The Clearing House[SM]
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The Honorable Timothy Geithner
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

Last year, The Clearing House Association provided you with our empirical study on the liquidity coverage ratio (LCR), which examined and analyzed the short-term liquidity requirements recommended by the Basel Committee in December 2010, together with an accompanying white paper, ***The Basel III Liquidity Framework: Impacts and Recommendations***. We hope you found that work to be constructive.

Today, I am pleased to provide you with an update to our empirical study on the LCR. This study is the culmination of in-depth analysis that The Clearing House has performed over the last several months using proprietary data from eleven of our member banks with assets totaling approximately $9.2 trillion (or 53 percent of total U.S. banking industry assets), as well as publicly-available information.

Our updated study finds that the U.S. banking industry is significantly more liquid today that it was when the LCR was first announced in December 2010. The U.S. industry average LCR rose from 59 percent in the fourth quarter of 2010 to 81 percent in the second quarter of 2012, and the liquid asset buffer shortfall has decreased during that timeframe from approximately $1.56 trillion to approximately $840 billion. Despite the significant gains in industry-wide liquidity, eight of eleven participating banks reported LCR shortfalls as of Q2 2012.

Our updated study also notes that part of the U.S. industry-wide improvement may be traced to excess reserves held in the Federal Reserve System and holdings of U.S. Treasury Securities, which together currently total approximately 12% of industry-wide bank assets. While this trend may, in part, reflect prudent liquidity management in view of uncertainty surrounding liquidity requirements, much of the LCR improvement is a result of strong deposit growth and reduced loan growth as reflected in the Federal Reserve Flow of Funds data. If excess reserves plus U.S. Treasury holdings were to return to historical levels, the U.S. industry average LCR could be expected to decline and the liquid asset buffer shortfall could be expected to increase.

Finally, the updated study also calculates the impact, based on Q2 2012 data, of the changes we proposed in ***The Basel III Liquidity Framework: Impacts and Recommendations***. On this point, our updated study finds that:

- Reducing the assumed drawdown rates on credit and liquidity lines to financials and liquidity lines to non-financials, which are both currently treated at 100%, to a 10% outflow would increase the industry average LCR by about 20% and reduce the liquid asset buffer shortfall by about $300B;
- Calibrating wholesale deposit run-off rates to crisis levels on a category-by-category basis (e.g., financial operational, financial non-operational, non-financial operational, non-financial non-operational), would increase the LCR by about 20% and reduce the shortfall by about $375B;
- Increasing the assumptions around less stable retail deposit outflows from a 10% to 20% run-off rate would reduce the industry average LCR by about 3% and increase the shortfall by more than $30B;
- Reducing stable retail outflow assumptions from a 5% to 3% run-off rate would increase the industry average LCR by about 2% and reduce the shortfall by about $40B;
- Removing the cap on level 2 high-quality assets would increase the industry average LCR by about 7% and reduce the shortfall by about $100B; and
- Treating undrawn Federal Home Loan Bank commitments as high-quality liquid assets would increase the industry average LCR by about 7% and reduce the shortfall by about $50-150 billion.

The Clearing House has consistently voiced support for the general LCR framework recommended by the Basel Committee. However, the prescriptive standards recommended by the Basel Committee are not a panacea and, as the Basel Committee itself has acknowledged, the LCR is a work-in-progress. The Clearing House believes that several of the critical calibrations are overly conservative, which overstate the true liquidity risk in the industry today. Assumed net cash outflows are too high while the assumed liquid asset buffer shortfall significantly understates the stock of assets that firms could use to meet their short-term cash needs. We urge U.S. banking regulators to recalibrate these flawed LCR assumptions before the LCR is implemented. It is important to note that if all of the recalibrations we describe above are made, the industry average LCR would increase from approximately 81 percent to approximately 142 percent – which we believe reflects the true nature of the robust liquidity position currently maintained by the U.S. banking industry.

On behalf of The Clearing House and our owner banks, I hope that you and your staff will find this analysis useful. Should you have questions about this study or other work that The Clearing House has undertaken, please do not hesitate to contact me at (212) 613-0138 or paul.saltzman@theclearinghouse.org; David Wagner, Senior Vice President, Finance Affairs at

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Respectfully,

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cc: The Honorable Neal Wolin
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The Honorable Janet L. Yellen
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