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Basel III ‘Endgame’

Regulators Propose Significant Revisions to Capital Rules Applicable to Large Banks

SUMMARY

On July 27, 2023, the Federal Reserve, the FDIC, and the OCC issued a proposal that would result in significant changes to the U.S. regulatory capital rules for banking organizations with total consolidated assets of \$100 billion or more.¹

As previewed by Federal Reserve Vice Chair for Supervision Barr,² the agencies estimate that the proposal would increase risk-weighted assets (“RWAs”) (*i.e.*, the denominator of risk-based capital ratios) by 20 percent in the aggregate across affected banking organizations at the holding company level, although the agencies note that the estimated effects vary meaningfully across those organizations.³

The interagency proposal, often referred to as “Basel III Endgame,” would implement both (i) the standards that the Basel Committee on Banking Supervision published in December 2017 to finalize the post-crisis Basel III reforms⁴ and (ii) the Basel Committee’s revised standard for market risk capital requirements finalized in February 2019, referred to as the “Fundamental Review of the Trading Book” or “FRTB.”⁵ The proposal also would make other targeted revisions to the U.S. capital rules.

Also on July 27, the Federal Reserve proposed to revise the surcharge applicable to U.S. global systematically important banks (“GSIBs”).⁶

The Federal Reserve approved the Endgame proposal by a vote of 4-to-2, with Governors Bowman and Waller dissenting, and approved the GSIB surcharge proposal by a vote of 6-to-0. The FDIC approved the Endgame proposal by a vote of 3-to-2, with Vice Chairman Hill and Director McKernan dissenting.

The Endgame and GSIB surcharge proposals reflect two elements of the “holistic review” of bank capital requirements undertaken by Vice Chair for Supervision Barr.⁷ In addition to these proposals, Vice Chair

Barr has indicated that there will be additional proposals relating to regulatory capital and related matters, including a potential extension of long-term debt requirements to banking organizations with assets of \$100 billion or more and revisions to the standardized liquidity requirements applicable to large banking organizations.⁸

Comments on both proposals are due November 30, 2023.⁹ We expect the proposals will be subject to extensive comment by affected banking organizations and other market participants.

OVERVIEW AND OBSERVATIONS

A. Endgame Proposal

In general, consistent with the Basel Committee's December 2017 and FRTB publications, the Endgame proposal focuses primarily on the calculation of RWAs. Certain aspects of the proposal would, however, also affect the components of regulatory capital (*i.e.*, the numerator of risk-based and leverage capital ratios). Notably, subject to a phase-in period, Category III and Category IV banking organizations (*i.e.*, non-GSIB banking organizations with \$100 billion to \$700 billion in total consolidated assets and less than \$75 billion in cross-jurisdictional activity) would no longer be permitted to opt out of including certain components of accumulated other comprehensive income ("AOCI") in regulatory capital. As a result, unrealized gains and losses on available-for-sale ("AFS") debt securities would flow through regulatory capital ratios for these banking organizations.¹⁰

The agencies estimate that the proposed revisions "would have the effect of modestly increasing capital requirements for lending activity,"¹¹ but argue that, "[a]lthough a slight reduction in bank lending could result from the increase in capital requirements, the economic cost of this reduction would be more than offset by the expected economic benefits associated with the increased resiliency of the financial system."¹²

A number of statements released in connection with the proposal addressed cost-benefit considerations. Federal Reserve Chair Powell, for example, noted that "[w]hile there could be benefits of still higher capital, as always we must also consider the potential costs," adding that "[t]his is a difficult balance to strike, and striking it will require public input and thoughtful deliberation."¹³ Chair Powell also observed that, although "[h]igh levels of capital are essential to enable banks to continue to lend to households and businesses and conduct financial intermediation, even in times of severe stress," "raising capital requirements also increases the cost of, and reduces access to, credit."¹⁴ Federal Reserve Governor Jefferson also expressed "concern" regarding the potential effects of the proposal on "lend[ing] to businesses and individuals."¹⁵

For trading activities, the agencies estimate that capital requirements would "increase substantially, though the specific outcome will depend on banking organizations' implementation of internal models."¹⁶ More specifically, the Federal Reserve staff memorandum accompanying the proposal estimates that

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capital requirements for trading activities would “more than doubl[e] for some firms.”¹⁷ The extent of the proposed increase in capital requirements for trading activities was another area of focus in a number of statements accompanying the proposal. Chair Powell, for example, cautioned that “the proposed very large increase in risk-weighted assets for market risk overall requires us to assess the risk that large U.S. banks could reduce their activities in this area, threatening a decline in liquidity in critical markets and a movement of some of these activities into the shadow banking sector.”¹⁸

Based on year-end 2021 data, the agencies estimate that some large banking organizations would face a capital shortfall if the proposal were finalized in its current form.¹⁹ However, Vice Chair Barr has suggested that, for banking organizations that would need to build capital to satisfy the new requirements, the increased capital requirements could be satisfied “through retained earnings in less than two years, even while maintaining their current dividends.”²⁰ Although not expressly stated, this two-year timeline appears predicated on the suspension of share repurchases. In addition, it is unclear whether this two-year timeline takes into account the fact that, in the ordinary course, banking organizations operate with capital levels in excess of applicable requirements.

The agencies characterize the proposed Endgame revisions as “generally consistent with recent changes to international capital standards issued by the Basel Committee.”²¹ A number of statements released in connection with the proposal, however, have focused on departures from these standards in U.S. implementation that are expected to increase capital requirements relative to the Basel Committee framework and corresponding capital standards in other jurisdictions. For example, Federal Reserve Chair Powell noted that the proposal “exceeds what is required by the Basel agreement, and exceeds as well what we know of plans for implementation by other large jurisdictions,” citing in particular the inability of U.S. banking organizations to use internal models for credit risk.²² FDIC Vice Chairman Hill’s dissenting statement identified various aspects of the proposal that he described as being “gold-plated” with respect to (*i.e.*, more stringent than) the Basel Committee standards and added that the agencies are “also declining to make several modifications that European jurisdictions have proposed, each of which further reinforces the relative conservatism of the U.S. approach.”²³ As an example, Vice Chairman Hill noted that the proposal’s minimum haircut floors for securities financing transactions are not part of the proposed implementation in the United Kingdom. Vice Chairman Hill’s further observed that the proposal “rejects the notion of capital neutrality” previously expressed as a “goal” for implementing the Basel Committee framework.²⁴ FDIC Director McKernan’s dissenting statement addressed various ways in which the proposal differs from the Basel Committee framework and implementation in other jurisdictions, in particular with respect to the following:

- **Investment grade corporate exposures:** The proposal would require that, for a corporate exposure to be eligible for the lower risk weight applicable to “investment grade” corporate exposures, the company or its parent must have securities outstanding on a public securities exchange, which FDIC Director McKernan noted have not been part of implementation in the European Union and United Kingdom;²⁵

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- **Residential real estate and retail credit exposures:** Risk weights for residential real estate and retail credit exposures that are higher than those applicable under the Basel Committee framework;²⁶
- **Exposures to small businesses, securities firms and banking organizations:** The proposal would not adopt reduced credit risk capital requirements “for exposures to small businesses, securities firms and other nonbank financial institutions, or highly capitalized banking organizations; or for short-term exposures to banking organizations;”²⁷
- **Internal loss multiplier:** The internal loss multiplier for operational risk capital “would be floored at one” whereas “[o]ther implementing authorities have set the internal loss multiplier equal to one, as permitted by the Basel III standards;”²⁸
- **Default risk:** Banking organizations “using the models-based measure for market risk would be required to use the standardized approach for default-risk capital;”²⁹
- **Cash-funded credit-linked notes:** Unlike the Basel Committee framework, the proposal does not provide that “cash-funded credit-linked notes issued by a bank... that fulfill the criteria for credit derivatives may be treated as cash-collateralized transactions;”³⁰
- **CVA exemption for commercial end-users:** With respect to credit valuation adjustment (“CVA”)³¹ risk capital requirements, the proposal “would not include a tailored approach to commercial end-users,” although “other implementing authorities have proposed a commercial end-user exemption for CVA risk capital requirements;”³² and
- **Securitization framework:** The proposal “would not adopt the Basel III standards’ approach to simple, transparent, and comparable securitizations.”³³

