 2121 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

If the Federal Deposit Insurance Corporation (FDIC) increases fees to offset some of the costs of implementing the bill, H.R. 2121 would increase the cost of an existing mandate on the depository and large financial institutions that are required to pay those fees. Using information from the affected agencies, CBO estimates that the incremental cost of the mandate would fall well below the annual threshold for private-sector mandates established in UMRA (\$156 million in 2017, adjusted annually for inflation).

Estimated cost to the Federal Government: The estimated budgetary effect of H.R. 2121 is shown in the following table. The costs of this legislation fall within budget function 370 (advancement of commerce).

	By fiscal year, in millions of dollars—											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018– 2022	2018– 2027
INCREASES IN DIRECT SPENDING												
Estimated Budget Authority	0	3	5	7	7	6	6	5	5	6	22	50
Estimated Outlays .....	0	3	5	7	7	6	6	5	5	6	22	50
INCREASES IN REVENUES												
Estimated Revenues .....	0	0	0	0	0	1	1	1	1	1	0	5
NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES												
Effect on the Deficit .....	0	3	5	7	7	5	5	4	4	5	22	45

Basis of estimate: The budgetary effects of H.R. 2121 stem from a small increase in the chance that the FDIC would incur additional costs to resolve failed financial institutions, because of the change in the SLR, which could reduce the amount of capital that a few banks hold. For this estimate, CBO assumes that the bill will be enacted late in 2018.

<sup>1</sup>The SLR is a capital-to-assets ratio that accounts for derivatives and other commitments that are not typically included in a bank's leverage ratio calculation.



CBO’s estimate for H.R. 2121 is based on the analysis that underlies projections for deposit insurance in its June 2017 baseline. Those projections incorporate the small probability of a financial crisis in any given year within the projection period and the more likely scenario of an average number of bank and credit union failures in any given year. As a result, the estimated cost of this legislation represents a weighted probability of outcomes—including some cases for which the probability is very low but for which the costs to the Deposit Insurance Fund (DIF) or the Orderly Liquidation Fund (OLF) are much larger. Both of those funds are administered by the FDIC.<sup>2</sup>

CBO estimates that the bill would effectively allow up to five large financial institutions to omit their cash balances held at the Federal Reserve and other central banks when calculating the SLR. The bill’s provisions could reduce the capital that those institutions must hold relative to their assets. The net effect of implementing the bill would vary among eligible institutions because the SLR is only one measure used by federal regulators to determine how much capital a bank must hold. The net budgetary effects of implementing the bill also would be different for the DIF and the OLF.

The number of financial institutions and the amount of assets that could be affected depend on how the federal financial regulators implement the bill. Specifically, H.R. 2121 stipulates that the change in the calculation of the SLR would apply to banks that are “predominately” in the business of custody services.<sup>3</sup> CBO expects that the three traditional custody banks in the United States—Bank of New York, State Street, and Northern Trust—would clearly qualify for the SLR adjustments authorized by the bill. Their combined assets were about \$720 billion in 2017. CBO estimates that regulators also may determine that other institutions would be eligible for the SLR adjustment if the value of their custodial activities is similar to that of the three traditional custody banks. For this estimate, CBO assumes that there is a 50 percent chance that regulators would allow two other financial institutions—JP Morgan and Citibank, with combined assets of \$4.4 trillion—to adjust their SLRs under the terms in the bill.<sup>4</sup>

Changes in the amount of capital that a bank holds can affect its probability of failure, which in turn may affect costs incurred by the DIF and the OLF.<sup>5</sup> Costs to the DIF would stem primarily from decreases in capital at JP Morgan and Citibank because the three traditional custody banks hold few insured deposits. In contrast, costs to the OLF would stem primarily from decreases in capital at the three traditional custody banks.

<sup>2</sup>The DIF resolves the assets of failed insured depository institutions and insures certain deposits up to \$250,000 per person. It is funded by premiums paid by insured institutions. The OLF would resolve failures of certain large, systemically important financial institutions—including banks and nonbanks. In the event of such a failure, costs to the OLF would be recouped by assessments on other large financial institutions (which are recorded as revenues in the budget).

<sup>3</sup>Custody services include holding and servicing assets on behalf of other clients. Custody services often are provided to large institutional investors and private wealth clients and include the settlement, holding, and reporting of customers’ marketable securities and cash.

