American Express Company
200 Vesey Street
New York, NY 10285

January 16, 2024

Via Electronic Delivery

Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
400 7th E Street, SW, Suite 3E-218
Washington, DC 20219

Re: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity

FRB Docket No. R–1813; RIN 7100–AG64
FDIC RIN 3064-AF29
OCC Docket ID OCC-2023-0008; RIN 1557- AE78

Ladies and Gentlemen:

American Express Company (together with its subsidiaries, "American Express") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC" and together the "Agencies") on the Agencies' proposal to substantially revise the capital requirements applicable to large banking organizations and to banking organizations with significant trading activity (the "Proposed Rules").[1]

The Proposed Rules are intended to be consistent with changes to international capital standards issued by the Basel Committee on Banking Supervision (the "Basel Committee"), and

[1] *See* 88 Fed. Reg. 64028 (Sept. 18, 2023).

are meant to (i) improve the calculation of risk-based capital requirements to better align with risk, (ii) reduce the complexity of the framework, (iii) enhance the consistency of requirements across banking organizations, and (iv) facilitate more effective supervisory and market assessments of capital adequacy.[2]

American Express appreciates the work of the Agencies and supports their efforts to improve the calculation of risk-based capital requirements so that they are simpler and better aligned with a firm's risk profile. Unfortunately, in practice the Proposed Rules exacerbate the complexity of the framework for many firms, including American Express, and would produce capital requirements for some firms, particularly American Express, that are fundamentally misaligned with risk in important ways. This misalignment would impose a significant cost on these firms with little corresponding benefit to safety and soundness or financial stability. Accordingly, we focus our comments here on opportunities for the Agencies to refine the Proposed Rules to be more risk-sensitive while still meeting the goals of promoting safety and soundness, reducing complexity, and enhancing resiliency.[3]

I. Executive Summary

American Express agrees that risk-based capital rules that are appropriately aligned with the risk profile of the firms to which they apply generally enhance the resiliency of those firms. However, we respectfully submit that risk-based capital requirements that significantly overstate risk serve to misallocate capital in ways that (i) fail to support safe and sound lending and the provision of financial services in the economy by restricting the ability of management and the board to determine how to best deploy resources, (ii) unfairly penalize low risk business models with little benefit to resiliency, and (iii) significantly disadvantage regional and non-complex banks by subjecting them to rules designed for the largest and most complex banks.[4]

As the Agencies have widely recognized, the current condition of the U.S. banking system is sound and resilient, with strong levels of capital and liquidity.[5] Nevertheless, as

---

[2] Proposed Rules at 64028.

[3] Although we focus our comments in this letter on recommendations for substantive improvements to the Proposed Rules, we also share the significant rulemaking process and economic data and analysis concerns raised to the Agencies by multiple trade associations (including the Bank Policy Institute and American Bankers Association, both of which we are members) in their letters dated October 13, 2023 and September 12, 2023.

[4] *See, e.g.*, Congressional Research Service, Bank Capital Requirements: Basel III Endgame, 2023, pp. 10-11 ("Appropriate risk weights incentivize banks to pursue activities where risk and reward are properly balanced. If regulators raise risk weights because previous weights were too low relative to actual risk, then the safety and soundness of the banking system would be improved by reducing the incentive to pursue that activity. By contrast, if regulators raise risk weights to be higher than is commensurate with the activity's actual risk, then banks would be too disincentivized to engage in an activity, and economic efficiency would fall (or the activity would migrate out of the banking system)."), *available at* https://crsreports.congress.gov/product/pdf/R/R47855 (internal citations omitted).

[5] *See, e.g.*, Testimony of Vice Chair for Supervision Michael S. Barr before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., Nov. 14, 2023, *available at* https://www.federalreserve.gov/newsevents/testimony/barr20231113a.htm; Statement of Michael J. Hsu, Acting

reflected in Figure 1, below, under the Proposed Rules, American Express would see a very significant overall increase in capital requirements – expected to be the highest impact among domestic non-GSIB banks, and so would have to hold substantially and disproportionally more capital compared to similarly situated peer firms. This punitive outcome for American Express is inconsistent with the risk of our simple business model, as reflected by our internal data, as well as by both the results of the Federal Reserve's periodic stress testing exercise and our consistent eligibility for the minimum 2.5% stress capital buffer floor.

Group	Bank	Impact	Stress Capital Buffer[2]
Credit Card	AXP[3]	40%	2.5
Credit Card	COF	4%	4.8
Credit Card	DFS	4%	2.5
G-SIBs	BAC	14%	2.5
G-SIBs	BK	21%	2.5
G-SIBs	C	20%	4.3
G-SIBs	GS	34%	5.5
G-SIBs	JPM	22%	2.9
G-SIBs	MS	44%	5.4
G-SIBs	STT	20%	2.5
G-SIBs	WFC	13%	2.9
Category II / III / IV Banks	ALLY	-1%	2.5
Category II / III / IV Banks	CFG	-1%	4.0
Category II / III / IV Banks	FITB	2%	2.5
Category II / III / IV Banks	HBAN	-1%	3.2
Category II / III / IV Banks	KEY	1%	2.5
Category II / III / IV Banks	MTB	-1%	4.0
Category II / III / IV Banks	NTRS	9%	2.5
Category II / III / IV Banks	PNC	3%	2.5
Category II / III / IV Banks	RF	2%	2.5
Category II / III / IV Banks	SANUSA	7%	2.5
Category II / III / IV Banks	SCHW	23%	2.5
Category II / III / IV Banks	TFC	1%	2.9
Category II / III / IV Banks	USB	5%	2.5

Notes:
1. All impacts except Goldman Sachs ("GS") and Morgan Stanley ("MS") are sourced from Barclays. GS and MS impacts are sourced from Citi.
2. Sourced from the Federal Reserve large bank capital requirements. Effective October 1, 2023.
3. Actual SCB would be ~1.7% without the mandated floor of 2.5%.

Figure 1: Analyst Projected Impact of Proposed Rules on U.S. Banking Organizations

American Express offers traditional banking services, primarily issuing credit and charge cards to consumers and businesses. American Express also operates the network upon which

Comptroller of the Currency, before the Committee on Banking, Housing, and Urban Affairs United States Senate, Nov. 14, 2023, *available at* https://www.occ.gov/news-issuances/congressional-testimony/2023/ct-occ-2023-124-written.pdf; *Financial Stability: Resilience, Challenges, and Global Connections*, Governor Lisa D. Cook, Nov. 8, 2023, *available at* https://www.federalreserve.gov/newsevents/speech/cook20231108a.htm; Statement by Chair Jerome H. Powell, July 27, 2023, *available at* https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20230727.htm; Testimony of Vice Chair for Supervision Michael S. Barr before the Financial Services Committee, U.S. House of Representatives, Washington, D.C., May 16, 2023, *available at* https://www.federalreserve.gov/newsevents/testimony/barr20230516a.htm; Statement of Michael J. Hsu Acting Comptroller of the Currency before the Committee on Financial Services U.S. House of Representatives May16, 2023, *available at* https://www.occ.gov/news-issuances/congressional-testimony/2023/ct-occ-2023-44-oral.pdf.; Remarks by Chairman Martin J. Gruenberg on "Oversight of Prudential Regulators" before the Committee on Financial Services, United States House of Representatives, May 16, 2023, *available at* https://www.fdic.gov/news/speeches/2023/spmay1523.html; Testimony of Vice Chair for Supervision Michael S. Barr Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Washington, D.C., March 28, 2023, *available at* https://www.federalreserve.gov/newsevents/testimony/barr20230328a.htm.

those (and certain third-party issued cards) operate.[6] Despite our simple business model, the Proposed Rules would have a uniquely disproportionate impact on American Express that is demonstrably unrelated to the operational or credit risk presented by the range of products and services currently enjoyed by our card members. Accordingly, and as described in greater detail below, we respectfully recommend the following enhancements to the Proposed Rules to better align them with the risk profiles of covered firms.