Federal Reserve Governor Waller’s dissenting statement addressed the interaction between the proposal and the Federal Reserve’s stress testing framework and stress capital buffer requirement, noting that the proposed increase in capital requirements “would be in large part driven by an increase in the capital required for operational and market risks—risks that [the Federal Reserve has] already been capturing in [its] stress testing for the past decade.”³⁴ Governor Waller added that the proposed revisions to the market risk framework would “capture certain risks already accounted for in the [Federal Reserve’s] stress test,” including the “market shock component of the stress test.”³⁵

Federal Reserve Governor Bowman warned of the proposal’s potential “detrimental impact on U.S. market liquidity and lending” as well as the “punitive treatment for noninterest and fee-based income through the proposed operational risk requirements.”³⁶

Federal Reserve Governors Waller and Bowman and FDIC Vice Chair Hill also expressed concern with the proposed application of the same requirements for calculating regulatory capital and RWAs to banking organizations in Categories I through IV.³⁷

B. GSIB Proposal

The Federal Reserve’s GSIB surcharge proposal³⁸ would calculate Method 2 surcharges based on narrower score band ranges to reduce “cliff effects”³⁹ and require banking organizations to report values based on an average daily or monthly basis, rather than as of a single date, to “reduce the effects of temporary changes to indicator values around measurement dates.”⁴⁰ The proposal also would revise

aspects of the calculation of “systemic indicators,” which serve as inputs both for the GSIB surcharge calculation and for determining the capital, liquidity and other enhanced prudential standards applicable to a banking organization under the tailoring framework adopted in 2019 to implement S. 2155.⁴¹ The Federal Reserve estimates that the proposed revisions to the systemic indicators would result in the combined U.S. operations of seven foreign banking organizations (“FBOs”) and two U.S. intermediate holding companies of FBOs (“IHCs”) becoming subject to Category II requirements.⁴² Although the proposal would retain the existing framework of the U.S. GSIB surcharge (which uses the higher of the surcharges calculated under Method 1, based on the Basel Committee framework, and Method 2, which is unique to the U.S.),⁴³ Governor Bowman suggested that the Federal Reserve “consider the impact of the GSIB surcharge method two calculation, and whether it may discourage low-risk activities or result in other unintended consequences” as well as “how the implementation of the US GSIB surcharge aligns with other jurisdictions.”⁴⁴

The Federal Reserve estimates that the combined effect of the proposed revisions to the GSIB surcharge would correspond to an aggregate increase in capital requirements of approximately \$13 billion for GSIBs.⁴⁵ An estimate of the combined aggregate effect of the Endgame proposal and GSIB surcharge proposal was not provided.

KEY ELEMENTS OF THE PROPOSALS

The proposals, aggregating more than 1,150 pages, include a number of aspects that are highly complex and technical. Below are several high-level observations regarding key elements of the proposals. In addition, [Annex 1](#) provides a chart illustrating the current regulatory capital and related requirements applicable to Category I through Category IV banking organizations and other banking organizations. [Annex 2](#) provides a chart illustrating the regulatory capital and related requirements that would apply under the Endgame proposal.

- **Scope of application:** The current “standardized approach”⁴⁶ under the regulatory capital rules applies generally to U.S. banking organizations⁴⁷ and encompasses credit risk capital requirements, which address exposures arising out of extensions of credit such as loans and debt securities, derivatives, securities financing transactions and unsettled transactions, as well as off-balance-sheet exposures such as commitments and guarantees, securitization exposures and equity exposures. Banking organizations with trading assets plus trading liabilities in the aggregate equal to (i) 10 percent or more of total assets or (ii) at least \$1 billion currently must also calculate market risk capital requirements.

In addition to calculating capital requirements under the generally applicable standardized approach, U.S. GSIBs,⁴⁸ Category II banking organizations⁴⁹ and their insured depository institution subsidiaries (generally, Category I and Category II organizations) also are subject to the models-based advanced approaches capital rules, which encompass credit risk (including the categories of credit risk referenced above), equity risk, operational risk, CVA risk and, for banking organizations meeting the criteria for calculating market risk capital requirements described above, market risk. The advanced approaches therefore incorporate two elements that are not reflected in the current standardized approach: operational risk and CVA risk.

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- Under the proposal, banking organizations with total consolidated assets of \$100 billion or more, including U.S. IHCs and depository institution subsidiaries of bank holding companies with \$100 billion or more in total consolidated assets, would be required to calculate capital requirements using the revised credit risk, equity risk, operational risk, CVA risk and market risk requirements implementing the revised Basel Committee standard (together, the “*Expanded Risk-Based Approach*”).
- The Expanded Risk-Based Approach with respect to credit risk and operational risk would generally replace the current models-based advanced approaches in the capital rules and would remove the option to use models with respect to equity risk.
- With respect to market risk, all Category I through Category IV banking organizations would calculate market risk capital requirements under the new market risk standard, which includes a standardized measure and, subject to supervisory approval, a models-based approach. For Category I through Category IV banking organizations, the proposal would not include any threshold for applicability of the revised market risk capital requirements based on the extent of a banking organization’s trading assets and liabilities.

In addition, banking organizations with trading assets plus trading liabilities in the aggregate equal to (i) 10 percent or more of total assets or (ii) at least \$5 billion also would be subject to the revised market risk capital requirements.

The revised market risk capital requirements, based on the FRTB, would replace the market risk framework currently in the capital rules, which is based on the July 2009 Basel market risk capital standards (commonly referred to as “*Basel II.5*”).⁵⁰

- With respect to CVA risk, Category I through Category IV banking organizations would calculate CVA risk capital requirements using either a basic approach or, with supervisory approval, a standardized measure. The proposal would eliminate the ability to use internal models to calculate CVA risk capital requirements.
- **Collins Amendment and Output floor:** Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “*Dodd-Frank Act*”), generally referred to as the “*Collins Amendment*,” provides that the generally applicable capital requirements for banking organizations (currently, the generally applicable standardized approach) must serve as a floor for any banking organization’s capital requirements. Accordingly, a banking organization subject to the advanced approaches currently is required to satisfy its minimum regulatory capital ratios as calculated under both the generally applicable standardized approach and the advanced approaches.⁵¹
- Under the proposal, a banking organization with \$100 billion or more in total consolidated assets would calculate its risk-based capital ratios under (i) the standardized approach capital requirements—comprising both the standardized approach in Subpart D of the regulatory capital rules and the revised market risk framework to implement the FRTB pursuant to the proposal—and (ii) the revised credit risk, equity risk, operational risk, CVA risk and market risk requirements calculated under the Expanded Risk-Based Approach. This structure reflects the requirements of the Collins Amendment.
- The calculation of RWAs under the Expanded Risk-Based Approach would be subject to an output floor of 72.5 percent of the banking organization’s aggregate RWAs calculated based on the approaches for credit risk, equity risk, operational risk and the standardized measure for market risk. This output floor is compared to a banking organization’s aggregate RWAs calculated based on the approaches for credit risk, equity risk, operational risk and market risk (including models-based approaches, if applicable). The proposal provides that the objective of an output floor would be “[t]o enhance the consistency of capital requirements and ensure that the use of internal models for market risk does not result in unwarranted reductions in capital requirements.”⁵²
- Under the Basel Committee standard, a banking organization’s RWAs are equal to the higher of (i) total RWAs calculated using the approaches the banking organization has supervisory

approval to use (including models-based approaches for credit risk and market risk) and (ii) 72.5 percent of total RWAs calculated under only the standardized approach with respect to credit risk, counterparty credit risk, CVA risk, securitizations, market risk and operational risk.⁵³ The Basel Committee noted that the output floor is applied “[t]o reduce excessive variability of risk-weighted assets and to enhance the comparability of risk-weighted capital ratios,” which “will ensure that banks’ capital requirements do not fall below a certain percentage of capital requirements derived under standardized approaches.”⁵⁴

