Meeting Between Staffs of the Federal Deposit Insurance Corporation, Federal Reserve System, Office of the Comptroller of the Currency, and Representatives from the Financial Services Forum ("FSF")

March 8, 2024

Participants:

Benedetto Bosco, Ryan Billingsley, Iris Li, Catherine Wood, Irina Leonova, Ernest Barkett, Richard Smith, Matthew Park, Andrew Carayiannis, Peter Yen, Merritt Pardini, Keith Bergstresser, Brian Cox, Adam Casella, Bob Charurat, Meraj Allahrakha, Olga Lionakis, Huiyang Zhou, Rachel Romm and Michael Maloney (Federal Deposit Insurance Corporation).

Missaka Warusawitharana, Andrew Willis, Jonah Kind, Sarah Dunning, Gillian Burgess, Jasmin Keskinen, Robin Oh, David Imhoff, Brian Chernoff, Cecily Boggs, Marco Migueis, Mark Buresh, Akos Horvath, Alexander Jiron, Dennis Mawhirter, Ben Ranish, Daniel Schwindt and Abigail Roberts (Federal Reserve System).

Margot Schwadron, Amrit Sekhon, Kevin Korzeniewski, Carl Kaminski, Venus Fan and Jie (Diana) Wei (Office of the Comptroller of the Currency).

Sean Campbell and Emma Tong (Financial Services Forum); Johathan Blum, Garrett Ahitow, Benget Redlinger and Michael Dorfman (Bank of America); Jiren Xu (BNY Mellon); Ann McKeehan and Jonathan Silverstone (Citigroup); Kyle Russ, Joseph Hwang and Ben Katz (Goldman Sachs); Alister Webster, Beth Cleland and Alizeh Hussain (JP Morgan); Robert McKeon and Fabrice Dumont (State Street); Tim Becker, John Allen, Yosef Nussbaum and Karl Reitz (Wells Fargo); Andrew Nash, Denise Pieck, Sarah Lantz and Michael Formichelli (Morgan Stanley); Chen Xu and Taylor Richards (Debevoise & Plimpton).

Summary: Staffs of the Federal Deposit Insurance Corporation, Federal Reserve System, and Office of the Comptroller of the Currency (collectively, the "agencies") met with representatives from FSF (collectively, the "FSF representatives") regarding the agencies' Notice of Proposed Rulemaking on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (FDIC RIN 3064–AF29) (the "NPR"), which was published in the Federal Register on September 18, 2023 (88 FR 64028). The FSF representatives discussed their concerns with, and the impact of, different aspects of the NPR as they relate to the issues discussed in FSF's comment letter, including its impact analysis. Additionally, FSF provided the attached slide presentation in connection with the meeting.

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Basel III Endgame Comment Overview

Impact Assessment and Key Comments

March 2024

Introduction

- Basel III Endgame (B3E) represents the most significant capital initiative since the financial crisis – both in terms of its impact and its scope.
- The FSF has undertaken an extensive quantitative assessment of the capital impact of B3E and this analysis supports our commentary.
- In this presentation we discuss the results of our quantitative analysis as well as our most significant comments on the proposal – both general structural comments as well as specific technical comments.
- **The FSF's overall recommendation is that the Basel III Endgame proposal be re-proposed. A full re-proposal is needed to address our concerns.**
- Our comments are more extensive than can be communicated in a single presentation. The FSF is coordinating with several trades (ABA, BPI, ISDA, SFA, SIFMA) and organizing several joint presentations to further elaborate on our collective comments.

Presentation Roadmap

- Discussion of Key Comments on the Proposal
    - Overarching Concerns with the Proposal
    - Structural and Overall Calibration Recommendations
    - Key Technical Recommendations

- Review of Forum Quantitative Impact Analysis (QIS)
    - FSF QIS Analysis: Key Assumptions
    - FSF QIS Key Takeaways
    - FSF QIS Results: Risk-Weighted Assets
    - FSF QIS Capital Impact of Proposed Requirements
    - FSF QIS TLAC and LTD Impact

Key Comments on the Proposal

Overarching Concerns with the Proposal

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1. **The proposal would harm the real economy, households, and businesses.**
   - Increased capital requirements directly increase the cost for banks of providing financial services, which are an essential part of supporting the U.S. real economy.
2. **The proposal would harm U.S. competitiveness.**
   - Proposed divergences from the Basel Framework do not serve American interests – rather, they would impose additional requirements on U.S. banks that would harm the American economy and the ability of U.S. banks to compete internationally.
3. **The proposal would increase the size of the non-bank sector and create financial stability risks.**
   - Since 2008, the size and scope of non-banks relative to banks has increased substantially. Heightened bank regulation is a clear and primary driver of this shift.
4. **The proposal ignores the existing strong state of capital levels and bank prudential standards for U.S. GSIBs.**
   - U.S. GSIBs have more than tripled their common equity tier 1 capital since 2008.

