BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date:	April 5, 2018
To:	Board of Governors
From:	Staff[1]
Subject:	Joint notice of proposed rulemaking to modify the enhanced supplementary leverage ratio standards applicable to U.S. global systemically important bank holding companies and certain of their insured depository institution subsidiaries

ACTIONS REQUESTED: Approval to invite public comment on a draft notice of proposed rulemaking (proposal) that would (1) recalibrate and tailor the Board's enhanced supplementary leverage ratio (eSLR) standards applicable to U.S. global systemically important bank holding companies (GSIBs) and their insured depository institution (IDI) subsidiaries regulated by the Board or Office of the Comptroller of the Currency (OCC), and (2) make corresponding amendments to the Board's total loss-absorbing capacity (TLAC) requirements along with other, minor changes to the TLAC requirements. In addition, staff seeks authority to make technical and minor changes (e.g., formatting) to the proposal in order to prepare it for publication in the Federal Register. The proposal would be issued jointly by the Board and OCC after each agency has completed its internal review procedures.

EXECUTIVE SUMMARY: The draft proposal would tailor the current calibration of the eSLR standards applicable to GSIBs and their Board- or OCC-regulated IDI subsidiaries (covered IDIs). These changes would provide improved incentives and better ensure that the eSLR generally serves as a backstop to risk-based capital requirements rather than as generally a binding constraint on firms. Specifically, the proposal would

- Replace the current 2 percent leverage buffer that applies uniformly to all GSIBs with a leverage buffer tailored to each GSIB, set at 50 percent of each firm's GSIB risk-based capital surcharge (GSIB surcharge);
- For covered IDIs, replace the current 6 percent threshold at which such IDIs are considered "well capitalized" under the prompt corrective action (PCA) framework with a threshold set at 3 percent plus 50 percent of the GSIB surcharge applicable to the IDI subsidiary's GSIB holding company; and

[1] Messrs. Gibson, Lindo, and Cuttler, and Mmes. Horsley, MacDonald, and Kirkpatrick (Division of Supervision and Regulation), and Mr. Van Der Weide, Ms. Schaffer, Messrs. McDonough, Schwarz, Frischmann, and Buresh, and Ms. Watkins (Legal Division).

- Make a corresponding change to each GSIB's external TLAC leverage buffer and long-term debt requirement, and make other, minor amendments to the TLAC rule.

Taking into account pre-stress and post-stress capital requirements, agency staffs estimate that the proposed changes would reduce the required amount of tier 1 capital for GSIBs by approximately $400 million, which is approximately 0.04 percent of total GSIB tier 1 capital as of the third quarter 2017.[2]

DISCUSSION:

A. Proposed modifications to the eSLR rule

1. Post-crisis leverage requirement reforms

In 2013, the Board, OCC, and Federal Deposit Insurance Corporation (FDIC and collectively, the agencies) adopted revised regulatory capital rules (capital rules) to address weaknesses at banking organizations that became apparent during the financial crisis of 2007-08. Under the capital rules, among other requirements, all subject banking organizations must maintain a minimum leverage ratio of 4 percent, measured as the ratio of a firm's tier 1 capital to its average total consolidated assets.[3] A banking organization that meets the capital rules' criteria for being considered an advanced approaches banking organization also must meet a minimum supplementary leverage ratio (SLR) of 3 percent, measured as the ratio of a firm's tier 1 capital to its total leverage exposure.[4] The SLR strengthens the capital requirements for advanced approaches banking organizations by including in the definition of total leverage exposure many off-balance sheet exposures in addition to on-balance sheet assets.

---

[2] The GSIBs held in aggregate nearly $955 billion in tier 1 capital as of third quarter 2017.

[3] The Board's capital rule applies to all state member banks and to top-tier bank holding companies and savings and loan holding companies domiciled in the United States, except for those subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C) and certain other holding companies, such as those engaged in substantial commercial or insurance underwriting activities.

[4] A banking organization is an advanced approaches banking organization if it has consolidated assets of at least $250 billion or if it has consolidated on-balance sheet foreign exposures of at least $10 billion, or if it is a subsidiary of a depository institution, bank holding company, savings and loan holding company, or intermediate holding company that is an advanced approaches banking organization. See 78 FR 62018, 62204 (October 11, 2013), 78 FR 55340, 55523 (September 10, 2013).