- The banking organization’s risk-based capital ratios would be the lower of each ratio calculated using RWAs under the standardized approach and the Expanded Risk-Based Approach, taking into account the output floor for purposes of determining RWAs under the Expanded Risk-Based Approach.
- **Capital conservation buffer:** In addition to minimum capital requirements, banking organizations also are subject to a capital conservation buffer requirement—which can be satisfied solely by common equity tier 1 capital (“*CET1*”)—that imposes graduated constraints on distributions and discretionary bonus payments if a banking organization does not satisfy the buffer requirement.

A Category I or Category II bank holding company or covered savings and loan holding company calculates two buffers. For purposes of its standardized approaches capital conservation buffer, the company adds its stress capital buffer requirement⁵⁵ to any applicable countercyclical capital buffer⁵⁶ and GSIB surcharge.⁵⁷ For purposes of its advanced approaches capital ratios, it uses a fixed 2.5 percent requirement instead of the stress capital buffer.

Bank holding companies and covered savings and loan holding companies that are not subject to the advanced approaches and U.S. IHCs, in each case with total consolidated assets of at least \$100 billion, calculate only one buffer, either the stress capital buffer (if in Category IV) or adding the stress capital buffer to any applicable countercyclical capital buffer (if in Category III).⁵⁸

For banking organizations that are not subject to the capital planning and stress capital buffer requirements, including all insured depository institutions, the buffer is calculated as 2.5 percent plus, if in Category I, Category II or Category III, any applicable countercyclical capital buffer.

- Under the proposal, bank holding companies, covered savings and loan holding companies and U.S. IHCs with total consolidated assets of at least \$100 billion would be subject to a single capital conservation buffer requirement that would include its stress capital buffer, in addition to any applicable countercyclical capital buffer and GSIB surcharge. That capital conservation buffer requirement would apply for purposes of calculating the banking organization’s risk-based capital ratios under both the standardized approach and the Expanded Risk-Based Approach.
- The agencies stated that the “proposal mitigates potential competitive benefits for large banking organizations first by requiring that they continue to be subject to [the] current standardized approach,” noting that this “requirement guarantees that a large banking organization covered by the proposal would maintain equity capital funding at a level at least as high as that required by the U.S. standardized approach for a banking organization not covered by the proposal.”⁵⁹
- **Stress testing and stress capital buffer:** The Federal Reserve’s capital planning and stress testing frameworks currently use only standardized approach RWAs for purposes of the Federal Reserve’s supervisory stress tests and the determination of firms’ stress capital buffer requirements.
 - Under the proposal, both the generally applicable standardized approach and the Expanded Risk-Based Approach would be used in the Federal Reserve’s supervisory stress tests and stress capital buffer calculations. A banking organization’s stress capital buffer requirement would be calculated based on its “binding” CET1 capital ratio under the standardized approach or the Expanded Risk-Based Approach.

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- Relatedly, the proposal would require banking organizations subject to the Federal Reserve's capital planning and stress testing requirements to project risk-based capital ratios using the calculation approach resulting in the binding capital ratios as of the start of the projection horizon.
- As reflected in the dissenting statement of Federal Reserve Governor Waller, the proposal does not propose potential changes to the Federal Reserve's supervisory stress tests or the stress capital buffer requirement to reflect that certain risks that are currently addressed only in the supervisory stress tests and therefore the stress capital buffer calculations through projections of stressed losses would, as a result of the proposal, be addressed in both the numerator of capital ratios through projections of stressed losses and the denominator of capital ratios through the RWA calculations under the Expanded Risk-Based Approach, particularly with respect to operational risk, CVA risk and, for firms subject to the global market shock,⁶⁰ market risk arising out of "tail" events and market illiquidity.⁶¹
- **AOCI opt-out election:** Banking organizations that are not in Category I or Category II currently are permitted to opt out of including all components of AOCI (excluding accumulated net gains and losses on cash flow hedges for items not fair-valued on the balance sheet) in CET1. For firms that have made this AOCI opt-out election, unrealized gains and losses on AFS debt securities do not flow through regulatory capital.⁶²
 - Under the proposal, banking organizations with total consolidated assets of at least \$100 billion would not be permitted to continue to make this AOCI opt-out election. As a result, Category III and Category IV banking organizations that have made an AOCI opt-out election would be required to recognize, among other items, unrealized losses on AFS debt securities in regulatory capital.
 - Category III and Category IV banking organizations would be subject to a phase-in period for including AOCI components in CET1 beginning July 1, 2025 until June 30, 2028, with full inclusion of required AOCI components starting July 1, 2028.
- **Deductions and minority interest framework:** Banking organizations in Category I or Category II currently are subject to more granular and complex deductions from regulatory capital than banking organizations not subject to the advanced approaches. Since 2019, other banking organizations, including those in Category III and Category IV, have applied a simplified deduction framework.⁶³

Currently, a banking organization that is not subject to Category I or Category II capital standards deducts its investments in the capital of unconsolidated financial institutions exceeding 25 percent of CET1 (minus certain deductions and other adjustments to CET1), and also deducts from CET1 any amount of mortgage servicing assets ("MSAs"), temporary difference deferred tax assets ("DTAs") and investments in the capital of unconsolidated financial institutions individually exceeding 25 percent of CET1.

In contrast, a banking organization subject to Category I or Category II capital standards deducts from CET1 amounts of MSAs, temporary difference DTAs and significant investments in the capital of unconsolidated financial institutions in the form of common stock both individually exceeding 10 percent of CET1 and, in the aggregate and to the extent not deducted, exceeding 15 percent of CET1 (minus certain deductions and other adjustments to CET1). Category I and Category II banking organizations also deduct their non-significant investments in the capital of unconsolidated financial institutions that, in the aggregate and together with investments in certain covered debt instruments qualifying for recognition under total loss-absorbing capacity ("TLAC") requirements, exceed 10 percent of CET1 (minus certain deductions and other adjustments to CET1) and deduct significant investments in the capital of unconsolidated financial institutions not in the form of common stock.

In addition, banking organizations not in Category I or Category II currently are subject to a simpler methodology for calculating minority interest limitations than banking organizations in Category I or Category II.

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- Under the proposal, Category III and Category IV banking organizations would be subject to the deductions framework and minority interest limitations that currently apply only to Category I and Category II banking organizations.
- **Credit risk:** Banking organizations currently calculate capital requirements for credit risk under the standardized approach by assigning prescribed risk weights to exposures based on applicable exposure classes and other characteristics within each exposure class. In addition, banking organizations subject to the advanced approaches calculate credit risk capital requirements under the advanced approaches using internal models pursuant to the advanced internal ratings-based approach.
- **Elimination of internal models for credit risk:** Under the proposal, banking organizations would not be permitted to use internal models to calculate credit risk capital requirements. All banking organizations would continue to calculate credit risk capital requirements using the generally applicable standardized approach, and Category I through Category IV banking organizations would also calculate credit risk capital requirements using the Expanded Risk-Based Approach.
- **SA-CCR:** Currently, a banking organization that is not subject to Category I or Category II capital standards may use either the current exposure methodology (“CEM”) or the standardized approach to counterparty credit risk (“SA-CCR”) to calculate the exposure amount for OTC derivatives for purposes of risk-based capital ratios and the supplementary leverage ratio. Banking organizations in Category I or Category II must use SA-CCR to calculate the exposure amount for OTC derivatives for purposes of standardized approach RWAs and the supplementary leverage ratio, and may use either SA-CCR or internal models for purposes of advanced approaches RWAs.