a. Operational Risk

i. Recommendation: Permit the Inclusion of Fee Revenue and Expenses Attributable to Card Products in the Interest, Lease, and Dividend Component

Our principal recommendation to refine the Services Component is for the Agencies to permit fee revenue generated by, and expenses attributable to, both charge and credit card products (*e.g.*, card member annual fees, card transaction-related discount revenue, and rewards, marketing, card member services expenses, etc.) to be included in the Interest, Lease, and Dividend Component (the "Interest Component") to reflect that these revenues and expenses are derived from and attributable to fundamentally the same payments and lending activities that generate interest income.[7]

ii. Alternative: Permit Netting of Card-Related Expenses

If the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, we recommend the Agencies permit institutions to net from fee revenue certain expenses associated with fee-generating products, such as non-funding related costs incurred in connection with generating revenue from card products. Netting these expenses would (i) reflect that these expenses are incurred in connection with fundamentally the same payments and lending services that generate interest income; and (ii) provide consistency across firms to avoid divergent capital outcomes based solely on the basis of permitted U.S. GAAP accounting positions (*e.g.*, firms that report fee revenue on a gross basis based upon GAAP guidance relative to firms who report fee revenue for comparable businesses net of expenses as a matter of industry practice).

iii. Alternative: Cap the Services Component of the Business Indicator

Similarly, if the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, we recommend the Agencies cap the Services Component of the Business Indicator, consistent with what is proposed for the Interest Component, to further align

[6] As one of the few institutions that issues charge cards in addition to credit cards, American Express is uniquely qualified to provide the Agencies with additional insight into the structure and risk of charge card products.

[7] *See* Question 74 of Proposed Rules at 64084-85.

the Services Component with the Interest Component and to mitigate the disproportionate impact on, and resulting overcapitalization of, banks with higher fee revenue.[8]

b. Credit Risk

i. Eliminate the Off-Balance Sheet Exposure Proxy Methodology for Charge Cards

We recommend the Agencies eliminate the proposed off-balance sheet "exposure" proxy methodology for charge cards and similar products with no pre-set spending limit (collectively, "NPSL Products"). As a policy matter, the concept of holding a potentially significant amount of capital against "off-balance sheet exposure" for NPSL Products is misguided. NPSL Products do not provide a committed credit line, demonstrate low risk from a credit perspective in practice, and can be actively managed to avoid the "ramp up" behavior a credit conversion factor ("CCF") is intended to address. As such, the credit risk associated with NPSL Products should continue to be addressed through prudent risk management and should not be assigned a proxy off-balance sheet exposure amount that is subjected to a CCF.

ii. Any Retained Off-Balance Sheet Exposure Methodology for Charge Cards must be Revised

To the extent the Agencies determine it is necessary to retain an off-balance sheet methodology for NPSL Products, we respectfully submit that the "proxy" methodology in the Proposed Rules is based on a flawed understanding of these products. As a result, the proposed methodology would dramatically overstate the "exposure" on NPSL Products and must be revised. Based upon our data and experience offering NPSL Products, we believe a multiplier of 1.0-1.6 times prior eight quarters average spend minus current spend would better represent the "exposure" intended to be captured through a CCF.

iii. Eliminate the Upward Departures on Retail Risk Weights

The proposed upward departures for transactors, revolvers, and general retail risk weights relative to the Basel Committee standards are not supported by data or otherwise justified by U.S.-specific considerations, and at a minimum should be revised to align with the Basel standards. Although there may be instances when departing from the international standards may be necessary or appropriate, those considerations do not support departing upwards on these risk weights.

[8] As previously noted by the Basel Committee, "[a] small number of banks that are highly specialized in fee businesses have been identified as facing a disproportionately high capital impact under the [Business Indicator]. The problem stems from the structure of the BI, which was designed to capture the operational risk profile of a universal bank and does not lend itself to accurate application in the case of banks engaged predominantly in fee-based activities." Basel Comm. on Banking Supervision, Consultative Document: Operational risk – Revisions to the simpler approaches, ¶ 46, at 16 (2014), *available at* https://www.bis.org/publ/bcbs291.pdf.

iv. Revise the Definition of Transactor

We recommend the Agencies revise the definition of "transactor" to refer to an exposure that is 95% paid for the prior six months. We appreciate that the Basel standards and the Proposed Rules attempt to incorporate improved granularity and risk sensitivity into the retail category, but we believe that the proposed definition of transactor is overly conservative and hypothetical in attempting to identify transactors within a credit card portfolio that have historically exhibited low credit risk. As a result, the proposed approach could unnecessarily exclude a population of credit card users that carry immaterial balances on occasion and have effectively an identically low credit risk profile. Based upon our data and experience, we believe the credit risk profile of a customer that pays at least 95% for the prior six months is substantially identical to a customer that pays 100% for the trailing 12 months, and so this modest and targeted adjustment to the definition would appropriately capture customers that exhibit low risk transactor behavior without introducing additional risk. In addition, a transactor definition of 95% paid for the prior six months is also consistent with the commonly used U.S. credit card industry definition.

c. Market Risk: Make the $5 Billion Threshold Generally Applicable

We recommend the Agencies eliminate the $100 billion asset threshold and simply make the $5 billion combined trading assets and liabilities threshold for application of the market risk capital rules generally applicable across banking organizations. Requiring firms such as American Express with de minimis or immaterial trading operations to build systems, incur costs, and dedicate resources to implement the market risk capital rules would create operational costs and burdens well in excess of any potential risk mitigation benefit, and would certainly conflict with the stated goal of the Proposed Rules to "reduce the complexity of the framework."[9]

II. Operational Risk

We believe that it is critical that any final rules appropriately revise the treatment of fee revenue in the Services Component of the Business Indicator to avoid the otherwise irrational and unsupportable results produced under the current proposal. American Express has a simple business model, primarily offering non-complex lending and payments products such as consumer, small business, and corporate credit and charge cards. However, although simple, our business model is also relatively unique, and as a result fee revenue has historically represented a significant proportion of American Express revenue. Notwithstanding that these fees (*e.g.*, card member annual fees, transaction fees, etc.) are inextricably connected to traditional, non-complex card products and payment services, American Express would face a significantly higher capital charge under the Proposed Rules than its peers. If implemented as proposed, without even accounting for the proposed credit risk changes, the operational risk charge alone

[9] Proposed Rules at 64028.

would be estimated to add approximately $86 billion to American Express's risk-weighted assets, requiring significantly more capital in order to maintain capital ratios at current levels.[10]

This result is astonishing on its face and dramatically inconsistent with (i) the treatment of similar businesses operated by our peer institutions, (ii) our experienced operational loss history, and (iii) expected losses in stress scenarios under current stress testing.

To address this outcome, we strongly encourage the Agencies to implement the following changes to the operational risk portion of the Proposed Rules. First, we recommend the Agencies permit fee revenue and expenses attributable to charge and credit card products to be included in the Interest Component to reflect that these revenues are derived from fundamentally the same payments and lending services that generate interest income, and that the "inputs to each component of the business indicator" are not "meant to overlap."[11] Alternatively, if the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, the Agencies should expressly permit institutions to net from fee revenue certain expenses associated with fee-generating products, such as non-funding related costs incurred in connection with generating, revenue from card products. Finally, likewise if the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, we recommend the Agencies cap the Services Component of the Business Indicator, consistent with what is proposed for the Interest Component to further mitigate the overcapitalization of banks with higher fee revenue.

a. Fee Revenue and Operational Risk at American Express

As both the Basel Committee in its materials and the Agencies in the preamble to the Proposed Rules have acknowledged, the Services Component of the Business Indicator as contemplated by the Proposed Rules would disproportionally affect banking organizations like American Express for whom fee revenue represents a significant proportion of overall revenue.[12]

American Express generates fee revenue both from initial and annual fees paid by American Express card members for card products, and from transaction fee revenue (discount revenue) generated each time a card member transacts using their card. Therefore, fee revenue represents a greater percentage of overall revenue for American Express than most of our peers offering similar card products. At the same time, American Express card members commonly

[10] We note but do not further address here that – if finalized as proposed – the cost of the cumulative significant increase in American Express risk-weighted assets under the Proposed Rules may also meaningfully compound the cost of the long-term debt requirements applicable to American Express under the Agencies' recently proposed long-term debt rule. *See* 88 Fed. Reg. 64524, 64551, Sept. 19, 2023 ("The agencies recognize that their Basel III reforms proposal would, if adopted, increase risk-weighted assets across covered entities. The increased risk-weighted assets **would lead mechanically to increased requirements for LTD** under the LTD proposal.") (emphasis added).