Under the eSLR rule, as adopted by the agencies in 2014 and revised in 2015, each GSIB[5] must maintain an SLR greater than 3 percent plus a leverage buffer of 2 percent to avoid limitations on distributions and certain discretionary bonus payments.[6] In addition, each IDI subsidiary of a holding company subject to the eSLR rule must maintain a 6 percent SLR to be considered "well-capitalized" under the PCA framework of each agency.[7]

2. *Revisions to the eSLR standards*

Risk-based and leverage capital requirements work best as effective complements when leverage capital requirements generally serve as a backstop to risk-based capital requirements rather than as generally a binding constraint.[8] If a leverage ratio is calibrated at a level that makes it generally a binding constraint, it can create negative incentives. For example, firms may reduce participation in or increase costs for low-risk, low-return businesses. At the same time, a leverage requirement that is calibrated at too low of a level will not serve as an effective complement to a risk-based capital requirement.[9]

Over the past few years, concerns have arisen that, in certain cases, the standards in the eSLR rule have become a generally binding constraint rather than a backstop to the risk-based standards. Thus, although the eSLR standards provide incentives to maintain a strong capital base, the current calibration also has created incentives for banking organizations to reduce their participation in lower-risk, lower return business activity, such as repo financing, central clearing services for market participants, and taking custody deposits, notwithstanding client demand for

---

[5] A U.S. top-tier bank holding company that is not a subsidiary of a foreign banking organization and that is an advanced approaches banking organization must determine whether it is a GSIB by applying a multifactor methodology based on size, interconnectedness, substitutability, complexity, and cross jurisdictional activity. 12 CFR part 217, subpart H. The current U.S. GSIBs are Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup, Inc., The Goldman Sachs Group, Inc, JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

[6] See 79 FR 24528 (May 1, 2014), and as amended by the GSIB surcharge rule. 80 FR 49082 (August 14, 2015).

[7] 12 CFR 208.41.

[8] See, e.g., 55 FR 32829 (August 10, 1990); 73 FR 43982, 43985 (July 29, 2008), describing the leverage ratio as "a straightforward measure of solvency that supplements the risk-based capital requirements."

[9] 78 FR 51101, 51105-6 (August 20, 2013); 78 FR 57725, 57727-8 (September 26, 2014).

those services. Accordingly, the proposal would recalibrate the standards in the eSLR rule to avoid potential negative outcomes while ensuring that the eSLR standards continue to serve as a meaningful backstop.

The proposed recalibration, described further below, assumes that the components of the supplementary leverage ratio use the capital rules' current definitions of tier 1 capital and total leverage exposure. Significant changes to either of these components would likely necessitate reconsideration of the proposed recalibration as the proposal is not intended to materially change the aggregate amount of capital in the banking system.

3. *Proposed revisions to the eSLR standards*

Recalibrating the leverage buffer in the eSLR rule to 50 percent of a firm's GSIB surcharge would continue to provide a meaningful constraint on leverage of GSIBs, while achieving a more appropriate complementary relationship between the firm's risk-based and leverage capital requirements. Specifically, the proposal would help ensure that the point-in-time leverage capital requirements generally serve as a backstop to the risk-based capital requirements.

Under the GSIB surcharge rule, a firm's GSIB surcharge varies according to the firm's systemic importance as measured using the methodology outlined in the rule. Accordingly, the framework set forth in the GSIB surcharge rule, which had not yet been proposed at the time the agencies adopted the eSLR rule, would provide a mechanism for tailoring the eSLR standards based on measures of systemic risk. In addition, the proposed calibration would reinforce incentives in the risk-based surcharge framework for GSIBs to reduce their systemic footprint by providing less systemic bank holding companies with a lower eSLR buffer and national bank and state member bank subsidiaries of these firms with a lower well capitalized threshold in the PCA framework.

Setting the leverage buffer in the eSLR rule at 50 percent of a firm's risk-based GSIB surcharge also mirrors the relationship between the minimum tier 1 risk-based capital ratio of 6 percent and the minimum SLR of 3 percent. The proposal also would seek comment on alternatives to reduce the bindingness of the eSLR standards, including carving out central bank reserves from the denominator of the SLR.

As noted, the proposal would modify the PCA framework for covered IDIs in order to help maintain the complementarity of the risk-based and leverage standards at both the holding company level and the IDI level. Staff analysis indicates that the recalibrated IDI-level leverage requirements proposed for use in the PCA well-capitalized threshold would generally function as a backstop to risk-based capital requirements consistent with the treatment of the eSLR standards as discussed above. In addition, the proposal seeks comment on the merits of an alternative approach whereby the eSLR standards would apply to covered IDIs in the same manner as the capital conservation buffer requirement, rather than as a well-capitalized threshold within the PCA framework.

4. *Impact Assessment*

In addition to the requirement to hold capital based on quarter-end calculations, the Board requires certain large bank holding companies, including the GSIBs, to be subject to supervisory stress testing, with the aim of ensuring that these firms can continue to lend and operate under stressful conditions. The supervisory stress testing requires these firms to engage in forward-looking capital planning and hold capital in excess of the minimum capital ratios by requiring them to demonstrate the ability to satisfy capital requirements under stressful conditions.[10]

Staff analysis indicates that, taking into account the capital constraints imposed by the supervisory stress tests, as well as the Board's regulatory capital rules, the proposal would reduce the amount of tier 1 capital required across the GSIBs by approximately $400 million.[11] That figure is approximately 0.04 percent of the amount of tier 1 capital held by the GSIBs as of the third quarter of 2017.