Overarching Concerns with the Proposal

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5. **The proposal as it relates to U.S. GSIBs is wholly unrelated to the 2023 regional banking turmoil.**
    - As they were during the COVID-19 pandemic, the U.S. GSIBs were an essential source of strength to the industry. Despite that, inexplicably, the proposal would penalize U.S. GSIBs more than any other banks.
6. **The proposal is not justified.**
    - The proposal offers no compelling analysis, data or evidence to suggest the proposed changes for U.S. GSIBs are at all warranted or necessary.
7. **The proposal must be re-proposed.**
    - Given the significant analytical gaps in the proposal and its incongruous implementation of the Basel III Endgame as compared to other jurisdictions, the Agencies must make available a more comprehensive analysis justifying the proposed requirements and re-propose the rule in full, providing for a new 120-day comment period.

Structure and Overall Calibration

Comprehensive Impact Analysis

- Agencies should undertake a comprehensive quantitative analysis.
  - Consider interaction between USNPR and all other existing prudential requirements: TLAC, LTD, GSIB, SCB, stress tests, etc.

Overall Structure of Capital Requirements

- Proposal is over-calibrated and results in unnecessarily punitive capital requirements.
- Agencies must calibrate the credit risk elements of ERBA to be consistent with the actual risk, by basing them on the outputs of the advanced approaches.
- The inclusion of the new, standardized operational risk and CVA RWA components in ERBA RWA presents several conceptual concerns that lead to over-calibrated requirements.
- The proposal can be modified in several ways to moderate the overall capital impact including:
  - Not applying SCBs to capital ratios determined under ERBA.
  - Removing stress test operational risk losses from the Business Indicator or excluding operational risk losses from the SCB.
  - Exclude CVA losses from the SCB.
  - Fundamentally recalibrating operational risk standardized RWA.
  - Recalibrating the GSIB surcharge to account for increased ERBA RWA.

Structure and Overall Calibration

Supervisory Stress Tests

- In addition to above recommendations (see previous slide), the FRB should revise the stress tests by:
  - Recalibrating the Global Market Shock and Large Counterparty Default or exclude these components from the SCB on account of overlap with the USNPR's FRTB.
  - Remove operational losses from the stress tests to reflect their inclusion in ERBA.
  - Adjusting loss-given default calibration assumptions to align with banks' own loss experience and risk-mitigating actions taken during stress periods.

Operational Risk

- Operational risk charges are the single largest source of capital increases in the USNPR.
- Operational risk accounts for 64% of the total RWA increase for Forum members.
- The proposed standardized operational risk methodology has significant conceptual flaws (see BPI letter).
- The total capital requirement for operational risk must be recalibrated to address both the broad-based over-calibration and the specific over-calibration related to banks with high fee income.
- To avoid over-calibration from assuming an 8% capital requirement, recommend application of a yearly institution-specific factor that accounts for institution specific capital requirements.

Structure and Overall Calibration

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Transition

- We support the principle of a multi-year transition period for banks to meet any changes in regulatory capital standards.
- The proposed transition period mechanics require adjustments to address how RWA changes are incorporated into the SCB and GSIB Surcharge.
- In the absence of adjustments, proposed transition period mechanics will result in more binding requirements mid-transition than at the end of the transition period.

Key Technical Recommendations

1. The final rule should not restrict the availability of the lower 65% risk weight for investment-grade corporate exposures to companies that have publicly traded securities outstanding.
    - The public listing requirement is unnecessary and artificially excludes creditworthy private companies of all sizes as well as certain regulated investment funds.
    - FSF analysis finds that restricting the investment-grade designation to companies with public securities would increase RWA by **$269.1BN** while increasing required capital by **$29.2BN**.

2. The final rule should retain the 100% risk weight for effective hedge pairs.
    - Unlisted equity instruments will not be subject to market risk treatment and removal of the 100% risk weight treatment for effective hedge pairs will result in capital requirements not commensurate with actual risk.
    - FSF analysis finds not retaining the 100% hedge pair treatment would increase RWA by **$235.4BN** while increasing required capital by **$24.8BN**.