[11] Proposed Rules at 64083.

[12] *See* fn. 8 *supra*.

pay their balances in full, exhibit transactor behavior, and generally revolve balances less than our peer firms, generating proportionately less interest income for American Express.

Importantly, though, our business lines and their associated products and fees are not complex or exotic – they are well-understood banking products and payment services that just happen to produce meaningful non-interest revenue in addition to interest income. Further, our experience demonstrates that there is virtually no correlation between growth in our non-interest revenue and operational risk losses. As shown in Figure 2 below, with the exception of the COVID period, our non-interest revenue has grown steadily over the past 10 years. Over this same period of revenue growth, our experienced operational risk losses have been notably stable.

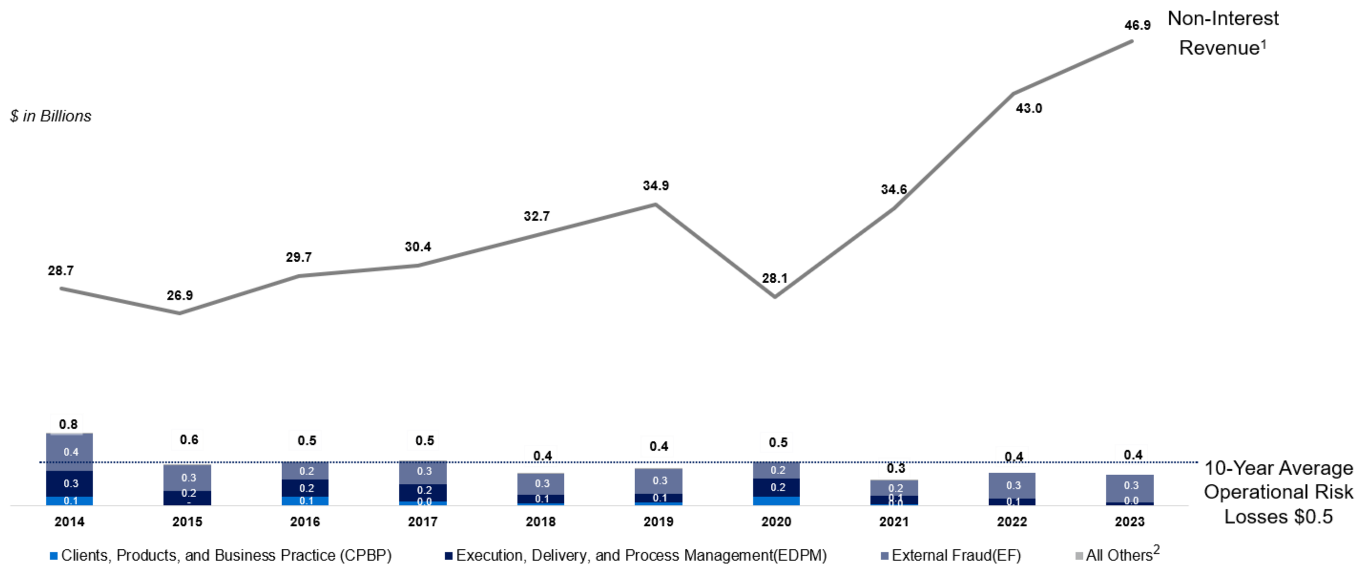
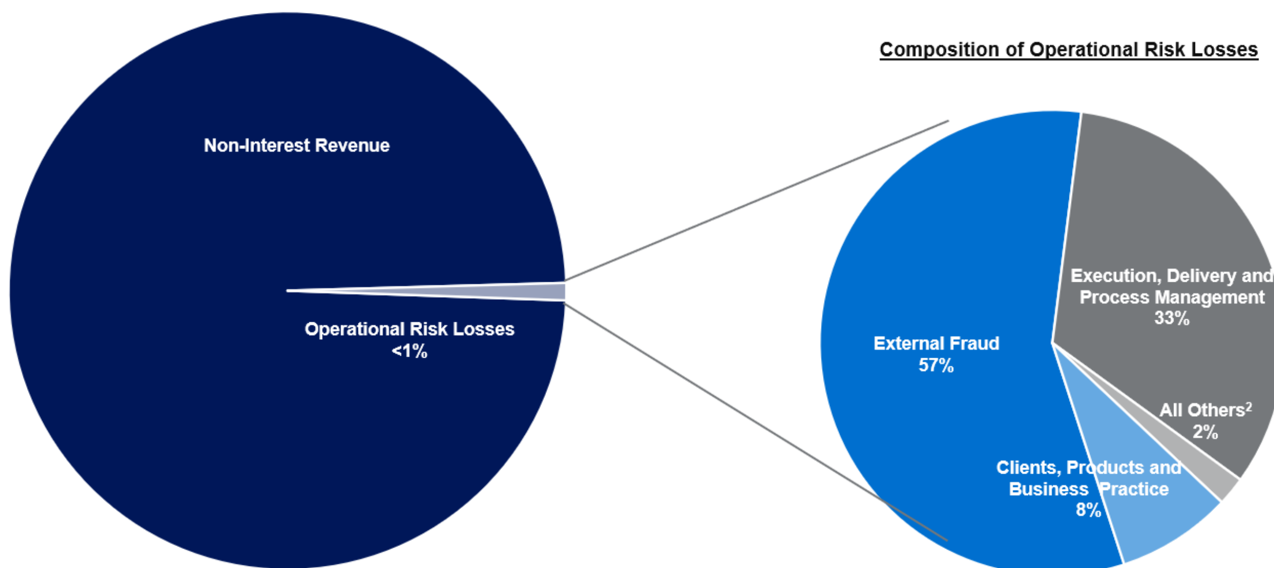


Figure 2: AXP Non-Interest Revenue Growth Compared to Experienced Operational Risk Losses

Our operational risk losses are consistently low, recently equaling less than 1% of our non-interest revenue. Similarly, the composition of those losses has been predictably stable. As shown below, within our low operational risk losses, external fraud has consistently accounted for over 50% of these losses historically. These external fraud losses are inherent in the nature of the offering of card products generally and are not linked to specific revenue streams (or to fee revenue in particular).



Notes:
1. Based on AXP's historical operational risk loss experience from 2014–2023. 2023 annualized based on data as of Q3 2023.
2. All Others include Business Disruption and Systems Failures, Damage to Physical Assets, Employment Practices and Workplace Safety, and Internal Fraud.

Figure 3: Composition of Operational Risk Losses

As noted above, the Basel Committee itself recognized that the operational risk component would "result[] in capital requirements that are too conservative relative to the operational risk faced by [fee-generating] banks."[13] Although the Basel Committee was apparently unable to agree on a fix for this problem in the final version of its international standards, the Agencies have a chance to do so now.[14] By making the changes recommended below, the Agencies can more appropriately align the actual operational risks associated with fee revenue to the new capital requirements.

b. Recommendation: The Agencies should permit fee revenue and expenses attributable to card products to be included in the Interest Component.

