GSIB Surcharge

Cite

FRB, Notice of Proposed Rulemaking (NPR), Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)

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Website

https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-gsib-20230727.pdf

Impact Assessment

- A significant number of smaller IHCs would move into higher categories with significantly more stringent capital and liquidity standards.
- FBOs operating only through branches and agencies could face additional liquidity requirements.
- Non-GSIB scores at super-regional or specialized banks could rise, also moving them under more stringent regulatory standards.
- The capital cost of all large BHCs and IHCs is likely to rise significantly, once the cumulative effects of all recent capital proposals are considered. This is not factored into the Fed's impact analysis, but may accelerate capital optimization with likely effects on portfolio allocation and relative competitiveness with large-foreign and nonbanks.
- The Fed's impact assessment also focuses only on Method 1 GSIB scores, but the U.S. standards have a unique Method 2 alternative also modified here that may determine a bank's GSIB score.

Overview

As anticipated in the wake of recent bank failures,[1] the FRB has proposed a significant revision to the current rules calculating systemic-risk scores that lead to GSIB designation.[2] These indicators are used not only for GSIB designation or a higher surcharge, but also for categorizing U.S. and foreign banks for other purposes and thus would also bring some banking organizations into categories subject to very strict prudential standards. The Board estimates that the overall impact of the changes to the surcharge and risk-scoring methodology are small and, regardless, warranted to enhance systemic resilience and consistency. It also estimates that the interaction of this new approach with certain liquidity and TLAC standards is generally minimal. However, the Fed has not assessed the relationship of scoring revisions to one way to calculate the GSIB charges, nor does the Board assess the cumulative impact of all of the changes proposed here in concert with its sweeping revisions to U.S. capital rules for all banking organizations with assets over $100 billion. It is also unclear how these changes in concert with all the others interact with the stress capital buffer applicable to large U.S.-domiciled

[1] See *Client Report* **GSIB21**, March 22, 2023.

[2] See **GSIB7**, *Financial Services Management*, July 23, 2015.

banking organizations. Despite the Fed's conclusions, it seems likely that the total impact will be considerable in light of methodological problems in this proposal as well as those FedFin identified with the impact analysis for the capital rewrite.[3]

Impact

The GSIB-surcharge construct originated with the Basel committee which in 2018 modified its designation approach.[4] As detailed in FedFin's report on the overall impact of proposed regulatory-capital revisions,[5] the banking agencies have concluded that recent regional-bank failures point to structural weaknesses in the banking system warranting a raft of changes. These start not only with the capital rules governing category I, II, III, and IV banks, but also this express proposal for the category I banks that also comprise designated GSIBs.

The new GSIB methodology could not only heighten the capital burden of currently-designated GSIBs, but also lead to higher scores category II, III, and IV BHCs and intermediate holding companies (IHCs) BHCs that could elevate them into a still costlier regulatory regime.[6] The Fed's impact analysis notes that seven foreign banking organizations (FBOs) with combined U.S. assets over $100 billion and two IHCs would become category II companies, a shift that not only adds higher capital requirements for FBOs with IHCs, but subjects them all to a raft of more restrictive liquidity requirements. The changes for FBOs would not bring these FBOs under full U.S. liquidity standards if their operations remain housed in branches or agencies, but administrative burden would increase along with the likely liquidity resources needed to ensure ongoing compliance. Seven IHCs would come under full U.S. liquidity requirements, with the Fed estimating that IHC costs for all these changes would also be minimal.

The FRB's impact assessment finds that currently designated domestic BHCs would see only "small" changes to their surcharges. However, one GSIB would not fully comply with its TLAC requirement based on the revised GSIB methodology. Further, the U.S. uses a second GSIB-scoring methodology – Method 2 – not included in the global standards, with banking organization subject to Fed scoring and reporting rules required to report systemic indicators not captured in Method 1 and then hold the higher of either method's score. Since the Fed's impact analysis generally addresses only Method 1, it is possible that some banking organizations could have higher final scores and thus either higher surcharges or tougher rules than the Board suggests.

Consistent with the shift to averages rather than point-in-time data proposed for big-bank capital standards, the GSIB proposal replaces quarter and year-end data points with various averages. These are also designed to prevent window-dressing – i.e., short-term activity shifts designed to minimize costly regulation. Banks accustomed to point-in-time analytics will need not only to revise their systems, but also anticipate resulting strategic implications.

As noted below, the proposal updates the currencies measured for the purpose of determining whether other entities could substitute for the bank in the payment market. The proposal generally reflects recent market developments (e.g., omitting the ruble), but does not seek data on what has become a major systemic concern: interconnectedness between the banking and cryptoasset ecosystem except to the extent overall exposures are captured for the interconnectivity factor. As a result, a bank could become a major player in cryptoasset payments without triggering systemic indicators, possibly creating a

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[3] See *Client Report* **CAPITAL234**, August 17, 2023.

[4] See **GSIB13**, *Financial Services Management*, July 13, 2018.