Key Technical Recommendations

3. The final rule should retain the 100% risk weight "bucket" for non-significant equity exposures- banking book equity exposures below 10% of total capital - and expand the 100% risk weight category to include equity investments made pursuant to a nationally legislated program (e.g., renewable tax credit equity financing).
   - FSF member experience over the last decade in using the 100% bucket has demonstrated that it appropriately captures their risk.
   - FSF analysis finds not retaining the 100% non-significant equity "bucket" would increase RWA by **$186.7BN** while increasing capital by **$18.7BN**.
   - FSF analysis finds not aligning treatment of nationally legislated programs to the Basel framework would increase RWA by **$123.2BN** while increasing capital by **$12.5BN**.

4. The p-factor under the Securitization Standardization Approach should be reduced from 1.0 to 0.5, to ensure alignment with underlying risk and to incentivize bona fide risk transfer hedging, and the p-factor for certain securitizations should be set to 0.25.
   - The proposal provides no evidence supporting an increase in the credit risk of securitization exposures that would merit such an increase in RWA. In addition, the proposal does not recognize the significant changes over the past decade that have increased transparency and decreased risk in securitization markets.
   - FSF analysis finds that not reverting the p-factor to 0.5 would increase RWA by **$71.1BN** while increasing required capital by **$7.9BN**.

Key Technical Recommendations

5. The Agencies should redevelop risk weights for residential mortgage and other retail exposures based on a risk-based, empirical analysis such as the advanced approaches; at a minimum risk weights should be aligned to the Basel framework.
   - The proposed mortgage risk weights are not commensurate with underlying risk.
   - FSF analysis finds that not aligning mortgage risk weights with Basel would increase RWA by **$176.1BN** while increasing required capital by **$18.3BN**.

6. The higher credit conversion factor for undrawn credit card lines should not be adopted.
   - These higher conversion factors are not commensurate with the underlying risk.

7. The minimum haircut floor framework for SFTs should not be implemented in light of significant conceptual and operational issues.
   - Minimum haircut floors create a "cliff effect" and are not being adopted in several other jurisdictions (e.g., EU and UK).
   - FSF analysis finds that implementing the minimum haircut floor framework would increase RWA by **$123.8BN** while increasing required capital by **$14.7BN**.

Key Technical Recommendations

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8. The final rule should adopt a 20% risk weight for more-than-well-capitalized banks, short-term bank exposures and regulated financial institutions.
   - These recommendations are intended to better align risk weights with actual risks.
   - FSF analysis finds not aligning short-term bank exposure with Basel would increase RWA by **$65.5BN** while increasing required capital by **$7.5BN**.
   - FSF analysis finds not treating highly-regulated financial institutions as investment grade would increase RWA by **$79.1BN** while increasing required capital by **$8.2BN**.

9. The capital markets component of the USNPR must be revised materially (see ISDA/SIFMA letter).
   - The capital markets component of the USNPR should be better aligned with actual risks.
   - FSF analysis finds that not materially revising the FRTB requirements would increase RWA by **$186.2BN** while increasing required capital by **$22.8BN**.
   - FSF analysis finds that not materially revising the CVA requirements would increase RWA by **$50.1BN** while increasing required capital by **$5.7BN**. New CVA RWA is totally additive to overall RWA.

FSF QIS Overview

FSF QIS Analysis: Key Assumptions

- Analysis is as of June 30, 2023.
- Analysis represents the aggregate impact to FSF members from the proposal.
- Required capital is calculated using the proposal's requirements.
- The stress capital buffer used in the calculation is as of 9/30/23.
- The analysis uses two levels of the GSIB surcharge: the level as of 9/30/23 (w/o-GSIB) and the level that is anticipated once: a) 2024 GSIB surcharge increases take effect, b) the FRB's GSIB surcharge proposal is finalized as proposed (w/GSIB).
- Comparison of FSF and FRB QIS data shows close alignment between both sets of data.

	W/O-GSIB Increase	W/GSIB-Increase		
		a) Δ in 2024Q1 GSIB	b) GSIB Proposal Impact**	**Total**
Average* GSIB Surcharge (%)	3.0	0.3	0.1	**3.4**
Average SCB (%)	4.1	**-**	-	**4.1**

*All averages are total asset weighted averages as of 6/30/23.

