January 16, 2024

Via Email

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Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)

Ladies and Gentlemen:

Citigroup Inc. ("Citi") [1] appreciates the opportunity to comment on the above-referenced proposal (the "Proposal") issued by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Office of the Comptroller of the Currency (the "OCC"), and the Federal Deposit Insurance Corporation (together with the Federal Reserve and the OCC, the "Agencies") to revise the capital requirements applicable to large banking organizations and to banking organizations with significant trading activity.[2]

[1] Citi is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate clients as well as governments and other institutions.

[2] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64,028 (proposed Sept. 18, 2023).

As a U.S.-based banking organization that has a global network of financial services that stretches across nearly 160 countries, we are concerned by the Agencies' failure to advance the international harmonization and comparability of the regulatory capital framework, which was the stated objective of the Basel Committee on Banking Supervision (the "BCBS") in finalizing the 2017 standards (the "BCBS standards") that serve as the foundation for the Proposal.[3] The Proposal would exacerbate the unlevel regulatory playing field that exists between large U.S. banking organizations and those in other jurisdictions, without justifying why material divergence from the BCBS standards is necessary.[4]

We are supportive of the feedback and recommendations provided in the comment letters submitted by industry trade associations of which Citi is a member.[5] For example, we agree with the trade associations' comments regarding the negative impacts of many of the proposed risk weights, the overcapitalization resulting from the overlap between the Proposal's expanded risk-based approach ("ERBA") and the Federal Reserve's stress testing framework, the significant divergence from the BCBS standards, and the dearth of analysis as to why capital requirements for the largest U.S. banking organizations need to increase by over thirty percent.[6] The Proposal does not adequately recognize or account for the other elements of the post-crisis capital framework to which U.S. global systemically important bank holding companies ("GSIBs") are subject—including the Federal Reserve's stress testing regime and a GSIB surcharge that is super-equivalent to the underlying BCBS framework—and which result in large U.S. banking organizations already holding historically high amounts of capital as well as higher levels of capital relative to foreign peer institutions.[7]

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[3] *See id.* at 64,028 ("The proposed revisions would be generally consistent with recent changes to international capital standards issued by the Basel Committee on Banking Supervision."); Press Release, Basel Comm. on Banking Supervision, Governors and Heads of Supervision Finalise Basel III Reforms (Dec. 7, 2017), https://www.bis.org/press/p171207.htm ("These reforms will help reduce excessive variability in risk-weighted assets and will improve the comparability and transparency of banks' risk-based capital ratios.").

[4] *See* Jerome H. Powell, Chair, Bd. of Governors of the Fed. Rsrv. Sys., Statement (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20230727.htm ("[T]he proposal exceeds what is required by the Basel agreement, and exceeds as well what we know of plans for implementation by other large jurisdictions.").

[5] These include, for example, comment letters of the Financial Services Forum, the Bank Policy Institute and the American Bankers Association, and the Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association.

[6] Press Release, Fin. Servs. F., Required Bank Capital Increase Would Far Exceed Government Estimates (Dec. 22, 2023), https://fsforum.com/news/required-gsib-capital-increase-would-far-exceed-government-estimates.

[7] *See, e.g.*, Michael S. Barr, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Capital Supports Lending (Oct. 9, 2023), https://www.federalreserve.gov/newsevents/speech/barr20231009a.htm ("[T]he common equity capital ratio of the largest banking organizations more than doubled, from 5.5 percent in 2009 to 12.4 percent at the end of last year."); FIN. STABILITY OVERSIGHT COUNCIL, ANNUAL REPORT 2023, at 52 (2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf ("In the case of G-SIBs, the Common Equity Tier 1 Capital . . . ratio has trended up since early 2022 and is

The Agencies should revise the proposed application of the stress capital buffer requirement.[8]

Under the Proposal, banking organizations subject to the Federal Reserve's capital plan rule would be subject to a single capital conservation buffer ("CCB") requirement—including the stress capital buffer ("SCB") requirement, applicable GSIB surcharge, and applicable countercyclical capital buffer requirement—regardless of whether their risk-based capital ratios result from the Proposal's ERBA or the standardized approach.[9]

We urge the Agencies to reconsider the proposed application of a single CCB requirement, including the SCB requirement, to a banking organization's risk-based capital ratios, regardless of whether the ratios result from ERBA or the standardized approach. The Proposal does not explain in any detail the Agencies' rationale for departing from the current requirement of applying a banking organization's SCB requirement only to the standardized approach risk-based capital ratios, nor does it present analysis as to why the increase in required capital that would result from this departure is necessary or appropriate. As a result, the Proposal fails to address the serious drawbacks of the proposed approach, including overlap between the SCB and elements of ERBA—resulting in overcapitalization at banking organizations subject to the Federal Reserve's supervisory stress tests—and magnification of the super-equivalence of the U.S. regulatory capital framework.

