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The Federal Reserve Finalizes Capital Surcharge for Global Systemically Important Banks

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Today, on the eve of the fifth anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Reserve Board [approved](#) a final rule (“Final Rule”) establishing an additional risk-based capital surcharge that would apply to the eight US global systemically important banks (“G-SIBs”). The Final Rule largely adopts the proposed rule issued in December 2014, and retains its super-equivalence to the framework agreed to by the Basel Committee. Key highlights of the Final Rule and notable changes from the proposed rule are set out below. A more detailed client note will follow.

Key Highlights

- **Applicability.** The Final Rule requires all US-based top-tier bank holding companies (“BHCs”) that are advanced approaches institutions to calculate their systemic importance using the methodology in the Final Rule on an annual basis.
- **What is the Surcharge?** BHCs that meet the “G-SIB threshold” will be required to hold additional common equity Tier 1 capital (the “G-SIB surcharge”) as an increase to the capital conservation buffer under the minimum risk-based capital requirements applicable to BHCs. A failure to meet the G-SIB surcharge will result in limitations on a G-SIB’s ability to make certain capital distributions and discretionary bonus payments.
- **How is the Surcharge Calculated?** The Final Rule sets out a methodology for: (1) the identification of a G-SIB and (2) the calculation of the G-SIB surcharge amount.
 - *The identification of a G-SIB:* In order to determine which BHCs are G-SIBs, 75 of the largest international banking organizations will submit systemic indicator scores in each of five broad categories correlated with systemic risk (size, interconnectedness, cross-jurisdictional activity, substitutability and complexity) and the BHC will calculate its share of the aggregate total amount of the indicator in that category. This

methodology is consistent with the Basel Committee framework and the proposed rule. Like the proposed rule, a BHC with a score of 130 basis points would be a G-SIB.

- *The calculation of the G-SIB surcharge amount:* A G-SIB would be required to calculate its G-SIB surcharge under two methods: Method 1 (using the same five categories described above) and Method 2, which incorporates an indicator for reliance on short-term wholesale funding in lieu of the substitutability category. A G-SIB's surcharge would be the higher of the two amounts determined under the two methods.
- **How Much is the Surcharge?** Each G-SIB would be subject to an initial G-SIB surcharge ranging from between 1.0% and 4.5%, the same range contemplated under the proposed rule, depending on the measure of its systemic importance. In contrast, the largest initial surcharge would be only 2.5% under the Basel Committee framework. The required G-SIB surcharge under Method 2 is expected to be approximately 1.8x larger than under Method 1. Federal Reserve staff explained that the Basel calibration was made at the lower end of a reasonable range, and that other jurisdictions are also gold-plating their capital requirements in relation to standards agreed to by the Basel Committee.
- **Implementation.** The Final Rule requires the G-SIBs to implement the G-SIB surcharge on a gradual basis, with 25% by January 1, 2016, 50% by 2017, 75% by 2018 and full implementation by January 1, 2019.

Notable Changes and Observations

- **Applicability.** Whereas the Final Rule generally applies only to BHCs with over \$250 billion in total assets, under the proposed rule, BHCs with \$50 billion or more in consolidated assets would have calculated their systemic importance. The change relieves approximately 23 US BHCs from having to make this calculation.
- **Denominator of Method 2.** Method 2 under the Final Rule uses a fixed measure in the denominator, rather than an annually updated relative measure, to calculate the surcharge amount. This methodology will allow a firm to change its G-SIB surcharge amount by changing its systemic footprint in relation to the fixed measure, regardless of whether its relative footprint changes. The Final Rule also revises the manner in which aggregate global indicator amounts are converted from euros to US dollars by using a rolling 3-year average instead of a single year-end spot rate.
- **Short-Term Wholesale Funding.** The Final Rule also adjusts several elements of the short-term wholesale funding calculation used in Method 2 in a manner generally favorable to BHCs subject to the G-SIB surcharge.
- **Stress Testing.** Although the Final Rule does not incorporate the G-SIB surcharge into stress testing and the Comprehensive Capital Analysis and Review (CCAR) process, Federal Reserve staff is evaluating this possibility. Recommendations may be released by the end of this year.
- **White Paper.** As an accompaniment to the Final Rule, the Federal Reserve issued a [white paper](#) that provides additional detail on its calculation methodology that supplements the calibration discussion included in the Final Rule.
- **FR Y-15.** The Federal Reserve also extended the comment period on previously proposed revisions to the FR Y-15 report, which would align the definition of short-term wholesale funding with the definition in the Final Rule.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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