<sup>4</sup>See The Clearing House, *The Custody Services of Banks* (July 2016), page 16, <http://tinyurl.com/yat2wep7>.

<sup>5</sup>The academic literature suggests that a 1 percent decrease in the capital-to-assets ratio for a bank can increase the probability of failure by between 5 percent and 60 percent. CBO used a midpoint of that range for this estimate.

Based on publicly available information about the components of bank balance sheets and on the loss and failure rate estimates that underlie CBO’s June 2017 baseline projections, CBO estimates that over the 2018–2027 period, implementing the bill would increase the deficit by \$45 million, or by roughly 0.05 percent of the June baseline projection for FDIC programs. That amount includes an increase in direct spending of \$50 million and an increase of revenues of \$5 million. CBO estimates that most of the costs would be offset after 2027 by an increase in fees paid by financial institutions.

Pay-as-You-Go considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 2121, THE PENSION, ENDOWMENT, AND MUTUAL FUND ACCESS TO BANKING ACT, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON FINANCIAL SERVICES ON OCTOBER 12, 2017

	By fiscal year, in millions of dollars—											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2022	2018–2027
	NET INCREASE IN THE DEFICIT											
Statutory Pay-As-You-Go Impact .....	0	3	5	7	7	5	5	4	4	5	22	45
Memorandum:												
Changes in Outlays .....	0	3	5	7	7	6	6	5	5	6	22	50
Changes in Revenues .....	0	0	0	0	0	1	1	1	1	1	0	5

Increase in long-term direct spending and deficits: CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits by more than \$2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

Mandates: H.R. 2121 contains no intergovernmental mandates as defined in UMRA.

If the FDIC increases premiums or fees to offset the costs of implementing the bill, H.R. 2121 would increase the cost of an existing mandate on the depository and large financial institutions required to pay those fees. Using information from the agencies, CBO estimates that the incremental cost of the mandate would be below the annual threshold for private-sector mandates established in UMRA (\$156 million in 2017, adjusted annually for inflation).

Estimate prepared by: Federal Costs: Kathleen Gramp and Sarah Puro; Mandates: Rachel Austin.

Estimate approved by: H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

## ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

## APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

## EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

## DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

## DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rulemakings: The Committee estimates that the bill requires no directed rulemakings within the meaning of such section.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1. Short title*

This Section cites H.R. 2121 as the “Pension, Endowment, and Mutual Fund Access to Banking Act.”

*Section 2. Treatment of funds deposited with a central bank in calculating the applicable supplementary leverage ratio*

This Section deems cash on deposit with a high-quality central bank held by a custody bank excluded from the denominator of the supplementary leverage ratio. Such funds are limited to (a) the total value of deposits of the custody bank linked to fiduciary or custodial and safekeeping accounts; and (b) an amount that is greater than a percentage of the total leverage exposure of the custodial bank, based on considerations such as the potential impact on the safety and soundness of the custodial bank and the ability of the custodial bank to continue to accept cash deposits from customers that are linked to fiduciary or custodial and safekeeping accounts.

A high-quality central bank includes the U.S Federal Reserve, the European Central Bank, or a central bank of a member country of the Organization for Economic Co-operation and Development (OECD) assigned a 0% risk weight under the U.S. Basel III standardized approach capital rules, whose sovereign debt is not in default, or has not been in default during the previous five years.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 2121 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the House of Representatives.

## ADDITIONAL VIEWS

One of the cornerstones of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was a mandate that the largest, most complex financial institutions be subject to enhanced prudential standards, including more stringent capital requirements and leverage limits, to better ensure safety and soundness and promote financial stability. The 2008 financial crisis exposed many problems with our financial regulatory framework, including an undercapitalized banking system. With the enactment of Dodd-Frank and related post-crisis regulatory developments, the largest U.S. banks have subsequently increased their loss-absorbing common equity capital by more than \$700 billion, more than doubling their common equity capital ratios from approximately 5 percent to more than 12 percent.<sup>1</sup> As a result of these reforms, the financial system is much safer, which in turn has promoted stable economic growth.