In line with the dual-stack approach in the current U.S. regulatory capital framework, we recommend that the final rule (a) apply the SCB requirement only to the standardized approach risk-based capital ratios and (b) apply a 2.5 percent buffer requirement, not the SCB requirement, to the risk-based capital ratios resulting from ERBA. Retaining a CCB requirement that differs depending on the approach used to calculate risk-weighted assets ("RWA") would better support what we understand to be the aims of the Agencies in connection with the Proposal as well as the objectives of the BCBS standards.

Applying the SCB requirement only to the standardized approach risk-based capital ratios would avoid introducing unnecessary overlap in the U.S. regulatory capital framework.

As noted above, under the Proposal, banking organizations subject to the Federal Reserve's capital plan rule would be subject to a single CCB requirement, including the SCB requirement, regardless of whether their risk-based capital ratios result from ERBA or the standardized approach. Functionally, however, and by the Agencies' admission, ERBA is

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now on par with the highest levels observed in more than 20 years."); Sean Campbell, *U.S. vs. European Capital Adequacy - the Increasingly Unlevel Playing Field Unfolding in Basel III Finalization*, FIN. SERVS. F. (May 4, 2023), https://fsforum.com/news/u-s-vs-european-capital-adequacy-the-increasingly-unlevel-playing-field-unfolding-in-basel-iii-finalization.

[8] This is responsive to the Proposal's Questions 7 and 8. Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. at 64,035.

[9] *Id.* at 64,034.

expected in most cases to generate the binding risk-based capital requirement for banking organizations subject to the Proposal.[10] As a result, a banking organization's SCB generally would be calculated in terms of the RWA produced by ERBA.

This gives rise to a concerning outcome wherein a banking organization's binding risk-based capital requirement would capitalize for operational risk via ERBA *and* the SCB requirement. ERBA would do so by including a standardized approach for calculating RWA for operational risk, which the Agencies define as "the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events."[11] The SCB requirement already capitalizes for operational risk by "incorporat[ing] expenses stemming from operational-risk events" projected under the severely adverse scenario in the supervisory stress test.[12] Both the SCB requirement and ERBA would require banking organizations to hold operational risk capital conservatively, under highly adverse conditions.[13] By applying the SCB requirement to a banking organization's risk-based capital ratios calculated using ERBA, the risk of operational losses would be captured by the Proposal both in the denominator of the banking organization's risk-based capital ratios and in the capital requirements themselves. This would be a departure from the current U.S. regulatory capital framework—in which operational risk is capitalized either in the denominator of the advanced approaches risk-based capital ratios or in the SCB requirement, but not both[14]—and represent a double counting of operational risk for the purposes of determining a banking organization's capital requirements.[15]

[10] *Id.* at 64,168 ("The overall increase would lead to the expanded risk-based framework becoming the binding risk-based approach for most large banking organizations.").

[11] *Id.* at 64,082.

[12] BD. OF GOVERNORS OF THE FED. RSRV. SYS., 2023 FEDERAL RESERVE STRESS TEST RESULTS 21 (2023), https://www.federalreserve.gov/publications/files/2023-dfast-results-20230628.pdf. In the 2023 stress test, the Federal Reserve's supervisory models projected $185 billion of operational risk losses for the twenty-three banks subject to the exercise, which were then used to set their SCB requirements. *Id.*

[13] *See, e.g.*, 12 C.F.R. pt. 252 app. A; Guowei Zhang et al., *The Federal Reserve Should Remove "Gold-Plating" in the Basel 3 Endgame*, SIFMA (Nov. 8, 2023), https://www.sifma.org/resources/news/the-federal-reserve-should-remove-gold-plating-in-the-basel-3-endgame.