Given the substantial similarity between fee-generating and interest-earning card products and services from an operational risk perspective, the Agencies should revise the Proposed Rules to include the fees generated by, and expenses attributable to, charge and credit

---

[13] Basel Comm. on Banking Supervision, Consultative Document: Standardised Measurement Approach for operational risk, ¶ 16(d), at 4 (2016), *available at* https://www.bis.org/bcbs/publ/d355.pdf.

[14] *E.g.*, "Take for example the business-indicator approach to operational-risk capital. The first Basel consultative document acknowledged that this approach 'does not lend itself to accurate application in the case of banks engaged predominantly in fee-based activities.' The second consultative document reiterated that the approach resulted in 'overcapitalization of banks with high fee revenues and expenses.' It also proposed a fix. But that fix was then quietly dropped from the final Basel III standards without public explanation. **That leaves this proposal to take an approach that its own Basel Committee authors have said does not work**." Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework, *available at* https://www.fdic.gov/news/speeches/2023/spjul2723c.html (emphasis added).

cards in the Interest Component of the Business Indicator.[15] This would allow for a consistent treatment of comparable businesses while more appropriately capturing the risk associated with these products.

As noted above, American Express earns fee revenue from several sources. For example, American Express issues several different charge card and credit card products which generate initial and annual fees paid by card members. Although similar in some respects to credit cards, charge cards have not historically generated significant interest income because charge card holders have generally been required to pay their balances in full each month, rather than carrying and paying interest on a revolving balance.[16] Another source of fee revenue results from American Express operating the network on which our charge and credit cards operate, which generates fee revenue (discount revenue) earned from each transaction.

American Express incurs expenses to attract and retain new card members, operate our network, and generally to run our business in a safe and sound manner. Like our revenues, our expenses are not exotic and an increase in the size of our expenses neither reflects nor increases the operational risk of our business. We invest in our traditional lending and payments products and services, including to provide valued card member benefits, to market and promote the attractiveness of our card products, and to bolster our ability to provide responsive and effective customer service. Although we incur these expenses to support our lending and payments businesses, under the Proposed Rules, many of our expenses would be included in the Services Component. This treatment exaggerates the risk of our business further and exacerbates the fundamental problem created by the proposed approach to the Services Component: our well-understood, non-complex business is treated as highly risky both on an absolute basis and compared to our peers.

Given the nature of charge and credit card products and related payment services, the associated fees and expenses fit more naturally within the Interest Component, which was intended to include "[i]nterest income from loans and advances," whereas the Services Component was intended to typically include "[f]ee and commission income from" activities like securities issuance or origination, and clearing and settlement.[17] Likewise, as the Agencies acknowledged in the release materials, the "inputs to each component of the business indicator" are not "meant to overlap."[18] In the case of card products, whether technically characterized as interest or non-interest in nature, these revenues and expenses are derived from fundamentally the same payments and lending services and should be treated together in the Interest Component.

[15] *See* Question 74 of Proposed Rules at 64084-85.

[16] Certain features of our current charge card products allow a card member to revolve a portion of their balance.

[17] Basel Comm. on Banking Supervision, Basel III: Finalising post-crisis reforms, at 134 (2017), *available at* https://www.bis.org/bcbs/publ/d424.pdf ("Basel Committee Standards").

[18] Proposed Rules at 64083.

Absent a correction, the result of the Proposed Rules would be one that defies logic and lacks historical support, and that the Agencies presumably did not intend: our set of longstanding, non-exotic, well-understood lending and payments activities would incur an increased operational risk capital charge substantially higher than any comparable business at another banking organization. To avoid this inappropriate and unique misalignment of capital to risk, we recommend the Agencies include the revenue derived from all types of card products, including the associated discount revenue, along with the expenses attributable to these activities, in the Interest Component to reflect the direct relationship between these revenues and expenses and the associated payments and lending activities, and to ensure that fee revenue and expenses associated with card products are not treated punitively or as disproportionately risky.

c. Alternative: The Agencies should permit netting of fee-related expenses with fee revenue related to charge and credit cards.

If the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, the Agencies should expressly permit institutions to net from fee revenue certain expenses associated with fee-generating card products when calculating the Services Component, such as non-funding related costs incurred in connection with generating revenue from card products, to reflect that – like the revenues – these expenses are incurred in connection with fundamentally the same payments and lending services that generate interest income.

As noted above, if left unchanged, the inclusion of fee revenue and expenses in the Services Component would produce a capital charge misaligned to the underlying risk and could have a significant effect on card issuers' ability or willingness to invest in product and service improvements and card benefits for customers. In the case of American Express, our investment in card benefits and customer service is viewed as a vital component of the value proposition of our card products that allows us to attract and retain new card members. As drafted, however, the Proposed Rules could impact industry participants' willingness to continue incurring those expenses. Expressly allowing card issuers to net the expenses associated with their card products (such as rewards programs and other services) for purposes of calculating the Services Component would avoid this result while better aligning capital levels and ratios consistent with operational risk.

We appreciate the Agencies' concern that a netting approach could "exaggerate the difference in operational risk between" firms that originate products and those that distribute products bought from third parties.[19] However, we do not see this as an insurmountable concern, nor one that justifies preserving the outcome under the current proposal. For example, this concern can be alleviated by limiting the netting to only expenses associated with certain products, such as non-funding related expenses incurred in connection with generating revenue from card products (*e.g.*, rewards, business development, card member services, and marketing expenses). Such an approach would better align the treatment of fee-related expenses with the

[19] *Id.* at 64084.

Interest Component to reflect that these expenses are incurred in connection with fundamentally the same payments and lending services that generate the associated revenues.

In addition, permitting netting would encourage a level playing field among banking organizations and avoid penalizing certain firms based solely on the basis of permitted U.S. GAAP accounting positions. For example, we note that some firms, such as American Express, currently report fee revenue on a gross basis based upon GAAP guidance, while other firms with comparable businesses may report fee revenue net of expenses as a matter of industry practice. We understand this range of accepted industry positions is generally supportable under U.S. GAAP accounting but, as applied in the context of the Services Component, would produce divergent capital outcomes and potentially place some firms at a disadvantage based solely on historical accounting and reporting determinations. As such, in addition to aligning with the Interest Component and recognizing the inherent connection between these expenses and payments and lending services, expressly permitting netting would eliminate any accounting-based disadvantage.

d. Alternative: The Agencies should cap the Services Component, similar to the cap for the Interest Component.

Similarly, if the Agencies decide not to include card-related fee revenue and expenses in the Interest Component, we recommend the Agencies cap the Services Component of the Business Indicator, consistent with what is proposed for the Interest Component. As proposed, the Interest Component of the Business Indicator would be capped at 2.25% of a firm's total interest-bearing assets,[20] but the contribution of the Services Component would not be capped at all. As the Agencies correctly recognize in the proposal, because "*operational risk does not necessarily increase proportionally to increases in net interest income*, the net interest income input would be capped at 2.25 percent of interest-earning assets."[21] Unfortunately, the Proposed Rules make a starkly different assumption regarding fee revenue, returning to the reductive conclusion that "higher overall business volume" should "correlate with higher operational risk capital requirements."[22]

This broad conclusion – and its divergence from the more rational treatment of interest income – means that as a firm grows organically, its capital requirements would grow significantly if that growth were driven by fee revenue, but not if it is driven by interest income, *regardless* of the similarity in the underlying products driving the growth. Fundamentally, operational risk in a card business is substantially the same regardless of whether a customer's card product has a fee associated with it, or whether the customer is spending on a pay-in-full NPSL Product or borrowing with the intention to revolve and pay interest on a credit product. Under the Proposed Rules, however, a strategic decision to focus in one area versus another could produce substantially divergent operational risk capital requirements – an arbitrary

[20] *Id*.

[21] *Id.* (emphasis added).