One example of such a reform is the implementation by U.S. banking regulators—specifically the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC)—of the supplementary leverage ratio (SLR) rule to ensure the largest banks don't become overleveraged and fail in an economic downturn. However, concerns have been raised with respect to how the SLR, in its current form, is being applied to custodial banks. The three largest custodial banks manage roughly \$65 trillion in assets for their customers, including pension funds, endowments and other institutional investors,<sup>2</sup> so they play an important role in our financial system. In a future economic downturn or financial crisis, institutional clients would likely liquidate securities being held by custodial banks for cash, causing a large and rapid influx of deposits into central banks. These deposits receive a zero percent capital risk weight, but remain subject to the SLR. Without some modification, the SLR could force custodial banks to limit deposits or raise capital in the midst of a crisis, making a bad situation worse.

In testimony before Congress, former Federal Reserve Chair Janet Yellen acknowledged the need to revisit the calibration of the

---

<sup>1</sup> Federal Reserve Board Vice Chairman of Supervision Randal Quarles, Testimony before the House Committee on Financial Services hearing entitled "Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System," (Apr 17, 2018), <https://financialservices.house.gov/uploadedfiles/hrg-115-ba00-wstate-rquarles-20180417.pdf>.

<sup>2</sup> See the U.S. Securities and Exchange Commission's (SEC's) 2016 Form 10-K for State Street Corp., available at <http://investors.statestreet.com/Cache/38179223.PDF?O=PDF&T=&Y=&D=&FID=38179223&iid=100447>; the SEC's 2016 Form 10-K for The Bank of New York Mellon Corp., available at <https://www.bnymellon.com/global-assets/pdf/investor-relations/form-10-k-2016.pdf>; the SEC's Form 10-K for Northern Trust Corp., available at Northern Trust, "2016 Annual Report to Shareholders" (2016), available at <https://www.northerntrust.com/documents/annual-reports/northern-trust-annual-report-2016.pdf?bc=25199835>.

SLR.<sup>3</sup> In August 2016, the Bank of England reversed course and excluded money held at the central bank and loans of up to three months from the calculation of a bank’s leverage ratio, and called on their foreign counterparts to adjust the Basel III standards at the international level.<sup>4</sup>

In the meantime, H.R. 2121, the Pension, Endowment, and Mutual Fund Access to Banking Act, seeks to address issues with the SLR’s application to custodial banks. The bill would require federal banking agencies to specify that funds of a custodial bank that are deposited with a central bank generally not be taken into account when calculating the applicable SLR for a custodial bank. The exemption is limited to banks that are predominantly engaged in custodial banking and the amount of funds deposited linked to the bank’s custodial and safekeeping accounts. And because of an amendment offered by Rep. Bill Foster during the Committee’s consideration of H.R. 2121 that was unanimously adopted, the exemption is limited to certain central banks, including the Federal Reserve and the European Central Bank, and can be further limited by regulators based on safety and soundness considerations.

A similar provision was included as section 402 in S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, which was passed by the Senate in March 2018, however the Senate provision lacks similar flexibility contained in H.R. 2121 with respect to the potential impact on the safety and soundness of the custodial bank.

It is worth noting several developments that occurred after the Committee’s consideration of H.R. 2121 in October 2017 that the House should consider prior to further action on the legislation.

#### *Scope of H.R. 2121 and CBO estimate*

The Congressional Budget Office (CBO), in reviewing H.R. 2121 for budgetary scoring purposes following the Committee’s consideration, wrote that they expect, “that the three traditional custody banks in the United States—Bank of New York, State Street, and Northern Trust—would clearly qualify for the SLR adjustments authorized by the bill. Their combined assets were about \$720 billion in 2017. CBO estimates that regulators also may determine that other institutions would be eligible for the SLR adjustment if the value of their custodial activities is similar to that of the three traditional custody banks. For this estimate, CBO assumes that there is a 50 percent chance that regulators would allow two other financial institutions—JP Morgan and Citibank, with combined assets of \$4.4 trillion—to adjust their SLRs under the terms in the bill.”<sup>5</sup> This is despite the fact that H.R. 2121 includes clear language that limits the scope to “a depository institution holding company *pre-*

<sup>3</sup>House Committee on Financial Services hearing entitled “Monetary Policy and the State of the Economy” Wednesday, (July 12, 2017), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402098>. Also see Alistair Gray and Sam Fleming, “Yellen signals Fed may relax crisis-era bank safety rule,” FINANCIAL TIMES, <https://www.ft.com/content/elf5f0f4-6800-11e7-9a66-93fb352baf6e>, and Former Governor Dan Tarullo, “Departing Thoughts,” remarks at the Woodrow Wilson School, Princeton University, (April 4, 2017), <https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm>.