Under the proposal, for purposes of RWAs calculated using both the Expanded Risk-Based Approach and the generally applicable standardized approach and for purposes of the supplementary leverage ratio, Category I through Category IV banking organizations would be required to apply SA-CCR, with certain targeted revisions, and would not be permitted to apply CEM to calculate the exposure amount for OTC derivatives. The proposal would remove internal models as an available approach.

- **Credit risk mitigation:** For purposes of the Expanded Risk-Based Approach, the proposal would revise several aspects of the framework for recognizing the credit risk mitigation benefits of certain types of guarantees, credit derivatives and collateral when calculating RWAs, including with respect to:
 - **Minimum haircut floors:** There currently are no minimum haircut floors for securities financing transactions under the U.S. capital rules.

Subject to specified exceptions, the proposal would implement minimum haircut floors for margin loans or repo-style transactions in which a banking organization either lends cash in exchange for securities or engages in certain collateral upgrade transactions with “unregulated financial institutions,” which generally includes non-bank financial entities that are not subject to prudential regulation.

Any transactions subject to the minimum haircut floors that do not meet the haircut floors prescribed in the proposal would be required to be treated as unsecured exposures for purposes of calculating capital requirements for credit risk (in other words, as if the transaction were uncollateralized).

- **Supervisory haircuts:** The proposal would increase certain of the supervisory haircuts that currently apply to various categories of collateral.
- **Corporate debt securities:** Under the proposal, a banking organization could recognize a corporate debt security as an eligible credit risk mitigant only if the corporate issuer of the debt security or its parent company has a publicly traded security outstanding.

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- **Master netting agreement:** The proposal would incorporate a new formula that would take into consideration the number of securities included in a netting set of eligible margin loans or repo-style transactions.
- **General credit risk:** For purposes of the Expanded Risk-Based Approach, the proposal would establish new exposure classes and recalibrate risk weights for many existing exposure classes under the generally applicable standardized approach, including with respect to:
 - **Unconditionally cancellable commitments:** The credit conversion factor (“CCF”) applicable to unconditionally cancellable commitments—which currently applies to eligible exposures such as certain credit card lines and home equity lines of credit—would increase to a 10 percent CCF from the 0 percent CCF that currently applies to unconditionally cancellable commitments under the generally applicable standardized approach.
 - **Residential mortgage exposures:** Under the generally applicable standardized approach, many first-lien residential mortgage exposures currently qualify for a 50 percent risk weight.⁶⁴ For purposes of the Expanded Risk-Based Approach, the proposal would increase risk weights for certain residential mortgage exposures with higher loan-to-value ratios.⁶⁵
 - **Exposures to banking organizations:** The proposal would implement more granular treatment for exposures to depository institutions and foreign banks based on a credit risk assessment of the depository institution or foreign bank and the original maturity of the exposure, which in some cases would result in higher risk weights for these exposures as compared to the generally applicable standardized approach.
 - **Corporate exposures:** The proposal would incorporate a 65 percent risk weight with respect to certain investment grade corporate exposures, in comparison to the 100 percent risk that currently applies to all corporate exposures under the generally applicable standardized approach.

To qualify for the 65 percent risk weight under Expanded Risk-Based Approach, the corporate entity or its parent company must have securities listed on a securities exchange.

The proposal also would implement new categories of exposures for project finance subject to specified risk weight treatment.

- **Retail exposures:** The proposal would include exposure categories for certain types of exposures to individuals or small businesses, which in some cases would result in lower risk weights for exposures meeting specified criteria as compared to the current generally applicable standardized approach.

The agencies discussed these risk weights and the risk weights for residential mortgage exposures in the impact and economic analysis, noting that the “proposal attempts to mitigate potential competitive effects between U.S. banking organizations by adjusting the U.S. implementation of the Basel III reforms, specifically by raising the risk weights for residential real estate and retail credit exposures.”⁶⁶

- **Securitizations:** Category I and Category II banking organizations currently generally use the Supervisory Formula Approach (“SFA”) for purposes of calculating RWA amounts for securitization exposures for purposes of the advanced approaches.

The proposal would eliminate the SFA and replace it with the securitization standardized approach (called the “SEC-SA”), a modified version of the Standardized Supervisory Formula Approach (often referred to as the “SSFA”) provided in the current version of the standardized approach.

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- **Equity exposures:** Category I and Category II banking organizations currently may calculate RWA amounts for equity exposures under either a simple risk-weight approach or, with supervisory approval, using internal models.

The proposal would eliminate the model-based approach for equity exposures and incorporate targeted revisions to the simple risk-weight approach, including removing the 100 percent risk weight for non-significant equity exposures, eliminating the effective and ineffective hedge pair treatment, and increasing the risk weight for equity exposures to certain investment firms with greater than immaterial leverage from 600 percent to 1,250 percent.

- **Cash-funded credit-linked notes:** Under the Basel Committee standard, cash proceeds received in connection with the issuance of credit-linked notes may qualify as eligible financial collateral under the framework for recognizing eligible credit risk mitigants.⁶⁷ The U.S. capital rules currently do not include a similar provision.

The proposal does not address the treatment of credit-linked notes with respect to the standardized approach or the Expanded Risk-Based Approach.

- **Operational risk:** The capital requirements for operational risk currently apply only to Category I and Category II banking organizations and only for purposes of advanced approaches RWAs. Category I and Category II banking organizations currently use the advanced measurement approaches (“AMA”), which use a banking organization’s internal operational risk models to calculate risk-based capital requirements for operational risk.
- **Scope and application:** Under the proposal, Category I through Category IV banking organizations would be required to calculate capital requirements for operational risk for purposes of RWAs calculated under the Expanded Risk-Based Approach. As a result, Category III and Category IV banking organizations, which are not currently subject to the advanced approaches, would become subject to operational risk capital requirements. Operational risk capital requirements would not, however, be added to the generally applicable standardized approach. Additionally, the proposal would replace the AMA with the standardized measurement approach (“SMA”).
- **SMA calculation:** The SMA is not based on a banking organization’s models and instead generally calculates operational risk capital requirements based on a banking organization’s income, expenses, interest-earning assets and historical losses, using Business Indicator (“BI”), Business Indicator Component (“BIC”) and Internal Loss Multiplier (“ILM”) calculations. A banking organization calculates its BI using income statement and balance sheet items and the BIC is determined by multiplying the BI by prescribed marginal coefficients that increase based on the BI calculation.
- **BI calculation:** Under the proposal, the BI would consist of (i) an interest, leases and dividend component, (ii) a services component and (iii) a financial component. With respect to the interest, leases and dividend component, the input for net interest income would be subject to a cap of 2.25 percent of interest-earning assets.
- **ILM calculation:** ILM is a function of the banking organization’s BIC and its Loss Component (“LC”).

The LC is equal to 15 times the average annual operational risk losses the banking organization incurred over the previous ten years.

When the LC is greater than the BIC, the ILM is greater than one, which results in higher operational risk capital requirements reflecting the incorporation of historical internal losses.

The proposal would not set the ILM at a value of one, which is permitted at national discretion under the Basel Committee standard. As a result, under the proposal, historical operational risk losses would be relevant in calculating operational risk capital requirements. In addition, the proposal would incorporate a floor of one for the ILM.