[5] See *Client Report* **CAPITAL234**, August 17, 2023.

[6] See **SIFI34**, *Financial Services Management*, October 23, 2019.

systemic version of the digital-asset market disruption evident following recent regional-bank failures.

What's Next

The FRB proposed the GSIB standards on July 27 by a 6-0 vote although Gov. Bowman expressed reservations about several aspects of the NPR. Comments are due by November 30, the same deadline set for the other capital proposal. GSIB-reporting changes would take effect two quarters after adoption (but not necessarily publication) of the final rule, with transition periods laid out where averages require longer data periods. The Fed seeks comment on a schedule many companies are likely to find abbreviated.

Banks currently alter their surcharges the year following score calculation, an approach the agencies believe facilitates capital planning. Comment is sought on whether to continue to do so. The proposal suggests various options including surcharge changes on April 1 following the year-end calculation or timing surcharge hikes with those mandated. The proposal also addresses the interaction of the GSIB proposal, clarifying for example that more recently calculated lower scores can apply more quickly than score increases under the stress capital buffer.[7]

Although congressional Republicans have vigorously opposed much in the capital rewrite when it comes to regional banks, attention to the GSIB standard has been muted.

Analysis

The NPR poses many questions about the pluses and minuses of each key proposal. Questions noted below are those with particular strategic impact and those seeking comments on specific alternatives.

A. Data Filing

1. GSIB Indicators

Current FR Y-15 data are reported based on quarter-end results, with GSIB ratings based on Y-15 data as of the end of the prior year. The proposal would change key FR Y-15 indicators to averages of daily data over the course of the prior quarter. Certain off-balance sheet reporting items would be monthly averages over the quarter and some indicators would remain quarter-end calculations. Method 1 and 2 GSIBs scores would be the average of all reported quarters over the course of the prior year. Firms that become GSIBs would start reporting the quarter after designation.

Only GSIBs would come under these averaging requirements; other banking organizations required to file the FR Y-15s could continue to use most current point-in-time deadlines. This is based on the view that window-dressing on a form that only informs a calculation is less likely to be manipulated than one calculating the costly GSIB surcharge.

The Board seeks comment on eliminating most if not all point-in-time indicators for purposes of the GSIB surcharge, as well as on the operational burden of its proposed approach.

[7] See **STRESS29**, *Financial Services Management*, April 18, 2018.

2. SLR Calculation

The current FR Y-15 methodology is also used to calculate a firm's leverage-ratio denominator. The changes proposed above align with those mandated in the broader rule for the SLR.[8]

B. Cliff Effects

Although the 100 bps bands for GSIB scoring in the current rule were intended to prevent sudden score changes, this has not in fact proved the case. As a result, the proposal would make the Method 2 score band narrow the scores to twenty bps ranges resulting in score changes of 0.1 score-point increments. The result of this shift is slightly lower surcharges at the low end of the spectrum, roughly consistent scores in the middle, and a "modest" increase at the upper end of the scorecard.

As noted, the agencies say the Method 2 methodology is substantively unchanged even though the revisions have substantive effect even if surcharge changes are small because the cost of the surcharge is considerable, especially at higher scores. Several questions are posed on these changes, including the extent to which this scoring method affects capital planning.

C. Systemic Indicators

These would affect all FR Y-15 filers.

1. Interconnectedness and Complexity

Key changes here would:

- expand the "financial institution" definition that is a key driver of the interconnectedness measure to include SLHCs, private-equity funds, asset-management companies, and ETFs. Questions here appear open only to adding other entities, not deleting those added by the proposal;
- revise the treatment of any form of client-cleared derivative positions to include them in all interconnected and complexity measures. This is now done even for agency positions on grounds that these are still systemic-risk transmission channels; and
- expand data points included in other key indicators, with questions posed on all these new measurements.

2. SLR Calculation

Changes here would add fixed-income and equity/other trading volumes to this Method 1 indicator to better address a bank's primary-and-secondary market liquidity (e.g., market-making). Method 1 weightings would also be modified to include the new indicators with an emphasis on fixed-income trading. Questions are posed on the effect of adding these new indicators and whether other instruments should be captured.

Currencies included in the payment indicator are also updated. Comment is sought on which currencies are affected without, as noted, any discussion of cryptocurrencies despite concerns in other arenas about systemic impact.

3. Cross-Jurisdictional Activity

[8] See **CAPITAL231**, *Financial Services Management*, August 4, 2023.

This indicator would be revised to capture gross derivative exposures, likely covering more banks under both category II requirements. The indicator is also revised to cover all foreign-office liabilities regardless of guarantee, a change the FRB believes reflects heightened resolution challenges.

4. *Short-Term Wholesale Funding*

The Method 2 calculation focused on this indicator, which would be revised to capture sweep deposits, including those within a BHC. Regional banks with large brokerage sweep-account activities could see their GSIB scores rise as well as move into category III rules if not already included in that framework for capital purposes.

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