<sup>4</sup>Huw Jones, “Bank of England eases banks’ capital leverage rule to help support economy,” REUTERS (Aug. 4, 2016), <http://www.reuters.com/article/britain-boe-banks/bank-of-england-eases-banks-capital-leverage-rule-to-help-support-economy-idUSL8N1AL40S>.

<sup>5</sup><https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/hr2121.pdf>.

*dominantly* engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution subsidiary of such a holding company.”<sup>6</sup> (emphasis added)

Despite CBO’s estimation, there should be no mistake or misinterpretation, it never was the intent, nor does the legislation provide for expanding its application to large universal banks like JPMorgan and Citibank that engage in a wider variety of financial activities beyond custodial banking compared to banks engaged predominantly in custodial banking activities.

*Basel Committee’s December 2017 agreement*

Furthermore, the Federal Reserve and other U.S. bank regulators reached an agreement with their international counterparts on the Basel Committee on Banking Supervision (Basel Committee)<sup>7</sup> in December 2017 to finalize the Basel III capital framework.<sup>8</sup> The agreement would allow individual country’s to provide more targeted flexibility for custodial assets with more safeguards. In a summary document, the Basel Committee wrote: “The Committee has also agreed that jurisdictions may exercise national discretion in periods of exceptional macroeconomic circumstances to exempt central bank reserves from the leverage ratio exposure measure on a temporary basis. Jurisdictions that exercise this discretion would be required to recalibrate the minimum leverage ratio requirement commensurately to offset the impact of excluding central bank reserves, and require their banks to disclose the impact of this exemption on their leverage ratios.”<sup>9</sup>

Even without H.R. 2121, the U.S. banking regulators have the authority to adjust SLR on their own to implement such a change, and arguably the Basel Committee’s recommendation is a more narrowly tailored option. To that end, some experts have made recommendations on streamlining various capital and leverage requirements.<sup>10</sup> Other experts have raised concerns about any exemption from leverage rules,<sup>11</sup> however, the Center for American Progress has recommended a similarly tailored solution that the Basel Committee recommended compared to a broader statutory change.<sup>12</sup>

<sup>6</sup>See subsection (d)(2).

<sup>7</sup>The Federal Reserve Board, the Federal Reserve Bank of New York, OCC and FDIC are U.S. members of the Basel Committee. See <https://www.bis.org/bcbs/membership.htm>. It is worth noting at the time this December 2017 agreement was reached, President Trump’s appointees for the Federal Reserve’s Vice Chair of Supervision and the Comptroller of the Currency were confirmed by the Senate and in place to participate in the Basel Committee’s deliberations.

<sup>8</sup>This has been referred by some as the Basel III “end game.” For more information, see <https://www.bis.org/bcbs/publ/d424.htm> and <https://www.bbvarsearch.com/wp-content/uploads/2017/12/Watch-Basel-IV.pdf>.

<sup>9</sup>[https://www.bis.org/bcbs/publ/d424\\_hlsummary.pdf](https://www.bis.org/bcbs/publ/d424_hlsummary.pdf) at 10.

<sup>10</sup>For example, see Robin Greenwood, Samuel G. Hanson, Jeremy C. Stein, and Adi Sunderam, “Strengthening and streamlining bank capital regulation,” <https://www.brookings.edu/pepa-articles/strengthening-and-streamlining-bank-capital-regulation/>.

<sup>11</sup>For example, see letters commenting on Section 402 of S. 2215, available at: <https://www.banking.senate.gov/newsroom/mmority/what-wall-street-reform-leaders-are-saying-about-s2155-the-dodd-frank-roll-back-bill>.

<sup>12</sup>CAP, “Resisting Financial Deregulation,” Dec. 4, 2017 at 14 and 15.