- **Market risk:** Banking organizations with trading assets plus trading liabilities in the aggregate equal to 10 percent or more of total assets or at least \$1 billion are currently required to calculate market risk capital requirements under the U.S. capital rules.

Banking organizations subject to the advanced approaches that meet the criteria for calculating market risk capital requirements also calculate an advanced measure for market risk that is substantially similar to the standardized approach for market risk.

Market risk capital requirements currently apply generally to “covered positions” as defined under the U.S. capital rules.

A banking organization calculating market risk capital requirements under the standardized approach or the advanced approaches generally applies an internal model-based approach, pursuant to which the banking organization uses an internal Value-at-Risk (“*VaR*”) model subject to supervisory approval that is calibrated to a 99 percent confidence level and a holding period of ten business days. Additional aspects of market risk capital requirements, such as specific risk, are captured using either models or standardized approaches.

- **Scope:** All Category I through Category IV banking organizations would be required to calculate market risk capital requirements. In addition, banking organizations with trading assets plus trading liabilities in the aggregate equal to (i) 10 percent or more of total assets or (ii) at least \$5 billion also would be subject to the revised market risk capital requirements. The proposal would replace the current market risk capital standard based on the Basel II.5 framework with the FRTB standard.
- **Market risk boundary:** The proposal would revise the criteria for determining whether a position is subject to market risk capital requirements and include a list of instruments that are presumptively subject to market risk or are subject to non-market risk capital requirements.

The proposal also would implement a capital “add-on” when a banking organization reclassifies an instrument after initial designation of the instrument as being subject to market risk capital requirements or non-market risk capital requirements.

- **Standardized approach:** The U.S. capital rules currently include only the models-based requirements for market risk under the Basel II.5 framework and do not include the Basel Committee’s standardized approach.

The proposal would implement a new standardized approach for market risk consisting of three components: (i) a Sensitivity-Based Approach (“*SBA*”) capital requirement, (ii) a default risk capital (“*DRC*”) requirement that generally applies to debt instruments, equity instruments and securitizations and (iii) a residual risk add-on capital requirement designed to address risks that may not be covered sufficiently under the *SBA* or *DRC*.

In broad terms, under the *SBA*, a banking organization would calculate the sensitivities of instruments subject to market risk capital requirements to delta risk,⁶⁸ vega risk⁶⁹ and curvature risk⁷⁰ in respect of prescribed risk classes.⁷¹

- **Models-based approach:** The proposal would revise the internal model-based approach to introduce more stringent requirements for using models to calculate market risk capital requirements.

A banking organization must receive supervisory approval to use models by individual trading desk and would be subject to both (i) a profit and loss attribution (“*PLA*”) test and (ii) backtesting requirements, in comparison to the current approach that applies the modeling requirements on an entity-wide basis and does not include an explicit *PLA* test.

A banking organization that does not satisfy these requirements must apply the standardized approach.

In addition, for certain exposures such as securitization positions and certain equity positions in investment funds, internal models would not be permitted and a banking organization

would be required to calculate market risk capital requirements for these exposures under the standardized approach for purposes of calculating RWAs under both the generally applicable standardized approach and Expanded Risk-Based Approach.

- A banking organization calculating market risk capital requirements under the internal models-based approach would use an expected shortfall method calibrated at a 97.5 percent level in lieu of the current requirement to calculate VaR calibrated at a 99 percent level. In addition, instead of a static 10-day holding period currently employed under the market risk capital rules, the proposal would implement more granular liquidity horizons.
- Under the proposal, non-modellable risk factors (in other words, exposures that do not satisfy the criteria for internal models) are subject to separate capital requirements.
- **Disclosure:** The proposal would make certain targeted revisions to the existing disclosure requirements with respect to market risk capital requirements, including quantitative disclosure requirements that would apply to banking organizations using the models-based measure and qualitative disclosure regarding processes and policies for managing market risk.
- **CVA risk:** Under the U.S. capital rules, capital requirements for CVA risk currently apply only to banking organizations subject to the advanced approaches and only for purposes of calculating advanced approaches RWAs. A banking organization may calculate CVA risk using either a simple CVA approach or, with prior supervisory approval, the advanced CVA approach that uses an internal model.
- **Scope:** Under the proposal, Category I through Category IV banking organizations would be required to calculate capital requirements for CVA risk for purposes of RWAs calculated under the Expanded Risk-Based Approach. As a result, Category III and Category IV banking organizations, which are not currently subject to the advanced approaches, would become subject to CVA risk capital requirements. CVA risk capital requirements would not be added to the generally applicable standardized approach.
- **Application:** The proposal would eliminate the internal models approach to calculate capital requirements for CVA risk. Instead, under the proposal, a banking organization required to calculate capital requirements for CVA risk would use the basic approach or, with supervisory approval, the standardized approach.
 - The standardized approach for CVA risk has broad conceptual similarity with the proposed revised market risk capital framework to implement the FRTB, in that banking organizations calculate capital requirements for delta risk and vega risk across prescribed risk types.
- **Disclosure:** In addition to the revisions to market risk disclosures described above, the proposal would revise existing qualitative disclosure requirements and introduce new and enhanced qualitative disclosure requirements. The proposal also generally would move many of the existing public quantitative disclosure to regulatory reporting forms through separate proposals.

The proposal also provides that “[t]he agencies are planning to separately propose modifications to the FFIEC 101 report so that all inputs to the business indicator” and “total net operational losses...would be publicly reported as separate inputs to the applicable calculations.”⁷²

- **Implementation and transitional arrangements:** The proposal would take effect beginning July 1, 2025. On that date, a banking organization would phase in its RWAs calculated under the Expanded Risk-Based Approach at 80 percent, with the Expanded Risk-Based Approach fully phased in beginning July 1, 2028. From July 1, 2025 through July 1, 2028, Category III and Category IV banking organizations that had made an AOCI opt-out election would phase in AOCI into its calculation of regulatory capital. The proposal would not include a transition period with respect to including the revised capital requirements for market risk to the calculation of RWAs under the standardized approach.

- Under the Basel Committee standard, in contrast, the output floor is phased in beginning at 50 percent on January 1, 2023 to 72.5 percent beginning January 1, 2028. During the phase-in period, national authorities are permitted to cap at 25 percent of a banking organization's RWAs the incremental increase in total RWAs resulting from the application of the output floor.

- **Leverage ratio:** The Basel Committee's December 2017 standard introduces a leverage ratio buffer applicable to all GSIBs in an amount equal to 50 percent of the applicable GSIB surcharge.

Under the proposal, Category IV banking organizations would become subject to the supplementary leverage ratio. The proposal would not revise the current scope or application of the enhanced supplementary leverage ratio under the U.S. capital rules, including the supplementary leverage ratio buffer that currently applies to U.S. GSIBs.⁷³

- **Countercyclical capital buffer:** The countercyclical capital buffer currently applies to Category I, Category II and Category III banking organizations.

Under the proposal, Category IV banking organizations would become subject to the countercyclical capital buffer.

- **GSIB surcharge:** The Federal Reserve also proposed to revise targeted elements of the GSIB surcharge that currently applies to U.S. GSIBs.⁷⁴

- A GSIB currently must calculate its GSIB surcharge under Method 1 and Method 2. Under the GSIB proposal, to reduce "cliff effects," Method 2 would be revised such that a 20-basis-point increase would correspond to a 0.1-percentage-point increase in the GSIB surcharge, in lieu of the 0.5-percentage-point increase that currently corresponds to 100-basis point increases in Method 2 scores. The proposal would not implement similar revisions to the Method 1 calculation.

- The proposal would amend the calculation of systemic indicators currently measured as of a year-end to calculate the indicators on an average basis over a full year.