**Estimated impact of GSIB surcharge proposal is taken from the Federal Reserve's proposal and is not an FSF estimate.

FSF QIS Key Takeaways*

	FSF QIS W/O-GSIB	FSF QIS W/GSIB	USNPR*	UK	EU
Increase in Required Capital (%)	24.9	29.9	19.0	3.2	5.6
Increase in RWA (%)	32.8	32.8	24.3	-	-

- Estimated capital impact significantly higher than USNPR estimate
  - FSF 24.9% vs. USNPR 19.0%
- Both FSF and USNPR indicate an impact on capital significantly higher than EU and UK implementation of Basel III. This will widen existing capital disparities between U.S and foreign GSIBs.
- FSF capital impact relative to USNPR driven by increased RWA estimate
  - FSF 32.8% vs. USNPR 24.3%

- Broad array of research suggests that the proposal's increase in required capital would **cost the U.S. economy over $100BN per year**.**

*FSF estimates are taken from the FSF comment letter, USNPR estimates are taken from the proposal, and estimates for the EU and UK are taken from the BoE. USNPR estimates reflect Category I and II banks.

** economic impact based on 13 academic research papers that quantify the economic cost of increased capital requirements. The underlying research papers are summarized in an FSF blog.

FSF QIS Results: Risk-Weighted Assets

Table 3: Impact of Proposed and Modified Requirements on RWA ($BN)

Risk Category	Current Standardized RWA	Proposed ERBA RWA	% Increase	Modified ERBA RWA	% Increase
Credit	**6,532.4**	**6,851.7**	**4.9**	**5,391.6**	(17.5)
Credit Risk	4,879.5	4,561.4	(6.5)	4,101.2	(15.9)
Securitization	179.3	243.0	35.5	138.6	(22.7)
Equity	287.0	793.9	176.6	304.3	6.0
Counterparty	1,186.7	1,253.5	5.6	847.4	(28.6)
Market	**382.7**	**660.5**	**72.6**	**474.4**	24.0
CVA	**N/A**	**216.7**	**N/A**	**166.6**	**N/A**
Operational	**N/A**	**1,454.3**	**N/A**	**939.3**	**N/A**
Total	**6,915.1**	**9,183.2**	**32.8**	**6,971.9**	**0.8**

Calculations based on Forum member data submissions as of Q2 2023.

- FSF presents a “Modified” RWA that incorporates several suggested changes – the Modified RWA results in only a slight increase in overall RWA of 0.8%.

- FSF QIS shows a 32.8% increase in RWA which is larger than the 24.3% increase reported in the USNPR (previous slide).
- FSF QIS shows a 4.9% increase in Credit RWA which is significantly different than 3% decline in Credit RWA reported in the proposal.

FSF QIS – Capital Impact of Proposed Requirements

Table 1: Impact of Proposed Capital Requirements

	Current	Proposal		Modified		Output Floor	
		Pre-GSIB	Post-GSIB	Pre-GSIB	Post-GSIB	Pre-GSIB	Post-GSIB
Required CET1 ($BN)	750.9	937.5	975.6	765.1	794.5	717.1	745.9
Change ($BN)	N/A	186.6	224.7	14.2	43.6	(33.8)	(5.0)
Change (%)	N/A	24.9	29.9	1.9	5.8	(4.5)	(0.7)

- The proposal would result in an **additional $187 billion in required capital** before considering increased GSIB surcharges. The **increase rises to roughly $225 billion** once the increase in GSIB surcharges is considered.

- A Modified version of the proposal results in a modest increase in required capital of between $14 billion and $44 billion.

- The proposal significantly disadvantages FSF members relative to foreign peers. Allowing continued use of models-based advanced approaches, subject to the Basel Framework's Output Floor, **would reduce required capital** – even after applying elevated GSIB surcharges to US GSIBs.

FSF QIS – TLAC and LTD Impact

Table 5: Impact of Proposed Capital Requirements on TLAC and LTD Requirements

	Current	Proposed	Modified
TLAC Requirement	1,714.4	2,037.0	1,709.1
Change ($BN)		322.6	(5.3)
Change (%)		18.8	(0.3)
LTD Requirement	775.6	825.9	772.4
Change ($BN)		50.3	(3.2)
Change (%)		6.5	(0.4)

- The proposal will significantly increase TLAC and LTD requirements through its impact on RWA.

- This increase should be considered in conjunction with the impact that will result from the Agencies' outstanding LTD proposal.

