KPMG

Regulatory Alert

Regulatory Insights for Financial Services

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Capital: FRB Remarks Outlining Basel III Endgame Re-Proposal

KPMG Insights:

- ***Timing:*** *Release of the interagency re-proposal is widely expected to be imminent (September 2024); expect a 60-day comment period and an implementation date one year after the effective date of a final rule.*
- ***Detail:*** *The high degree of detail included in the FRB speech may be interpreted as anticipated provisions to be included in the re-proposal release.*
- ***Tailoring and Recalibration:*** *Potential changes may generally provide exemptions from various parts of the rule for Category III and IV banking institutions while additional changes may impact credit risk, operational risk, and market risk.*
- ***Capital Requirement:*** *Potential changes are expected to lower capital requirements from those in the July 2023 proposal.*

In a speech before the Brookings Institution, Federal Reserve Board Vice Chair of Supervision Michael Barr outlines potential changes to the Basel III Endgame and G-SIB Surcharge proposals previously released in July 2023. He states the changes are the result of a joint effort by the FRB, FDIC, and OCC and are both "broad and material".

Although the issuance date for the re-proposal was not provided, in verbal Q&A responses it was stated that the re-proposal would be considered in an open board meeting and would be subject to a sixty (60) day comment period. Implementation would be required one-year after a final rule was released.

As outlined in the speech and highlighted below, key changes that may be part of the re-proposal include:

- Application of the "Tailoring Rule" to the Basel III Endgame rule.
- Impact to all areas of the rule, including credit risk, operational risk, and market risk.

Basel III Endgame

Potential changes would apply the "Tailoring Rule" (based on Category I – IV banking institutions, which reflects the relative risk and complexity, and systemic risk, of large versus smaller banks) to the Basel III Endgame. Based on FRB statements, the re-proposal may include:

1. Tiering:

- Category III firms (those with assets between $250 and $700 billion) exemption from the frameworks for market risk (FRTB) and CVA capital change unless they engage in significant trading activity. Further, the re-proposal may revert to the simpler, current definition of capital (i.e., the numerator in the capital ratio) for these firms with the exception of the requirement to reflect unrealized losses and gains on certain securities and other aspects of accumulated other comprehensive income (AOCI).
- Category IV firms (those with assets between $100 and $250 billion) exemption from the credit risk and operational risk frameworks of the expanded risk-based approach, as well as market Risk (FRTB) and CVA (and presumably SA-CCR) unless they engage in

significant trading activity. For these firms, the re-proposal may also apply the simpler, current definition of capital with the exception of the requirement to reflect unrealized losses and gains on certain securities and other aspects of accumulated other comprehensive income (AOCI).

Additional changes that may be included in the re-proposal would impact all major areas of the rule – credit risk, operational risk, and market risk. Highlights of the potential changes include:

2. Credit Risk:

- Reduce risk weights for residential real estate and retail exposures.
- Extend reduced risk weight for low-risk corporate debt to regulated entities.
- Eliminate the minimum haircut for securities financing transactions.
- Lower the risk weight for tax credit equity financing exposures to reflect their lower inherent risk compared to other equity investments.

3. Operational Risk:

- Require no adjustment to a firm's operational risk charge based on its operational loss history.
- Calculate fee income on a net basis for operational risk capital requirement.
- Reduce operational risk capital requirements for investment management activities.

4. Market Risk and Derivatives:

- Introduce a multiyear implementation period for the profit and loss attribution tests that are used to confirm that models are working as intended.
- Clarify that uniform mortgage-backed securities positions would be treated as having a single obligor, regardless of whether they were issued by Freddie Mac or Fannie Mae.
- Reduce the capital required for the client-facing leg of a client-cleared derivative.

G-SIB Surcharge:

Changes considered for the G-SIB Surcharge include:

- Not adopting the previously proposed changes to capital requirements associated with client clearing.
- Improving the calculation of the capital surcharges for G-SIBs by reflecting changes in the global banking system since adoption of the G-SIB surcharge in 2015, including accounting for effects from inflation and economic growth in the measurement of a G-SIB's systemic risk profile.

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