- The Federal Reserve requests comment regarding potential modifications to the effective date of changes to the GSIB surcharge requirement following changes to a banking organization's GSIB score. The proposal would clarify that the GSIB surcharge for a calendar year is the surcharge calculated in the immediately prior calendar year unless the surcharge calculated in the calendar year two years prior was lower, in which case the GSIB surcharge calculated in the calendar year two years prior would be operative.

- The proposal would amend aspects of the Systemic Risk Report (FR Y-15). Notably, the proposal would revise the systemic indicator with respect to cross-jurisdictional activity to include derivatives. The interconnectedness and complexity systemic indicators also would be revised to include a banking organization's exposure to its client with respect to client-cleared derivative positions under the "agency" clearing model in the U.S.

The proposal indicates that the proposed changes to the cross-jurisdictional activity systemic indicator in the aggregate would result in seven FBOs that are currently subject to Category III or Category IV standards becoming subject to Category II standards and two U.S. IHCs subject to Category III standards becoming subject to Category II standards.⁷⁵

As noted in the proposal, the combined U.S. operations of these FBOs would become subject to more stringent capital and liquidity requirements, including (i) daily liquidity reporting (rather than monthly or no liquidity reporting), (ii) monthly internal liquidity stress testing (rather than quarterly) and (iii) full liquidity risk management requirements (rather than reduced). The U.S. IHCs becoming subject to Category II standards would be required to conduct annual company-run stress testing (rather than every two years) and meet the full liquidity coverage ratio and net stable funding ratio requirements, rather than a reduced 85 percent requirement.

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- The proposed changes to the GSIB surcharge and FR Y-15 reporting form would take effect two calendar quarters after the date of adoption of a final rule.

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ENDNOTES

- 1 Federal Reserve, FDIC, OCC, *Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity* (July 27, 2023), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-basel-iii-20230727.pdf> (“Endgame proposal”).
- 2 Vice Chair Barr noted that “One can think of the proposal’s more accurate risk measures as equivalent to requiring the largest banks [to] hold an additional 2 percentage points of capital, or an additional \$2 of capital for every \$100 of risk-weighted assets.” Michael S. Barr, *Holistic Capital Review*, Remarks at the Bipartisan Policy Center (July 10, 2023), available at <https://www.federalreserve.gov/newsevents/speech/files/barr20230710a.pdf> (“Barr Holistic Capital Review”).
- 3 Endgame proposal p. 492.
- 4 Basel Committee, *Basel III: Finalising Post-Crisis Reforms* (Dec. 2017), available at <https://www.bis.org/bcbs/publ/d424.pdf>. The Basel III Endgame reforms are discussed in *Basel Committee Releases Standards to Finalize Basel III Framework*, Sullivan & Cromwell (Dec. 19, 2017), available at https://www.sullcrom.com/SullivanCromwell/Assets/PDFs/Memos/SC_Publication_Bank_Capital_Requirements_12192017.pdf.
- 5 Basel Committee, *Minimum Capital Requirements for Market Risk* (rev. Feb. 2019), available at <https://www.bis.org/bcbs/publ/d457.pdf>.
- 6 Federal Reserve, *Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)* (July 27, 2023), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-gsib-20230727.pdf> (“GSIB surcharge proposal”).
- 7 Barr Holistic Capital Review.
- 8 Barr Holistic Capital Review.
- 9 On July 12, 2023, the American Bankers Association, the Bank Policy Institute, the Financial Services Forum, the Institute for International Bankers and the Securities Industry and Financial Markets Association submitted a letter requesting a 120-day comment period. See Letter to Chair Jerome H. Powell, Board of Governors of the Federal Reserve System (July 12, 2023), available at <https://bpi.com/wp-content/uploads/2023/07/Joint-Trades-Letter-to-Chair-Powell-7-12-23-.pdf>.
- 10 To the extent recognized in AOCI, unrealized gains and losses on held-to-maturity (“HTM”) debt securities would also flow through regulatory capital.
- 11 Endgame proposal p. 489.
- 12 Endgame proposal p. 489.
- 13 Jerome H. Powell, *Statement by Chair Jerome H. Powell* (July 27, 2023), available at <https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20230727.htm> (“Powell Opening Statement”).
- 14 Powell Opening Statement.
- 15 Federal Reserve Board, *Open Board Meeting on July 27, 2023*, available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/20230727open.htm>.
- 16 Endgame proposal p. 489.
- 17 Staff Memorandum to the Board of Governors (July 18, 2023), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-memo-20230727.pdf>.
- 18 Powell Opening Statement.

ENDNOTES (CONTINUED)

- 19 Endgame proposal p. 495. See also Michael Barr, *Opening Statement on the Large Bank Capital Requirement Proposal by Vice Chair for Supervision Michael S. Barr* (July 27, 2023), available at <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm> (“Barr Opening Statement”).
- 20 Barr Opening Statement.
- 21 Endgame proposal p. 2.
- 22 Powell Opening Statement.
- 23 Travis Hill, *Statement by Travis Hill, Vice Chairman, FDIC, on the Proposal to Revise the Regulatory Capital Requirements for Large Banks* (July 27, 2023), available at <https://www.fdic.gov/news/speeches/2023/spjul2723b.html> (“Hill Dissenting Statement”).
- 24 Hill Dissenting Statement. Randal Quarles, the former Vice Chair for Supervision of the Federal Reserve, noted a broad preference for neutrality in capital levels. Randal K. Quarles, *Between the Hither and Farther Shore: Thoughts on Unfinished Business*, Remarks at the American Enterprise Institute (Dec. 2, 2021) (“A major issue that we are grappling with is how to implement these reforms, which reduce the role of bank internal models on bank capital requirements, while maintaining the overall level of aggregate capital requirements...What policymakers will need to do as they implement the Basel III reforms is determine whether adjustments to other parts of the capital framework are necessary to ensure that we do not unduly increase the level of required capital in the system.”), available at <https://www.federalreserve.gov/newsevents/speech/quarles20211202a.htm>.
- 25 Jonathan McKernan, *Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework* (July 27, 2023), available at <https://www.fdic.gov/news/speeches/2023/spjul2723c.html> (“McKernan Dissenting Statement”) (“To be eligible for the reduced credit-risk-capital requirement for investment-grade corporate exposures, the company (or its parent) must have securities outstanding on a recognized securities exchange. The Basel Committee has offered no rationale for concluding that having a publicly listed security correlates strongly with a company’s capacity to meet financial commitments. Understandably, the European Union and United Kingdom regulators’ implementation proposals have dropped the concept. Our proposal keeps it, but is stuck offering only a cursory rationale.”).
- 26 McKernan Dissenting Statement (“The expanded risk-based approach would increase the Basel III risk weights for residential real estate exposures (by 20 percentage points), other real estate exposures not dependent on cash flows generated by the real estate (by 25 percentage points for exposures to individuals, 15 percentage points for exposures to small- or medium-sized entities (‘SMEs’)), and retail exposures (by 10 percentage points) to ensure competitive parity between the large banking organizations covered by this proposal and the smaller banking organizations that are not.”).
- 27 McKernan Dissenting Statement.
- 28 McKernan Dissenting Statement.
- 29 McKernan Dissenting Statement.
- 30 McKernan Dissenting Statement.
- 31 CVA generally relates to potential changes in the value of derivative instruments as a result of the deterioration in the creditworthiness of a counterparty.
- 32 McKernan Dissenting Statement.
- 33 McKernan Dissenting Statement.