[22] *Id.* at 64083.

outcome wholly unrelated to the risk of the underlying activity and unsupported by data in the Proposed Rules.

Having multiple revenue streams – interest income and fee revenue– that are derived from simple products means that American Express's business model is stable, rather than volatile or exotic. Indeed, as noted above, our experience has shown that, similar to the Agencies' observation on interest income, there is virtually no correlation between operational risk losses and the amount of fee revenue generated by American Express products and services.

Accordingly, in the case of a card issuer and network operator like American Express, the presumption that higher business volume corresponds to higher operational risk is simply inaccurate and instead overstates risk and produces disproportionate capital requirements for fee revenue with no corresponding benefit to safety and soundness.

As demonstrated above, American Express's experience shows that even with respect to fee revenues, and particularly as a firm reaches a level of maturity and experience with its products, operational risk losses should not be presumed to increase proportionally to increases in fee income. Accordingly, we recommend that the Agencies impose a cap on the contribution of the Services Component consistent with the Interest Component, set at 2.25% of the firm's total assets.

III. Credit Risk – Off Balance Sheet

The Proposed Rules would deviate from the Basel Committee standards to introduce a proxy methodology to estimate an off-balance sheet "exposure" for NPSL Products (the "Proxy Methodology") that must be eliminated or revised in any final rule. American Express has a broad portfolio and long history of offering NPSL Products and is uniquely positioned to comment on issues impacting these products under the Proposed Rules. As discussed in greater detail below, both the concept of an off-balance sheet exposure for traditional NPSL Products and the Proxy Methodology conceptualized in the Proposed Rules are flawed.

a. NPSL Products have a low risk profile.

As a threshold matter, in practice, charge card products present low credit risk generally, and consistently demonstrate lower credit risk than comparable credit card products. For example, both our consumer and small business NPSL Products consistently have a higher average customer FICO score than our corresponding credit card products. Similarly, both our consumer and small business NPSL Products have historically produced lower net write-off rates than our corresponding credit card products. For example, Figure 4 below illustrates the recent relative industry write-off rates for credit card products compared to our NPSL Products.

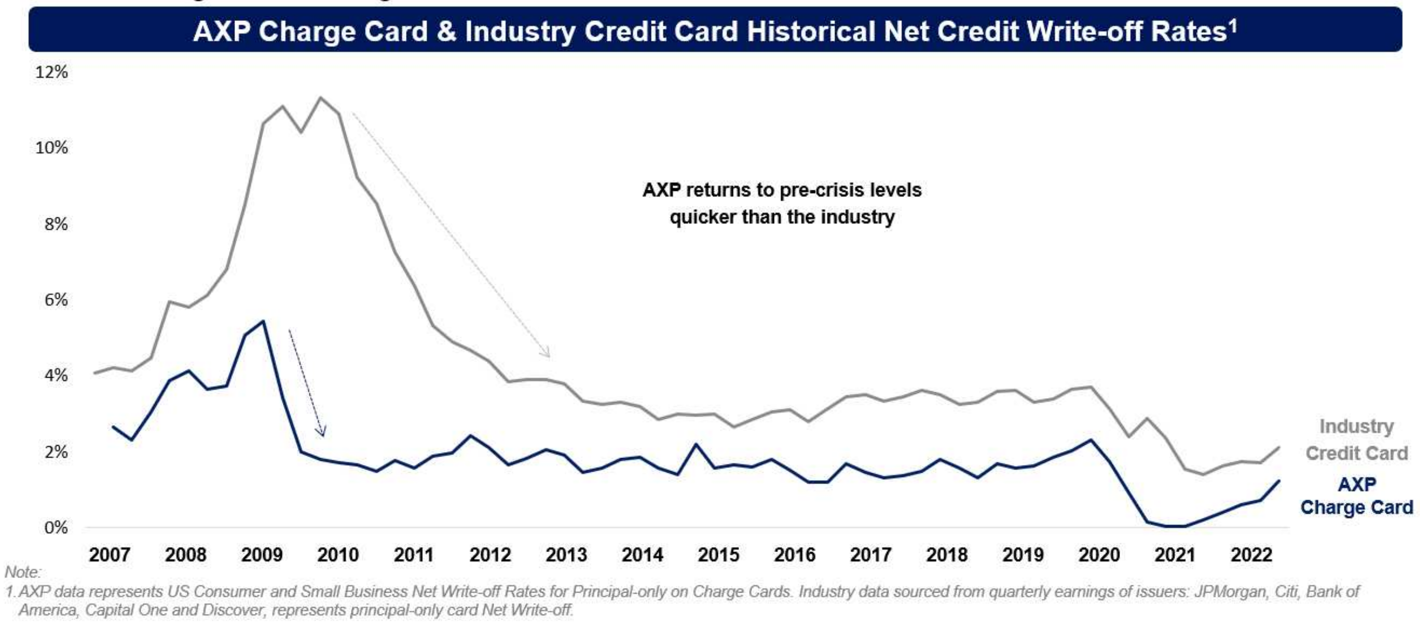


Figure 4: Comparison of Historical Net Write-Off Rates

Notwithstanding the strong credit risk profile of these products, as shown in Figure 5 below, if the Proxy Methodology for NPSL Products were applied as proposed, the impact on risk-weighted assets would be approximately <u>double</u> the outcome for comparable credit card products.

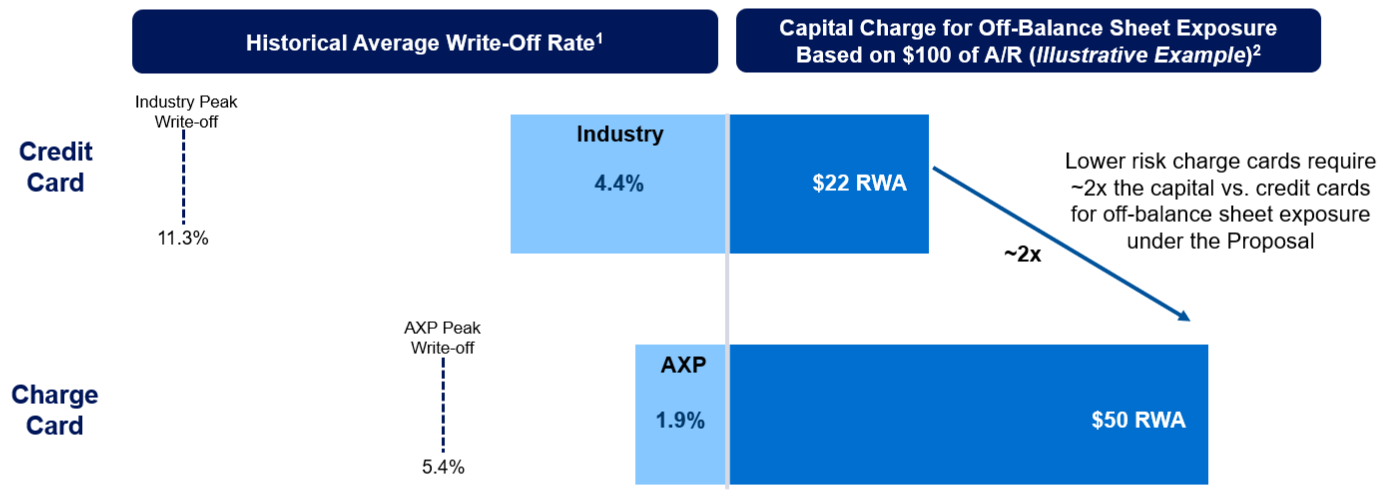


Figure 5: Comparison of Credit Card v. AXP Charge Card Metrics

Treating NPSL Products as carrying significantly greater risk than credit card products is inconsistent with our data and experience managing the risk of both products. The unique features of our charge card products (discussed below) allow them to be closely managed from a credit risk perspective both in ordinary environments and times of stress. Accordingly, a Proxy Methodology that produces an off-balance sheet "exposure" amount for NPSL Products that would indicate those products are substantially higher risk than credit cards is incorrect, counterintuitive, and inconsistent with the basic policy of risk-based capital requirements. To serve their purpose, risk-based capital requirements fundamentally should be suitably proportionate to the risk they are intended to address. Capital requirements that are fundamentally misaligned with risk are non-economic and fail to advance the goals of safety and soundness, financial stability, individual firm resiliency, or economic growth. Imposing such a punitive capital charge for NPSL Products could also increase the cost of NPSL Products and possibly cause industry participants to reevaluate the economic viability of these products.