[14] Category I and II banking organizations currently calculate operational risk RWA using the advanced measurement approaches; however, the advanced approaches CCB requirement includes a 2.5 percent buffer requirement in lieu of an SCB requirement. Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. at 64,034, 64,082. The standardized approach CCB requirement includes the SCB requirement, but the standardized approach does not require banking organizations to calculate operational risk RWA. *Id.*

[15] There is likewise overlap in how the Proposal and the SCB requirement both capture market risk. The Proposal's new market risk framework is intended to better account for tail risks; however, the global market shock component for the severely adverse scenario in the Federal Reserve's supervisory stress test—which helps determine a banking organization's SCB requirement—already capitalizes for losses projected during market distress. *Id.* at 64,169; 12 C.F.R. pt. 252 app. A; BD. OF GOVERNORS OF THE FED. RSRV. SYS., 2023 STRESS TEST SCENARIOS 8–9 (2023), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230209a1.pdf.

The Proposal does not acknowledge this overlap, but it has been discussed by Agency principals. Specifically, the justification provided for the overlap—in which operational risk would be capitalized in two different, and interlinked, components of the U.S. regulatory capital framework—has been that the Proposal would affect how minimum regulatory capital requirements are calculated, while the supervisory stress test determines the calculation of the SCB requirement.[16] This rationale, which effectively denies the existence of this double counting, falls short of justifying the Proposal's double counting of operational risk for two reasons. First, RWA calculated using ERBA, including the proposed standardized approach for operational risk, are not relevant solely for assessing a banking organization's minimum required regulatory capital. To the contrary, ERBA-generated RWA would serve also as the denominator when determining whether a banking organization has met its SCB requirement. Second, from a practical perspective, studies—including from the BCBS itself—have shown that banks treat capital buffers as de facto regulatory minimums.[17] Applied to the U.S. regulatory capital framework, this suggests that the minimum regulatory capital requirement and the SCB requirement are both constituent parts of a banking organization's effective minimum capital requirement. As a result, large U.S. banking organizations hold and manage capital on a day-to-day basis against elements that are accounted for in both the SCB requirement (through supervisory stress test losses and the application of the SCB requirement to RWA) and the minimum capital ratios (through the calculation of RWA). To the extent those elements generate capital needs for the same risk areas, banking organizations would hold capital against them twice in order to meet their effective minimum capital requirement.

We recommend that the Agencies replace the SCB requirement with a 2.5 percent buffer requirement for the purposes of the CCB requirement applied to a banking organization's risk-based capital ratios resulting from ERBA. This would fully satisfy the Agencies' intention that banking organizations hold capital for operational risk losses, retain the increased risk sensitivity of ERBA, eliminate the overlap between components of the U.S. regulatory capital framework for operational risk, and improve the overall coherence of the Proposal. Applying the SCB requirement to the risk-based capital ratios resulting from the standardized approach and a 2.5 percent buffer requirement to the risk-based capital ratios resulting from ERBA would introduce no additional complexity into the U.S. regulatory capital framework. Indeed, a CCB requirement that differs depending on the approach used to calculate RWA would be akin to the current construct for banking organizations subject to the Federal Reserve's capital plan rule and the advanced approaches requirements.[18]

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[16] *E.g.*, Michael S. Barr, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Holistic Capital Review (July 10, 2023), https://www.federalreserve.gov/newsevents/speech/barr20230710a.htm.

[17] *See, e.g.*, BASEL COMM. ON BANKING SUPERVISION, BUFFER USABILITY AND CYCLICALITY IN THE BASEL FRAMEWORK 4–16 (2022), https://www.bis.org/bcbs/publ/d542.pdf.

[18] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. at 64,034.

Applying the SCB requirement only to the standardized approach risk-based capital ratios would avoid further magnifying the super-equivalence of the U.S. regulatory capital framework relative to international standards.

Maintaining the application of a banking organization's SCB requirement only to its standardized approach risk-based capital ratios would avoid magnifying the super-equivalence of the U.S. regulatory capital framework relative to international standards. As discussed at length in the comment letters of the industry trade associations of which Citi is a member,[19] the Proposal materially diverges from the BCBS standards in several key respects and would exacerbate the existing super-equivalence in the regulatory capital framework. ERBA's comparative stringency relative to the BCBS standards, as well as their implementation in other jurisdictions, would result in significant competitive inequities for U.S. GSIBs that are already subject to an SCB requirement and GSIB surcharge methodology not found in other jurisdictions' regulatory capital frameworks. Applying the U.S.-specific SCB requirement to a U.S.-specific implementation of the BCBS standards would only compound the overall super-equivalence of the U.S. regulatory capital framework, challenging the ability of U.S. GSIBs to serve as global providers of critical financial services to consumers, businesses, governments, and other institutions. Our recommendation would be one step toward mitigating the broader concerns regarding an unlevel international playing field.