ENDNOTES (CONTINUED)

- 34 Christopher J. Waller, *Statement on Large Bank Capital Requirement Proposals by Governor Christopher J. Waller* (July 27, 2023), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/waller-statement-20230727.pdf> (“Waller Dissenting Statement”).
- 35 Waller Dissenting Statement.
- 36 Michelle W. Bowman, *Statement by Governor Michelle W. Bowman At the Board Meeting considering proposed rules to implement the Basel III endgame agreement for large banks and adjustments to the surcharge for U.S. global systemically important banks* (July 27, 2023), available at <https://www.federalreserve.gov/aboutthefed/boardmeetings/bowman-statement-20230727.pdf> (“Bowman Dissenting Statement”).
- 37 Waller Dissenting Statement (“Finally, as this proposal applies to all firms with more than \$100 billion in assets, I am concerned that we are headed down a road where we would be no longer in compliance with section 165 of the Dodd-Frank Act, as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act, which mandates tailoring for firms above \$100 billion in assets and provides that firms with between \$100 billion and \$250 billion in assets are not subject to enhanced prudential standards unless a standard is affirmatively applied to such firms based on specific factors set out by Congress. It is unclear to me whether this proposal meets that statutory bar.”); Bowman Dissenting Statement (“I am also concerned that today’s proposal moves one step closer to eliminating the tailoring required by S. 2155 from the prudential capital framework.”); Hill Dissenting Statement (“For purposes of the capital rules, the proposal effectively collapses Categories II, III, and IV into one category. The proposal undoes almost all of the tailoring of the capital framework for large banks, and is a repudiation of the intent and spirit of S. 2155.”).
- 38 The GSIB surcharge is currently codified in 12 C.F.R. Part 217, Subpart H.
- 39 GSIB proposal p. 15.
- 40 GSIB proposal p. 1.
- 41 The tailoring framework is discussed in *Regulatory Tailoring for Large Domestic and Foreign Banking Organizations*, Sullivan & Cromwell (Oct. 18, 2019), available at <https://www.sullcrom.com/SullivanCromwell/Assets/PDFs/Memos/SC-Publication-Banking-Agencies-Finalize-Tailoring-of-Enhanced-Prudential-Standards-and-Capital-and-Liquidity-Requirements.pdf>.
- 42 GSIB proposal pp. 46-47.
- 43 The GSIB surcharge is discussed in *Bank Capital Requirements: Federal Reserve Board Approves Final Common Equity Surcharge For U.S. Global Systemically Important Banks* (July 29, 2015), available at <https://www.sullcrom.com/SullivanCromwell/Assets/PDFs/Memos/SC-GSIB-Surcharge-Memo.pdf>.
- 44 Bowman Dissenting Statement.
- 45 GSIB proposal p. 45.
- 46 The current standardized approach is codified in Subpart D of the agencies’ regulatory capital rules and applies generally to banking organizations subject to U.S. regulatory capital requirements.
- 47 For these purposes, banking organizations refer to the scope of entities subject to the U.S. regulatory capital rules, including U.S. bank holding companies, covered savings and loan holding companies, state-chartered banks and national banks, state savings associations and federal savings associations and U.S. IHCs of FBOs established under the Federal Reserve’s Regulation YY. In addition to the generally applicable regulatory capital rules, insured depository institutions also are separately subject to the agencies’ prompt corrective action framework under Section 38 of the Federal Deposit Insurance Act. 12 U.S.C. § 1831o.

ENDNOTES (CONTINUED)

- 48 Under Section 252.5(b) of the Federal Reserve's Regulation YY, a banking organization is a GSIB if it is identified as a GSIB pursuant to 12 C.F.R. § 217.402.
- 49 Under Section 252.5(c) of the Federal Reserve's Regulation YY, a U.S. bank holding company or U.S. IHC is a Category II banking organization if it is not a GSIB and has (A) \$700 billion or more in average total consolidated assets; or (B) (1) \$75 billion or more in average cross-jurisdictional activity; and (2) \$100 billion or more in average total consolidated assets. With respect to a U.S. IHC that is a Category II banking organization pursuant to these criteria, although a U.S. IHC generally must comply with the Federal Reserve's regulatory capital rules in the same manner as a bank holding company, a U.S. IHC is not required to calculate RWAs and capital ratios using the models-based advanced approaches. 12 C.F.R. § 252.153(e)(1)(i)(A).
- 50 Basel Committee on Banking Supervision, *Revisions to the Basel II Market Risk Framework* (July 2009), available at <https://www.bis.org/publ/bcbs158.pdf>.
- 51 Under Section 171 of the Dodd-Frank Act, the minimum risk-based capital and leverage requirements established by the agencies under Section 171 may not be less than the generally applicable risk-based capital and leverage requirements under the prompt corrective action framework. 12 U.S.C. § 5371. The agencies have indicated that Section 171 of the Dodd-Frank Act applies only with respect to the minimum requirements, and does not apply to the capital conservation buffer. The 2012 interagency proposal to implement Basel III notes that, for purposes of the capital conservation buffer, a banking organization would use standardized total RWAs if the banking organization is subject to the standardized approach and advanced total RWAs if the banking organization is subject to the advanced approaches. *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action*, 77 Fed. Reg. 52,792, 52,803, footnote 33 (Aug. 30, 2012) (proposed rule). The 2013 final rule to implement Basel III issued by the Federal Reserve and the OCC provides that a banking organization subject to the advanced approaches use its "risk-based capital ratios under section 10 of the final rule (that is, the lesser of the standardized and the advanced approaches ratios) as the basis for calculating their capital conservation buffer (and any applicable countercyclical capital buffer). The agencies believe such an approach is appropriate because it is consistent with how advanced approaches banking organizations compute their minimum risk-based capital ratios." See *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. 62,018, 62,036 (Oct. 11, 2013)
- 52 Endgame Proposal p. 24.
- 53 Basel Committee on Banking Supervision, *Calculation of minimum risk-based capital requirements*, paragraph 20.4 (effective Jan. 1, 2023).
- 54 Basel Committee on Banking Supervision, *Basel III: Finalizing post-crisis reforms*, p. 137 (Dec. 2017), available at <https://www.bis.org/bcbs/publ/d424.pdf>.
- 55 A banking organization's stress capital buffer is determined from the results of the Federal Reserve's supervisory stress test. Subject to a floor of 2.5 percent, the stress capital buffer is equal to (i) the ratio of the bank holding company's CET1 to RWAs calculated under the standardized approach as of the final quarter of the prior capital plan cycle, *minus* (ii) the lowest project ratio of CET1 to RWAs calculated under the standardized approach in any quarter of the planning horizon under a supervisory stress test, *plus* (iii) the ratio of (1) the sum of planned common stock dividends for each of the fourth through seventh quarters of the planning horizon to (2) RWAs in the quarter in which the bank holding company had its lowest projected ratio of CET1 to RWAs calculated under the standardized approach in any quarter of the planning horizon under a supervisory stress test. 12 C.F.R. § 225.8(f)(2).