*New regulatory proposals to adjust capital leverage rules*

In addition, the Federal Reserve Board has been developing<sup>13</sup> and recently released two proposals that would make major changes to capital, stress testing and leverage requirements for the largest U.S. banks. On April 10, 2018, the Federal Reserve Board announced the first proposal, which would simplify its capital rules for large banks and introduce a “stress capital buffer,” or SCB, which would in part integrate the forward-looking stress test results with the Fed’s non-stress capital requirements.<sup>14</sup> The second and more pertinent proposal issued by the Federal Reserve Board, along with the OCC, is a plan to substantially revise the current enhanced supplementary leverage ratio (eSLR) that applies to global systemically important banks (G-SIBs), including two custodial banks.<sup>15</sup>

Currently, G-SIBs must maintain a supplementary leverage ratio of more than 5 percent to avoid limitations on capital distributions and certain discretionary bonus payments. The insured depository institution subsidiaries of the G-SIBs must maintain a supplementary leverage ratio of 6 percent to be considered “well capitalized” under the agencies’ prompt corrective action framework. The proposal modifies these minimum leverage ratios with a new calculation: 3 percent plus half of each G-SIB’s risk-based capital surcharge for both the holding company and insured depository institution subsidiaries. Arguably, this proposal implements the recent Basel III end game agreement. According to the Fed, “Taking into account supervisory stress testing and existing capital requirements, agency staff estimate that the proposed changes would reduce the required amount of tier 1 capital for the holding companies of these firms by approximately \$400 million, or approximately 0.04 percent in aggregate tier 1 capital.”

That said, this proposal received a dissenting vote from Fed Governor Lael Brainard, the first such dissent since 2011 when former Governor Duke dissented from a proposal on interchange fees.<sup>16</sup> In a recent speech, Governor Brainard said, “At a time when valuations seem stretched and cyclical pressures are building, I would be reluctant to see our large banking institutions releasing the capital and liquidity buffers that they have built so effectively over the past few years, especially since credit growth and profitability in the U.S. banking system are robust.”<sup>17</sup>

The FDIC announced opposition to the Fed plan as well and disputed the potential impact on capital requirements for the largest banks. After the proposal was released, FDIC Chairman Martin Gruenberg said, “Strengthening leverage capital requirements for the largest, most systemically important banks in the United States was among the most important post crisis reforms . . . the amount of tier 1 capital required under the proposed eSLR stand-

<sup>13</sup> <https://www.bloomberg.com/news/articles/2018-01-19/fed-said-to-be-finishing-proposal-to-ease-up-on-bank-leverage> and <https://www.bloomberg.com/news/articles/2018-02-01/deposit-shunning-banks-get-big-break-as-u-s-eases-leverage-rule>.

<sup>14</sup> <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm> and <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180410a1.pdf>.

<sup>15</sup> <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm>.

<sup>16</sup> <https://www.politicopro.com/financial-services/article/2018/04/fed-occ-release-plan-to-ease-backup-capital-rule-for-biggest-banks-477397>.

<sup>17</sup> <https://www.federalreserve.gov/newsevents/speech/brainard20180403a.htm>.



ard across the lead IDI subsidiaries would be approximately *\$121 billion less* than what is required under the current eSLR standard to be considered well-capitalized”<sup>18</sup> (emphasis added). In a speech given before the eSLR proposal was made public, FDIC Vice Chair Hoenig raised similar concerns.<sup>19</sup>

In response to a request from Committee staff for more information, the FDIC estimates the eSLR proposal would lower capital requirements for the primary federally-insured bank subsidiary of each G-SIB as follows:

- JPMorgan Chase & Co.: \$34.597 billion (20.83% reduction in tier 1 capital)
- Citigroup: \$26.978 billion (23.3% reduction)
- Bank of America: \$22.838 billion (18.5% reduction)
- Wells Fargo: \$20.406 billion (16.9% reduction)
- Bank of New York Mellon: \$5.911 billion (33.65% reduction)
- State Street: \$5.346 billion (37.5% reduction)
- Morgan Stanley: \$2.507 billion (25% reduction)
- Goldman Sachs: \$1.93 billion (9.49% reduction)

These developments come despite the fact that Fed Chair Powell recently said that the Fed’s requirements for the largest banks are “very high and they’re going to remain very high,” he said following a recent speech at the Economic Club of Chicago.<sup>20</sup> Chair Powell continued, “As you look around the world, U.S. banks are competing very, very successfully. They’re very profitable. They’re earning good returns on capital. Their stock prices are doing well. So I’m looking for the case, for some kind of evidence that—and I’m open to this—some kind of evidence that regulation is holding them back, and I’m not really seeing that case as made at this point.”<sup>21</sup>

<sup>18</sup> <https://www.americanbanker.com/news/fed-occ-back-proposal-to-ease-big-bank-capital-measure>.