We would certainly not suggest, however, that the answer would be to preserve this approach for NPSL Products and increase the capital charge for credit cards, nor to view departing from the Basel standards to estimate an off-balance sheet exposure for NPSL Products as an *offset* for providing relief for card fee revenues and expenses under the operational risk standard. As discussed elsewhere in this letter, we believe there are important opportunities to improve those calculations as well. Rather, based upon our experience with and knowledge of NPSL Products, we would suggest refinements to the Proxy Methodology as outlined below.

b. The Agencies should eliminate the Proxy Methodology for NPSL Products.

For the reasons discussed above and herein, the concept of an unused portion of a committed credit line simply does not translate to traditional NPSL Products. Traditional NPSL Products (i) do not offer, communicate, or imply a contractual commitment to extend a certain amount of credit to the customer; (ii) are not managed to any internal or uncommunicated credit line; and (iii) most importantly, approve transactions individually on a transaction-by-transaction basis based on real-time credit decisions, which we call point-of-sale or dynamic authorization.

NPSL Products function more like payment tools than traditional credit facilities: they do not obligate issuers to provide customers a committed line of credit (as clearly demonstrated by the Agencies' attempt to define a proxy), nor do they offer assurance that the next transaction will be authorized. There is no formal credit line, nor are these products managed with any kind of "shadow" or informal credit line – each transaction is separately underwritten at the time of the transaction and approved or denied based upon a variety of non-limit-based factors including our internal credit model, and the card member's current balance and spending pattern. In practice, charge card transactions can be and are routinely disrupted and declined as a result of this dynamic authorization. Accordingly, the concept of holding a potentially significant amount of capital against "off-balance sheet exposure" for traditional NPSL Products is misguided.

We believe that the credit risk associated with NPSL Products should continue to be addressed through prudent credit risk management using existing tools and recommend that the Agencies eliminate the proposed Proxy Methodology for NPSL Products.

c. Any retained off-balance sheet exposure methodology for NPSL Products must be revised.

Although we believe there should logically be no approximated off-balance sheet exposure for NPSL Products, we also note that the Proxy Methodology in the Proposed Rules is based on a flawed understanding of NPSL Product customer behavior, and so would dramatically overstate the "exposure" on these products as currently structured.

Theoretically, assigning a CCF to the unused portion of an unconditionally cancelable committed off-balance sheet exposure is meant to apply capital against the concern that a customer with a committed credit line may, in times of individual or economy-wide stress, ramp up spending or otherwise increase drawdowns on those commitments relative to historical behavior, thus bringing more of that off-balance sheet amount onto the balance sheet. However, point-of-sale dynamic authorization of transactions on NPSL Products and responsible credit risk management mitigate that risk significantly.

Under the Proposed Rules, the Proxy Methodology for NPSL Products would be based upon the average amount drawn on the NPSL Product over the prior eight quarters (or since it was issued if it was issued more recently than eight quarters ago), multiplied by ten, less the current drawn amount.[23] The result in practice is a significant capital charge, based on *ten times* a charge card holders' average spend, even when the issuer can begin denying any and all subsequent transactions in real time and at any time. Such an aggressive and seemingly arbitrary formula is wholly unsupported by any data in the Proposed Rules beyond the conclusory statement that "supervisory experience suggests that obligors similar to those with charge cards have average credit utilization rates equal to approximately 10 percent."[24]

Respectfully, our decades of experience offering NPSL Products to consumers and business customers should help inform a more reasonable conclusion.

Based upon our experience offering NPSL Products, we have observed and measured various data points regarding the behavior of NPSL Product customers. Our historical data demonstrates that card members may in practice show a slight balance increase as compared to average historical spending in the months between ceasing to be current and the time of default. Importantly, however, as shown in Figure 6 below, that average incremental increase in spending is only approximately six *percent* above average historical spending – substantially less than the Proxy Methodology's presumed 10 *times* average historical spending. Adjusting to include eventual recoveries, our data suggests the "exposure" at the time of default would actually be approximately 10 percent **lower than** historical spending, further highlighting how dramatically the Proxy Methodology overstates exposure as proposed.

[23] Proposed Rules at 64055.

[24] *Id*. at 64056.

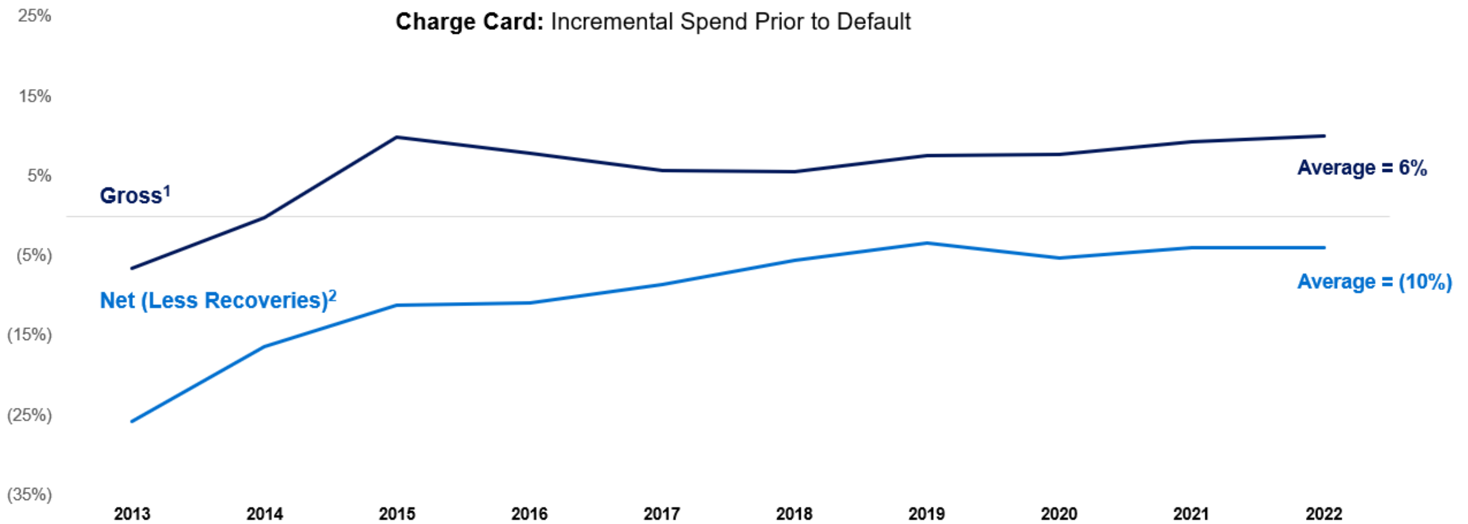
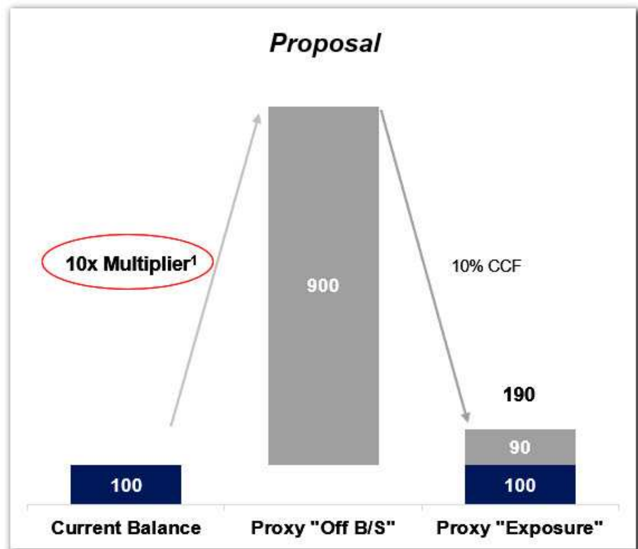
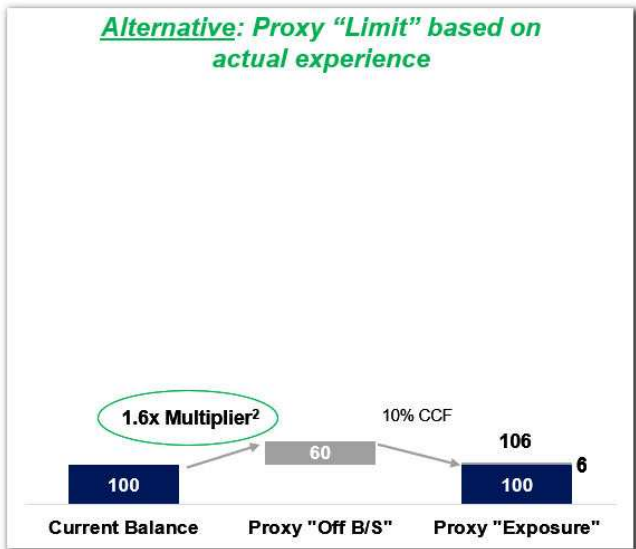