ENDNOTES (CONTINUED)

- For a bank holding company that is not a Category IV bank holding company, the Federal Reserve calculates the stress capital buffer annually. In general, for a Category IV bank holding company, as defined in Section 252.5(e) of the Federal Reserve's Regulation YY, the Federal Reserve calculates the bank holding company's stress capital buffer requirement biennially, occurring in each calendar year ending in an even number, and adjusts the stress capital buffer requirement biennially in each calendar year ending in an odd number based on the planned dividends in the company's capital plan submission. 12 C.F.R. § 225.8(f)(1). A U.S. bank holding company or U.S. IHC is a Category IV banking organization if it has average total consolidated assets of at least \$100 billion and is not a GSIB, Category II banking organization or Category III banking organization.
- 56 Banking organizations subject to the advanced approaches and Category III banking organizations are required to calculate a countercyclical capital buffer amount. Under Section 252.5(d) of the Federal Reserve's Regulation YY, a U.S. bank holding company or U.S. IHC is a Category III banking organization if it is neither a Category I nor a Category II banking organization and has either at least \$250 billion in average total consolidated assets or \$100 billion in average total consolidated assets and at least \$75 billion in average total nonbank assets, average weighted short-term wholesale funding or average off-balance-sheet exposure.
- 57 A bank holding company is a GSIB subject to the GSIB surcharge if its Method 1 score, as calculated under 12 C.F.R. § 217.404, equals or exceeds 130 basis points.
- 58 The Federal Reserve's capital planning and stress capital buffer requirement applies to top-tier U.S. bank holding companies and U.S. covered savings and loan holding companies with at least \$100 billion in total consolidated assets and to U.S. IHCs with total consolidated assets of at least \$100 billion established by an FBO pursuant to Section 252.153 of Regulation YY. 12 C.F.R. § 225.8(b), 12 C.F.R. § 238.170(b)(1).
- 59 Endgame proposal p. 499.
- 60 The global market shock scenario "is a set of hypothetical shocks to a large set of risk factors reflecting general market distress and heightened uncertainty...The global market shock affects the mark-to-market value of trading positions and counterparty credit losses in the first quarter of the scenario." Federal Reserve, *2023 Stress Test Scenarios*, pp. 8-9 (Feb. 2023), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230209a1.pdf>. The global market shock scenario applies to Category I, Category II and Category III banking organizations with aggregate trading assets and liabilities of at least \$50 billion, or trading assets and liabilities of at least 10 percent of total consolidated assets. 12 C.F.R. § 252.54(b)(2)(i).
- 61 The Federal Reserve's 2023 stress test methodology provides the following with respect to the global market shock: "The trading and private equity model covers a wide range of firms' exposures to asset classes such as public equity, foreign exchange, interest rates, commodities, securitized products, traded credit (e.g., municipals, auction rate securities, corporate credit, and sovereign credit), private equity, and other fair-value assets. Loss projections are constructed by applying movements specified in the global market shock scenario to market values of firm-provided positions and risk factor sensitivities. In addition, the global market shock is applied to firm counterparty exposures to generate losses due to changes in CVA." Federal Reserve, *2023 Stress Test Methodology*, p. 14 (June 2023) (footnote text omitted), available at <https://www.federalreserve.gov/publications/files/2023-june-supervisory-stress-test-methodology.pdf>.
- 62 Substantially all Category III and Category IV banking organizations have made this AOCI opt-out election. In addition, to the extent recognized in AOCI, unrealized gains and losses on HTM debt securities also do not flow through regulatory capital.
- 63 *Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 84 Fed. Reg. 35,234 (July 22, 2019).

ENDNOTES (CONTINUED)

- 64 A first-lien residential mortgage exposure qualifies for a 50 percent risk weight if it (i) is secured by a property that is either owner-occupied or rented; (ii) is made in accordance with prudent underwriting standards, including relating to the loan amount as a percent of the appraised value of the property; (iii) is not 90 days or more past due or carried in nonaccrual status; and (iv) is not restructured or modified.
- 65 The agencies note that they “are supportive of home ownership and do not intend the proposal to have a disparate impact on home affordability or homeownership opportunities, including for low- and moderate-income (LMI) home buyers or other historically underserved markets” and that they “are particularly interested in whether the proposed framework for regulatory residential real estate exposures should be modified in any way to avoid unintended impacts on the ability of otherwise credit-worthy borrowers who make a smaller down payment to purchase a home.” Endgame proposal p. 71.
- 66 With respect to potential competitive effects, the agencies add that “[w]ithout the adjustment relative to Basel III risk weights in this proposal, marginal funding costs on residential real estate and retail credit exposures for many large banking organizations could have been substantially lower than for smaller organizations not subject to the proposal. Though the larger organizations would have still been subject to higher overall capital requirements, the lower marginal funding costs could have created a competitive disadvantage for smaller firms.” Endgame proposal pp. 499-500.
- 67 Basel Committee on Banking Supervision, *Calculation of RWA for credit risk*, paragraph 22.34, footnote 3 (effective Jan. 1, 2023).
- 68 Delta risk would be defined as “the risk of loss that could result from changes in the value of a position due to small changes in underlying risk factors.”
- 69 Vega risk would be defined as “the risk of loss that could arise from changes in the value of a position due to changes in the volatility of the underlying exposure.”
- 70 Curvature risk would be defined as “the incremental risk of loss of a market risk covered position that is not captured by the delta capital requirement arising from changes in the value of an option or embedded option and is measured based on two scenarios (curvature scenarios) involving an upward shock and a downward shock to each prescribed curvature risk factor.”
- 71 The specified risk classes would be (i) interest rate risk; (ii) credit spread risk for non-securitization positions; (iii) credit spread risk for correlation trading positions (“CTP”); (iv) credit spread risk for securitization positions non-CTP; (v) equity risk; (vi) commodity risk; and (vii) foreign exchange risk.
- 72 Endgame proposal p. 189.
- 73 Banking organizations subject to the advanced approaches and Category III banking organizations are subject to a supplementary leverage ratio of 3 percent. In addition, a GSIB is subject to an enhanced supplementary leverage ratio buffer of 2 percent and an insured depository institution subsidiary of a GSIB is required to maintain a supplementary leverage ratio of 6 percent to be considered “well capitalized” under the prompt corrective action framework.
- 74 12 C.F.R. Part 217, Subpart H.
- 75 GSIB proposal pp. 46-47.

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ANNEX 1

CURRENT REQUIREMENTS

	Category I	Category II	Category III	Category IV	Other Firms
TLAC/Long-Term Debt	✓				
Stress Testing: Company-Run (DFAST)	✓ (Annual)	✓ (Annual)	✓ (Every Two Years)		
Stress Testing: Supervisory	✓ (Annual)	✓ (Annual)	✓ (Annual)	✓ (Two-Year Cycle)	
Stress Capital Buffer	✓	✓	✓	✓ (Two-Year Cycle)	
Annual Capital Plan Submission	✓	✓	✓	✓	
G-SIB Surcharge	✓				
Advanced Approaches	✓	✓			
Countercyclical Capital Buffer	✓	✓	✓		
Opt-Out of AOCI Capital Impact			✓	✓	✓
Capital Rules Simplification			✓	✓	✓
SA-CCR	✓	✓	(Optional)	(Optional)	(Optional)
TLAC Holdings Deductions	✓	✓			
Generally Applicable Leverage Ratio	✓	✓	✓	✓	✓
Supplementary Leverage Ratio	✓ (Plus Enhanced)	✓	✓		

ANNEX 2

PROPOSED REQUIREMENTS

	Category I	Category II	Category III	Category IV	Other Firms
TLAC/Long-Term Debt	✓				
Stress Testing: Company-Run (DFAST)	✓ (Annual)	✓ (Annual)	✓ (Every Two Years)		
Stress Testing: Supervisory	✓ (Annual)	✓ (Annual)	✓ (Annual)	✓ (Two-Year Cycle)	
Stress Capital Buffer	✓	✓	✓	✓ (Two-Year Cycle)	
Annual Capital Plan Submission	✓	✓	✓	✓	
G-SIB Surcharge	✓				
Expanded Risk-Based Approach	✓	✓	✓	✓	
Countercyclical Capital Buffer	✓	✓	✓	✓	
Opt-Out of AOCI Capital Impact					✓
Capital Rules Simplification					✓
SA-CCR	✓	✓	✓	✓	(Optional)
TLAC Holdings Deductions	✓	✓	✓	✓	
Generally Applicable Leverage Ratio	✓	✓	✓	✓	✓
Supplementary Leverage Ratio	✓ (Plus Enhanced)	✓	✓	✓	