<sup>19</sup> Hoenig said, “[I]t concerns me that the U.S. regulatory agencies have joined the recent Basel Committee agreement that, according to some estimates, could remove as much as \$145 billion of capital from the eight largest banking firms. This is counterproductive. As I noted earlier, the U.S. banking system is stronger than that of any other region. Even with tangible equity at only 6.62 percent of total assets plus the fair value of derivatives, the market has come to rely most heavily on U.S. banks over their less well-capitalized foreign peers. Also, U.S. bank stocks are trading at premiums with an average price-to-book ratio of 1.4. In contrast, foreign banks trade at an average ratio well below 1, a reflection of their lower capital and poorly priced risks. Should the U.S. banking agencies embrace the Basel standard, the reduction in private capital would necessarily be underwritten by the FDIC, the Federal Reserve, and then the taxpayer. As an example, one bank that received more than \$100 billion dollars of capital and liquidity support in the last financial crisis would be free to reduce its capital by 30 percent under the new Basel accord. The United States should not engage in this race to the bottom.” Available at: <https://www.fdic.gov/news/news/speeches/spmar2818.html>.

<sup>20</sup> <https://www.federalreserve.gov/newsevents/speech/powell20180406a.htm>.

<sup>21</sup> Politico Pro, “Powell doesn’t see need to loosen rules on biggest banks,” April 6, 2018. Furthermore, while lowering the SLR would reduce the likelihood of it serving as a binding constraint, increasing risk-based capital rules would have the same effect. The Federal Reserve Board’s own research has indicated current capital rules are on the lower end of requirements that best balances benefits associated with mitigating systemic risk with a bank’s funding costs (see <https://www.federalreserve.gov/econres/feds/files/2017034pap.pdf>). According to a 2017 farewell speech by former Fed Governor Tarullo, “A recent study by three Federal Reserve Board researchers concludes that the tier 1 capital requirement that best achieves this balance is somewhere in the range of 13 percent to 26 percent, depending on reasonable choices made on some key assumptions. By this assessment, current requirements for the largest U.S. firms are toward the lower end of this range, even when one takes account of the de facto capital buffers imposed on most firms in connection with the stress test.” (See <https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm>). The Federal Reserve Bank of Minnesota recently released an even more aggressive plan to increase capital and leverage requirements, with Step 1 of their proposal requiring the largest banks to issue common equity equal to 23.5 percent of risk-weighted assets and a corresponding leverage ratio of 15 percent, with further increases

*Conclusion*

It is our view that H.R. 2121 is intended to deal with an important, but narrow issue with respect to current leverage rules and how they may limit custodial banks' ability to respond to a sudden surge of deposits from pension funds and other institutional investors in the event of a crisis. While improvements to leverage and other prudential rules should be considered, it is worth stressing that Dodd-Frank and the enhanced prudential rules generally have strengthened the resilience of the financial system and better protected taxpayers and the U.S. economy from another costly crisis.

As regulators have issued new proposals to revise leverage limits and other rules, it is clear U.S. banking regulators possess the authority to make modifications to address these issues without further legislation. However, these proposals go well beyond addressing this particular issue regarding custodial assets, and warrant further scrutiny by Congress.

It is critically important that an attempt to solve a narrow problem does not result in a much more sweeping and unintentional reduction of critical standards that would undermine the safety and soundness of our largest financial institutions. Such a result would be contrary to the intent of H.R. 2121.

MAXINE WATERS.  
BILL FOSTER.

○

---

in capital required to eliminate a bank's systemic importance. Their proposal also summarizes other relevant research on appropriate capital and leverage requirements put forward by the Bank for International Settlements, Financial Stability Board, Basel Committee, Macroeconomic Assessment Group and the International Monetary Fund (IMF) (see <https://www.minneapolisfed.org/publications/special-studies/endingtbtf>).