- The minimum denomination requirement of the LTD proposal is itself expected to have significant and negative market impacts.

Conclusion

- The USNPR is expected to raise required capital for FSF members by roughly 25%; including the impact of increased GSIB surcharges raises the estimate to roughly 30%.
- The USNPR is over-calibrated and will result in significant economic costs which we have estimated to be on the order of $100BN per year.
- The proposal does not fully consider its impact with all other requirements (e.g., GSIB) – the Agencies must consider the overall impact of prudential requirements on capital.
- The US implementation of B3E will also widen the existing capital disparity between FSF members and their foreign competitors.
- Our comment letter provides several structural as well as technical recommendations that are informed by a rigorous data analysis and are intended to improve the risk sensitivity and international consistency of the framework.
- The FSF is coordinating with other trades to follow up with several coordinated briefings to engage more deeply on key areas of concern in the USNPR.
- **A full re-proposal of the USNPR is needed to address the concerns we have raised.**

Appendix: Summary of Mitigants

- Our comment letter considers several mitigants that improve the risk sensitivity and international consistency of the proposal. The mitigants result in a Modified ERBA (see slide 7).
- The table below lists each mitigant as well as its RWA and capital impact.

Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)		
	RWA Impact	**Capital Impact**
Credit Risk		
Credit		
Treat Broker Dealers as Banks	7.9	0.8
Align bank short-term risk-weight with Basel framework	28.6	3.2
Treat highly regulated financials as investment grade corporates	31.0	3.1
No securities listing requirement for investment grade status	200.9	21.4
Align residential mortgage risk-weights with Basel Framework	176.1	18.3
Allow use of simple approach (CRM) without requiring collateral agreement where it is required that the transaction is removed from stay risk	15.6	1.9
Total	**460.1**	**48.5**

Appendix: Summary of Mitigants

Continue: Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)		
Securitization		
Revert p-factor to 0.5 in securitization framework	71.1	7.9
Cap risk-weight at maximum potential loss	1.0	0.1
Revert to existing definition of W parameter	32.2	3.7
Total	**104.4**	**11.6**
Equity		
Align treatment of nationally legislated programs with Basel framework	123.2	12.5
Retain 100% risk-weight for all hedge pairs	235.4	24.8
Apply 400% risk-weight only for venture capital investments	26.0	3.1
Apply 600% risk-weight to investment funds with material leverage	7.0	0.9
Retain 100% for all non-significant equity	97.9	10.8
Total	**489.5**	**52.1**
Memo: Retain 100% for all non-significant equity (standalone impact)	186.7	18.7

Appendix: Summary of Mitigants

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Continue: Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)		
Counterparty		
Derivatives		
Treat broker-dealers as banks	7.6	0.8
Treat highly regulated financials as investment grade corporates	31.9	3.4
No securities listing requirement for investment grade status	40.2	4.6
Align bank short-term risk-weight with Basel framework	30.0	3.6
All other mitigants	14.1	1.4
Total	**123.8**	**13.9**
Securities Financing Transactions (SFTs)		
Remove SFT haircut floors	123.8	14.7
Treat broker-dealers as banks	7.3	0.8
Treat highly regulated financials as investment grade corporates	16.2	1.7
No securities listing requirement for investment grade status	28.0	3.2

Appendix: Summary of Mitigants

Continue: Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)		
Align bank short-term risk weight with Basel framework	6.9	0.7
All other mitigants	100.0	10.6
Total	**282.2**	**31.6**
Market		
All trading book mitigants	186.2	22.8
Total	**186.2**	**22.8**

Appendix: Summary of Mitigants

Continue: Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)		
CVA		
All CVA mitigants	50.1	5.7
Total	**50.1**	**5.7**
Operational		
Set ILM = 1 Adjusted for BPI Letter	515.0	56.4
Total	**515.0**	**56.4**
Addenda: Combined Impacts		
Treat Broker Dealers as Banks	22.8	2.4
Align bank short-term risk-weight with Basel framework	65.5	7.5
Treat highly regulated financials as investment grade corporates	79.1	8.2
No securities listing requirement for investment grade status	269.1	29.2

Calculations based on Forum member institution data submissions as of Q2 2023. RWA impacts are calculated as the aggregate difference between the RWA that would result before and after the mitigant is applied. The capital impact is defined as the aggregate decline in required capital resulting from applying each mitigant. Totals do not add due to rounding.