Staff analysis indicates that the more firm-specific and risk-sensitive approach to the eSLR buffer in the proposal would more appropriately align each GSIB's leverage buffer with its systemic footprint and would better support incentives for such a firm to reduce that footprint. Importantly, under the proposal, if a firm's systemic footprint increased, its applicable eSLR

---

[10] 12 CFR 225.8(e)(2).

[11] This analysis compares the current rules to the proposal regarding the amount of tier 1 capital that GSIBs are required to hold to meet the tier 1 risk-based capital ratio, leverage ratio, and supplementary leverage ratio minimums plus applicable buffers, as well as the minimums of these ratios under the Board's supervisory stress test. Analysis reflects data from the Consolidated Financial Statements for Holding Companies (FR Y-9C), the Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (FFIEC 031), and the Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101), as reported by the GSIBs and the covered IDIs as of third quarter 2017.

standard would also increase. Further, and notwithstanding the proposed recalibration, GSIBs remain subject to the most stringent regulatory standards, including in particular the risk-based GSIB surcharge and TLAC standards.

For covered IDIs, the proposed rule would replace the current 6 percent eSLR standard in the "well capitalized" threshold with a new standard equal to 3 percent plus 50 percent of the risk-based capital surcharge applicable to the firm's GSIB holding company. The current eSLR standard tends to be more binding than risk-based capital requirements at the IDI level than at the holding company level because the eSLR standard is calibrated at 6 percent at the IDI level, rather than 5 percent at the holding company level.

Based on data as of third quarter 2017, the eSLR standard is the most binding tier 1 capital requirement for all eight lead IDI subsidiaries of the GSIBs. Under the proposal, the eSLR standard would be the most binding tier 1 capital requirement for three of these IDIs. The proposal would reduce the amount of tier 1 capital required across the lead IDI subsidiaries of the GSIBs by approximately $121 billion.[12] While the proposed eSLR standards would provide additional flexibility at the IDI level, the current risk-based capital requirements, supervisory stress testing constraints, and other limitations applicable at the holding company level would continue to be binding and limit the amount of capital that GSIBs could distribute to investors, thus supporting the safety and soundness of GSIBs and helping to maintain financial stability.

B. Proposed related amendment to the TLAC rule and other minor revisions

The TLAC rule applies a 2 percent TLAC leverage buffer in addition to the minimum required 7.5 percent SLR component of a GSIB's external TLAC requirement. The TLAC rule also establishes a minimum leverage-based external long-term debt (LTD) requirement for a GSIB equal to the GSIB's total leverage exposure multiplied by 4.5 percent. When these TLAC and LTD standards were adopted, they were designed to parallel the standards under the eSLR

---

[12] This analysis compares the current rules to the proposal regarding the amount of tier 1 capital that the lead IDI subsidiaries of the GSIBs are required to hold to meet the well-capitalized standard for the supplementary leverage ratio and the minimum tier 1 risk-based capital ratio plus the capital conservation buffer. The amount of tier 1 capital required across all covered IDIs that reported their total leverage exposure on the FFIEC 031 report would decrease by approximately $122 billion under the proposal. Note that IDIs are not subject to supervisory stress testing by the Board.

rule.[13] Accordingly, the proposal would amend the TLAC rule to (1) replace each GSIB's 2 percent TLAC leverage buffer with a buffer set to 50 percent of the firm's GSIB surcharge; and (2) revise the leverage component of the LTD requirement to equal total leverage exposure multiplied by 2.5 percent (i.e., 3 percent minus 0.5 percent to allow for balance sheet depletion) plus 50 percent of the GSIB's applicable GSIB surcharge.[14] In addition, the proposal seeks comment on whether and how to recalibrate the minimum leverage-based TLAC requirement to reflect the proposed eSLR recalibration. Finally, the proposal would make minor changes to the TLAC rule, including changes to provide that the amount of long-term debt is calculated the same way for all TLAC requirements and to make clear that new covered intermediate holding companies of foreign banking organizations have three years to comply with the TLAC rule.

RECOMMENDATIONS: For the reasons discussed above, staff recommends that the Board invite public comment for 30 days on the draft proposal. Staff also recommends that the Board delegate to staff the authority to make technical and minor changes to the attached materials to prepare them for publication in the *Federal Register*.

Attachment

---

[13] Under the TLAC rule, a GSIB's external TLAC leverage buffer for the total leverage exposure component of the external TLAC requirement is equal to 2 percent of total leverage exposure, the denominator of the SLR, which is the same buffer set under the eSLR rule.

[14] The leverage component of the LTD requirement was calibrated by subtracting a 0.5 percent balance sheet depletion allowance from the amount required to satisfy the combined minimum supplementary leverage ratio requirement and eSLR standard (i.e., 5 percent).