Figure 6: Amex Charge Card Data – Incremental Spend Prior to Default

Accordingly, if the Agencies insist upon implementing a proxy methodology to attempt to replicate an off-balance sheet "exposure" amount for NPSL Products, we recommend they utilize a formula that is based upon data and experience and reflective of actual NPSL Product customer behavior and is thus more appropriately tailored to risk (and less arbitrary). As demonstrated above, based upon our data and experience, the average incremental increase in balance prior to default is approximately 1.6 times average historical spending (approximately 0.9 times including recoveries). As such, we believe a multiplier of 1.0-1.6 times average spend over the prior eight quarters minus current spend would be far more appropriate.





Notes:
1. Based on methodology prescribed under Proposal – Avg Balance over prior 8 quarters x 10 less current outstanding.
2. Based on 2013-2022 average principal-only incremental balance between the last month where an account is current and the month when the same account is in default (excluding recoveries) of US Consumer and Small Business charge products. Multiplier = [(Incremental Balance / CCF) + Current Balance] / Current Balance

Figure 7: Comparison of Proposed Proxy Methodology to Amex Experience

If the Proposed Rules are finalized without a change in this area, NPSL Products will receive an arbitrary and substantially disproportionate capital charge that directly conflicts with our data and experience, and that provides no corresponding benefit to credit risk mitigation or safety and soundness more broadly. Penalizing these simple, low risk payment products would also significantly impact their economics and could cause issuers of NPSL Products, such as American Express, to reevaluate the pricing or continued viability of these products. Increasing the cost or limiting the availability of NPSL Products could reduce payment and credit options and credit availability for consumers, businesses, and the economy. Accordingly, we strongly recommend that the Agencies reconsider the Proxy Methodology and CCF for NPSL Products.

d. The CCF should be set at zero for unused portions of unconditionally cancelable commitments to extend credit.

The proposed CCF for credit cards is disproportionate and could have a detrimental effect on the availability of credit. There has historically not been a need for a CCF for the unused portions of unconditionally cancelable credit card lines because credit lines themselves are the more appropriate tool for credit risk management. In practice, the most creditworthy borrowers tend to have the highest available credit lines and lowest relative utilization rates. Under the Proposed Rules, however, banks would effectively be punished for offering higher credit lines to their most creditworthy borrowers, particularly if those borrowers prudently choose not to routinely utilize a significant portion of their available credit. Because an issuer's capital charge would be based on the unused portions of committed credit lines, the issuers may understandably reduce lines where appropriate, including for borrowers who are demonstrably less risky (and thus have higher lines). Any reduction in access to credit lines or lower credit limits could correspondingly increase credit utilization rates for consumers and small businesses, thus potentially leading to lower credit scores. In turn, lower credit scores could adversely affect the ability to access any kind of financing, including mortgages, auto loans, or student loans.

American Express agrees with the Agencies that issuers of credit should be required to hold an appropriate amount of capital to deal with credit risk. However, that capital should be commensurate with the actual risk. If not reconsidered, the unnecessary and excessive capital charges contemplated for unconditionally cancelable commitments could have a detrimental effect on responsible credit risk management and, potentially, the cost and availability of credit.

IV. Credit Risk – On Balance Sheet

We also recommend the Agencies make adjustments to the on-balance sheet portion of the credit risk component of the Proposed Rules. In particular, as the Agencies are aware, the proposed risk weights for residential real estate and regulatory retail credit exposures are significantly higher than those in the Basel Committee's standards. We believe this treatment is not necessary from a safety and soundness perspective, not supported by data in the release materials or in any other agency-released information as of the date of this letter, and not justified by any U.S.-specific considerations.

a. The risk weights for retail credit exposures should match the Basel Committee's standards.

The Agencies should at a minimum return to the risk weights for transactors, revolvers, and other retail exposures assigned in the Basel Committee standards.

The Basel Committee standards provide for risk weights of 45% for exposures to "transactors," 75% for "revolvers," and 100% for other regulatory retail exposures.[25] The Proposed Rules, however, would add 10% to the risk weights for exposures to each category: 55% for transactors, 85% for revolvers, and 110% for other retail exposures.[26]

The Agencies offer cursory and insubstantial justification for departing upwards from the Basel Committee standards in the proposed revised U.S. risk weights for regulatory retail exposures. In fact, the only support for the proposed arbitrary 10% upward departure is the Agencies' purported concern with the "potential competitive effects" between covered banking organizations and smaller banking organizations not subject to the Proposed Rules.[27] With respect to these competitive considerations, the "potential competitive effects" cited appear to be limited to "marginal funding costs,"[28] but it is unclear (i) how the Agencies arrived at this determination, (ii) whether they considered holistically the full financial impact of the Proposed Rules on covered institutions (along with, *e.g.*, the impact of similarly timed proposals applicable to the same cohort of firms such as the new proposal to require certain banking organizations to issue a certain amount of qualifying long-term debt), and (iii) how any data underlying that determination should mathematically support a 10% upward departure from the Basel standards.

Rather than speculating without evidence that, absent the upwards departure, marginal funding costs "could have been" lower for covered banking organizations than smaller banks, the Agencies should recognize that marginal funding costs for covered banking organizations would <u>almost certainly be increased</u> by other aspects of the Proposed Rules, including the new standardized approach for Operational Risk, <u>as well as</u> other existing or proposed prudential regulatory requirements, including liquidity requirements (the Regulation YY liquidity buffer and, for some banking organizations, liquidity coverage ratio and net stable funding ratio requirements), and the recently proposed long-term debt requirements. Although the Agencies acknowledge that under the Proposed Rules, covered banking organizations would be subject to meaningfully higher capital requirements than those that are not subject to the rules,[29] the Agencies seemingly ignore the cumulative impact of their rulemaking agenda on funding costs for covered banking organizations in favor of a generally unsupported preference to increase risk weights.

---

[25] Basel Committee Standards at 17-18.

[26] Proposed Rules at 64052.

[27] *See id.* at 64170.

[28] *Id*.

[29] *Id*.

Although the rationale for the Basel standards arriving at 45% and 75% are themselves somewhat opaque, departing upward another 10% in the United States purely on the basis of an expected (but not demonstrated) "potential" difference in comparative funding costs is arbitrary and insufficiently supported by data.