Applying the SCB requirement to the standardized approach risk-based capital ratios, and a 2.5 percent buffer requirement to the risk-based capital ratios resulting from ERBA, would improve the coherence of the U.S. regulatory capital framework as compared to the Proposal and align more closely with the stated goals of the Agencies and the BCBS. Our recommendation would retain the Agencies' two-stack approach but adjust the composition of the stacks to better address the stated policy objectives of the Agencies and the BCBS, with (a) one capital stack containing a U.S.-specific RWA calculation and buffer requirement (*i.e.*, the standardized approach and the SCB requirement) and (b) one capital stack based on the BCBS capital framework (*i.e.*, ERBA and a 2.5 percent buffer requirement). This would better fulfill the Agencies' goal of improving "the risk capture and consistency of capital requirements across large banking organizations" by not amplifying elements of the U.S. regulatory capital framework to which only the largest banking organizations are subject.[20] Importantly, it also would better support the BCBS standards' aim of increasing the comparability of international capital requirements by avoiding an outcome wherein one super-equivalent component of the U.S. regulatory capital framework (the SCB requirement) is layered on top of another (ERBA).

Our recommendation would still "ensure that the stress capital buffer requirement contributes to the robustness and risk-sensitivity of the risk-based capital requirements."[21] The Agencies have made the retention of the standardized approach one of the key design features of

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[19] *See supra* note 5.

[20] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. at 64,030.

[21] *Id.* at 64,034–35.

the Proposal, ostensibly to "ensure that large banking organizations would not have lower capital requirements than smaller, less complex banking organizations."[22] As a result, applying the SCB requirement in the standardized approach capital stack would continue adding to the risk sensitivity of the calculation of large banking organizations' risk-based capital ratios. This would mirror the existing framework for advanced approaches banking organizations subject to the Federal Reserve's capital plan rule; the SCB adds to the risk sensitivity of their capital requirements by being applied only to the current standardized approach capital stack.

Applying the SCB requirement only to the standardized approach risk-based capital ratios would avoid complications with the Proposal's transition provisions.[23]

Finally, our recommendation is the simplest solution to some of the complex, technical issues raised by the multi-year ERBA transition. Beginning July 1, 2025, and throughout the ERBA transition, there would be misalignment between the calculation of RWA used to size the SCB requirement and the calculation of RWA at any point in time.[24] This may generate increases in required capital beyond what is warranted by a banking organization's risk profile and what is intended by the Proposal. Applying a static, 2.5 percent buffer requirement in the ERBA capital stack in lieu of the SCB requirement would eliminate this issue altogether, easing the ERBA transition for banking organizations subject to the Proposal and for the Agencies.

A poorly calibrated regulatory capital framework that results in undue overcapitalization would have negative impacts on banking organizations, their customers and clients, the economy, and financial stability. We urge the Agencies to consider carefully (a) the recommendations set forth in the aforementioned industry trade association letters, concerning the changes that should be made to ERBA to make it more appropriate for large banking organizations and markets, and also concerning the significant procedural missteps in the Proposal's issuance, and (b) our recommendation that the SCB requirement be applied only to a banking organization's standardized approach risk-based capital ratios.

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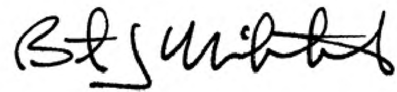
[22] *Id.* at 64,030–31. We strongly disagree with the Proposal's suggestion that large banking organizations, including GSIBs, could ever, in practice, face lower capital requirements than smaller banking organizations not subject to the full panoply of risk-based and leverage capital requirements in the U.S. framework, and the Proposal provides no analytic justification for this suggestion.

[23] This is responsive to the Proposal's Question 9. *Id.* at 64,035.

[24] Specifically, during the proposed transition period, the RWA that would be used to calculate the SCB requirement would lag behind the binding ERBA requirements, resulting in an inflated SCB requirement.

We appreciate the opportunity to comment on the Proposal. If you have any questions, please do not hesitate to contact the undersigned.

Sincerely,



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