

From: David Otudeko <David.Otudeko@abi.org.uk>
Sent: Friday, December 22, 2023 5:09 AM
To: regs.comments@federalreserve.gov; Comments
Subject: [EXTERNAL MESSAGE] Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity - (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-...
Attachments: US Basel 3.1 NPR ABI Response Letter Final.pdf

Good Morning,

Please find attached a letter from the Association of British Insurers (ABI) in response to the notice for proposed rule making titled "*Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*".

We would welcome the opportunity to discuss the points outlined in this letter in more detail if useful to you. We are also at your disposal if you have any questions so, please do not hesitate to reach out if this is the case.

Regards,
David

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I sometimes work flexibly, and I am sending this message now because it suits me, but I don't expect you to read, respond or action it outside of your own working hours.



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Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity (Federal Reserve Docket No. R-1813; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008) – Potential Implications for the UK Long Term Savings and Insurance Industry.

The UK insurance and long-term savings market and the ABI

The Association of British Insurers (ABI) is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy, employing over 300,000 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London.

The UK insurance and long-term savings industry manages investments of over £1.9 trillion, contributes over £16bn in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK. Please note we would be happy, and stand ready, to provide further information if this would be helpful to HM Treasury.


For the purposes of this response, 'insurers' refers to insurance, reinsurance and long-term savings companies.

We are writing with respect to the Notice of Proposed Rulemaking ("the NPR") issued by the "agencies", that is, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRS) and the Federal Deposit Insurance Corporation (FDIC), revising capital requirements for large banking institutions and applicable to banking organizations with significant trading activity. We welcome the opportunity to respond to this NPR and would like to register our gratitude to the agencies for seeking comments on its proposals from a wide range of stakeholders.

The UK long term savings and insurance industry is a significant counterparty for U.S. investment banks. The products offered by these institutions are not only an important source of financing, but the derivatives offered by U.S. banks are crucial in helping our industry mitigate market risk, particularly interest rate risk and foreign exchange risk. We recognize that the U.S. Basel III endgame changes are aimed at improving the calculation of risk-based capital requirements to better reflect the risks assumed by U.S. banking institutions. However, we are nonetheless concerned that some of the proposed changes could result in unintended consequences for our sector. In particular:

- **Changes proposed to the Credit Valuation Adjustment (CVA) approach.**

Proposals to include derivatives that insurers centrally clear through a bank, as well as uncleared derivatives, in CVA capital requirements will increase the level of capital impacted U.S. banks are required to hold. These increased costs could be passed on to buy side market participants including companies in our sector. We are therefore of the view that this change would result in higher hedging costs for UK Insurers relying on U.S. banks for derivatives. Whilst we expect this change to have a larger impact on the longer-dated derivative transactions our sector transacts with U.S. investment banks compared to those of shorter duration, we still expect to see a cost increase for these transactions.



Furthermore, the proposed CVA calculation lacks differentiation between counterparties treating all financial counterparties as equal regardless of their regulatory or financial strength. This issue is exacerbated by the removal in the proposals of the use of internal models for the calculation of credit and market risks. Further granularity in the identification of financials and the subsequent allocation of risks weights would allow for improved sensitivity based on the risk profile of the individual company or sector.

- **Changes proposed to the market risk standards through the Fundamental Review of the Trading Book (FRTB).**
Proposals modify the market risk standards, which will apply to purchases and sales of physical securities, including bonds and equities, as well as derivative transactions. The U.S. regulators estimate an increase of 77% in the capital cost for market making. The proposed FRTB significantly constrains the use of models, thereby reducing the benefit of hedges. In addition to potentially higher hedging costs through derivatives, FRTB will also result in potentially higher costs on bonds and equities and may reduce liquidity in these markets. Much like the impact of proposed CVA changes, the increased costs this change would drive could also be passed on to buy side market participants including companies in our sector.
- **Determination of “investment grade” Counterparties.**
Whilst proposals introduce preferential risk weights for investment grade counterparties, these can only be applied if the counterparty has publicly traded shares. We see these proposals as being unduly penal for certain highly rated UK long-term savings providers and insurers with no publicly listed securities. Ultimately, these companies could find it more expensive to transact with U.S. investment banks for derivatives or financing compared to UK and EU based Investment banking counterparties where this public listing requirement does not exist.
- **Downstream Counterparty Concentration Risk and Pricing Impacts.**
The application of elements of these proposals to U.S. banks exclusively (and not to UK or EU based banks) would likely influence insurers’ decisions on banking counterparties due to costs remaining lower for non-U.S. banks. The resulting cost differentiation could see a material number of UK or European insurers choose to move from U.S. banks to UK or European counterparties for hedging products post reform. This could drive a risk of geographical concentration and aggregation of risk and market activity within these jurisdictions. We infer that a sudden and material demand increase for derivatives within these markets could also negatively impact pricing and potentially limit the availability of price competitive counterparties for our sector.

We would ask that the agencies consider the possible unintended consequences of the U.S. Basel III endgame reform proposals for buy side market participants and wider financial markets beyond the shores of the U.S. before they are implemented. In our view some of these consequences could be material and warrant detailed consideration before reform proposals become policy.

We would welcome the opportunity to explain any of the points outlined above in more detail and if you require added clarity or have any questions please do not hesitate to get in contact.

Yours Faithfully

The ABI