In addition to being unsupported by data illustrating its need to address U.S.-specific jurisdictional considerations, the Agencies' decision to impose an upward departure on regulatory exposures will also disadvantage U.S. firms like American Express that operate internationally. Relative to their non-U.S. competitors that are not subject to equivalent gold-plating, U.S. firms competing internationally will be required to hold more capital against substantially the same exposures with no corresponding risk mitigation benefit. Thus, rather than effectively addressing any U.S.-specific considerations, these upward departures *create* entirely new "competitive effects" that may distort international competition to the detriment of U.S. firms.

The Agencies certainly have better suited tools than regulatory capital rules to encourage fair competition among banking organizations of <u>all</u> sizes and across international markets. As a matter of sound regulatory policy and international competitiveness, the Agencies should limit upward departures from the Basel standards to those necessary to address specific characteristics of U.S. markets, requirements under U.S. GAAP, practices of U.S. banking organizations, and U.S. legal requirements. Accordingly, we recommend that the Agencies return to the risk weights for retail credit exposures set forth in the Basel Committee's standards.

b. The definition of "transactor" should match the industry's definition.

We recommend the Agencies revise the definition of transactor to refer to an exposure that is 95% paid for the prior six months ("<u>95/6</u>"). As noted above, we appreciate that the Basel standards and the Proposed Rules are intended to improve granularity and risk sensitivity within retail exposures, but we believe that the proposed definition of transactor could be improved so that it more accurately identifies transactor behavior without unnecessarily excluding low credit risk transactors who may not satisfy the strict – and we would suggest unnecessarily conservative and theoretical – standard of 100% for the trailing 12 months ("<u>100/12</u>").

The Proposed Rules define a transactor as "a regulatory retail exposure that is a credit facility where the balance has been repaid in full at each scheduled repayment date for the previous 12 months or an overdraft facility where there has been no drawdown over the previous 12 months."[30] However, for risk management purposes, we understand the industry commonly uses an internal definition of "transactor" to refer to a credit facility where at least 95% of the balance has been paid for the past six months. As shown in Figure 8, below, based upon our internal data, customers who satisfy the 95/6 definition of "transactor" are largely indistinguishable in terms of FICO score from customers that would meet the 100/12 definition of "transactor."

[30] *Id.* at 64187.

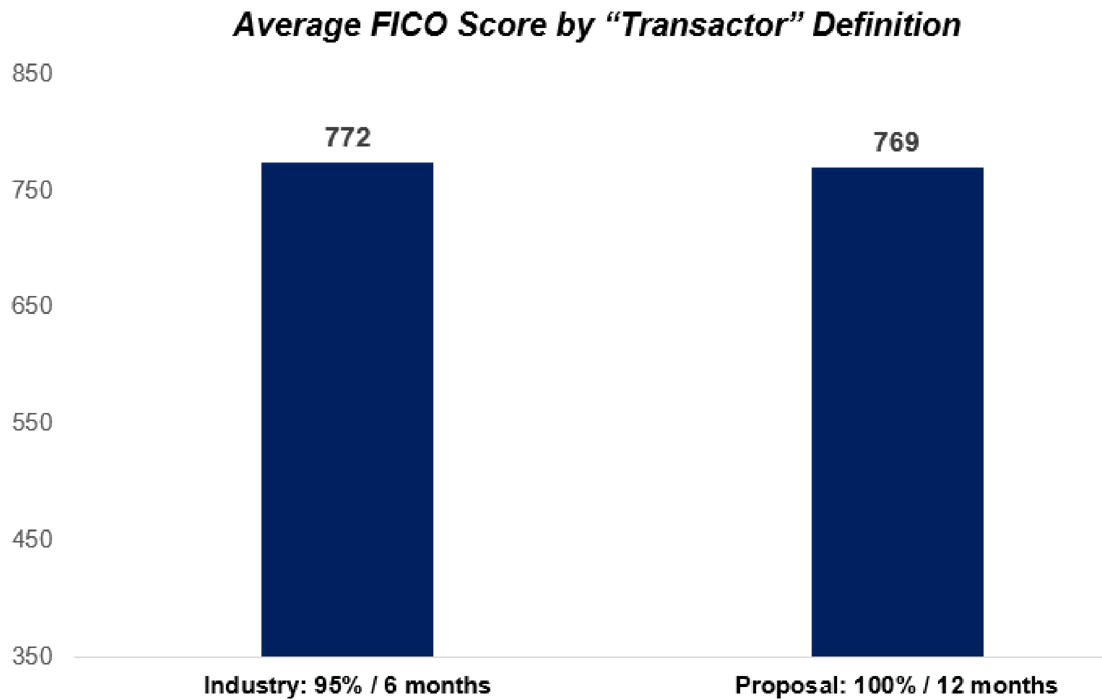


Figure 8: Comparison of Average FICO Score by Transactor Definition

While the customer base is largely indistinguishable, the 95/6 definition provides greater flexibility within the portfolio to accommodate, for example, human errors in submitting payments where the customer otherwise exhibits transactor behavior but periodically carries an immaterial balance or inadvertently submits less than the full payment.

Accordingly, we recommend the Agencies adopt the 95/6 definition of "transactor" in the final rules to allow banking organizations to deploy a commonly used and well-understood definition of transactor without (i) understating credit risk; or (ii) penalizing inadvertent customer errors when paying bills.

V. Market Risk: Make the $5 Billion Threshold Generally Applicable

The Proposed Rules would subject all banking organizations with over $100 billion in total assets to the market risk capital rules. The market risk capital rules are a technically complex and costly to implement set of rules developed for organizations with significant trading and capital markets operations. In recognition of this intent, the scope of the rules was historically limited to organizations with $1 billion in combined trading assets and liabilities, and those whose combined trading assets and liabilities equal 10% or more of total assets.[31] Further, in recognition of the passage of time since the $1 billion threshold was established, the Proposed

[31] 12 C.F.R. § 217.201(b).

Rules would raise the dollar-based threshold to $5 billion in combined trading assets and liabilities. Notwithstanding the updated threshold, the Proposed Rules would contemporaneously introduce the flawed presumption that all banking organizations over $100 billion have significant trading operations warranting application of the market risk capital rules. This is demonstrably incorrect – for example, American Express currently reports less than $10 million, or less than 0.005% of its total assets, in combined trading assets and liabilities.[32]

Requiring firms with de minimis or immaterial trading operations to build systems, establish processes and layers of governance, incur costs, and dedicate resources to implement the market risk capital rules would divert resources from more productive uses, introduce unneeded complexity, and create operational costs and burdens well in excess of any potential risk mitigation benefit. Instead, to help ensure these rules remain appropriately targeted to the trading and capital markets risks they are intended to address, we recommend the Agencies eliminate the general $100 billion total assets threshold (or any blanket size- or Category-based threshold) for application of the market risk capital rules, and instead simply make the $5 billion trading assets and liabilities threshold generally applicable across banking organizations.

VI. Conclusion

We appreciate the work of the Agencies in developing the Proposed Rules and appreciate the opportunity to comment. We respectfully submit that the Agencies should take the discrete steps outlined above to refine and improve the Proposed Rules to ensure that any final rules are substantially more risk-sensitive while still meeting the goals of promoting safety and soundness and enhancing resiliency.

* * *

[32] September 30, 2023, Form FR Y-9C, Schedule HC-D.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Agencies and would be happy to discuss any of them further at your convenience. If we may be of further assistance, please contact me at 212-640-3061 or kerri.s.bernstein@aexp.com.

Sincerely,

Kerri Bernstein
Executive Vice President &
Corporate Treasurer

cc: Christophe Le Caillec
Jeff Campbell
Anderson Lee
Brett Loper
Amy Best Weiss
Juliana O'Reilly
American Express Company