Simpson Thacher

Basel III Endgame Evolution

Strategic Implications for Investment Banking, Corporate Treasury and Global Markets

April 9, 2026

On March 19, 2026, the federal banking agencies issued a package of proposed changes to the regulatory capital requirements for banking institutions of all sizes, from the largest GSIBs and super-regional banks to community banks. This package of proposals (the "Proposed Rules") is a second full attempt at implementing the 2017 "Basel III Endgame" international framework—following the agencies' initial package of proposals in July 2023 (the "2023 NPR")—to better reflect credit, trading and operational risk in the calculation of regulatory capital ratios. As summarized in our initial memorandum, the Proposed Rules would mark the culmination of a nearly decade-long effort to complete the fundamental overhaul of bank capital requirements initially spurred by the 2008-2009 financial crisis.

As part of our **series of industry-focused client memoranda**, this alert examines the expected impacts of the re-proposal on market participants within **investment banking, corporate treasury and global markets** businesses.

The proposed recalibration of bank capital requirements would implement a structural shift in the banking agencies' approach towards investment banking, corporate treasury, and global markets, pivoting away from the focus on internal models under the current "advanced approaches" in favor of a granular, more standardized framework. By focusing on individual trading desks as the fundamental units of market risk measurement and introducing an explicit capital charge to capture the creditworthiness of derivative counterparties, these revisions—alongside a modernized GSIB surcharge framework and recalibrated supervisory stress testing models—are expressly intended to ensure capital requirements are less procyclical and better support the role of large banking organizations as essential capital market intermediaries.

The following analysis highlights key aspects of the re-proposal to assist investment bankers, corporate treasurers and trading desks as they navigate the potentially transformative effects of these revised bank capital rules on their business and strategic planning.

Return to Regulatory Tailoring

While the 2023 NPR would have largely collapsed regulatory "tailoring" efforts by applying a one-size-fits-all "expanded risk-based approach" ("ERBA") to every bank with at least $100 billion in assets, the Proposed Rules would restore the threshold for mandatory ERBA compliance to banks in Categories I and II (and, to a modified extent, those with significant trading or derivatives activity), generally consistent with the thresholds for "advanced approaches" and market risk requirements under existing capital rules.[1] Banks of any size would be permitted to opt in to ERBA standards.[2]

With this return to regulatory differentiation, as a general matter banks with under $700 billion in total assets would continue to be subject to simpler calculations of capital and risk-weighted assets under a "Standardized" approach, and be exempt from the new "Market Risk" and "CVA Risk" (as well as "Operational Risk") frameworks under the ERBA. In addition to large banks (≥$700 billion in assets), other "Category II" banks (*i.e.*, those with at least $75 billion in cross-jurisdictional activity, regardless of asset size) would also be subject to the ERBA, including its Market Risk, CVA Risk and Operational Risk frameworks.

Further, the ERBA's Market Risk framework would apply to non-Category I or II banks that have significant trading activity (*i.e.*, aggregate trading assets and liabilities of at least $5 billion over the prior four quarters—increased from the current $1 billion trading activity threshold—or trading assets and liabilities representing at least 10% of the bank's total assets). The CVA Risk framework would apply to non-Category I or II banks that have *both* significant trading activity and at least $1 trillion in gross notional OTC derivative exposure over the prior four quarters.

For ERBA banks that are the primary focus of this memorandum, the proposed amendments are expected to provide regulatory capital relief in the aggregate (with common equity tier 1 capital requirements expected to decline by 2.4%). However, for investment banking, corporate treasury and global markets business lines specifically, the Proposed Rules are expected to increase capital requirements. The common CET1 capital requirements attributable to trading-related activities (including equity and debt capital markets activities as well as sales and trading and investment services) are expected to increase by 9.2%, while the CET1 capital requirements attributable to other banking services (including investment banking advisory and corporate treasury services) are expected to increase by a substantial 33.5% across ERBA banks.

[1] Category III and IV banks would, however, be required to recognize AOCI in regulatory capital, subject to a five-year phase-in period.

[2] The Proposed Rules estimate that several Category III and IV banks, and about one-third of smaller banks, would see significant reductions in capital requirements by opting in to the ERBA standards.

Dealing, Market-Making and Trading Desks

NEW "TRADING DESK" PARADIGM FOR MODELS-BASED MEASUREMENT

The hallmark of the proposed overhaul of the Market Risk regulatory capital framework is a move from bespoke, firm-wide internal modeling standards under the current "advanced approaches" rules to a granular, standardized framework designed to enhance consistency and transparency across the largest banking organizations. Structurally, the proposed Market Risk framework would shift from the current rules' approach of using internal models on an entity-wide basis (at the level of the consolidated banking organization) to using internal models only on a trading desk-by-desk basis.

Under the Proposed Rules, each ERBA bank would be required to define each constituent "trading desk," identifying which trading desks are model-eligible or ineligible, or used for internal risk transfers. The Proposed Rules define a trading desk as a unit of organization within a banking organization that purchases or sells positions covered by the Market Risk framework and that satisfies the following criteria:

- *Unified Business Strategy and Operations*: Structured to implement a well-defined business strategy, and engaged in coordinated trading activity with a unified approach to active risk management;
- *Common Risk Metrics and Limits*: Operates under a common and calibrated set of risk metrics, risk levels, and joint trading limits, and organized to ensure appropriate management of specific trading and hedging limits and strategies; and
- *Reporting and Booking*: Books its trades together and submits compliance reports and other monitoring information as a single unit.

Each trading desk must operate under a clearly defined policy, approved by senior management, that includes the general strategy of the trading desk (including economics, primary activities, and trading and hedging strategies), the risk and position limits established for the trading desk, and the internal controls and governance structure (including regular reports and escalation procedures) established to oversee the activities of the trading desk.

In the new framework, a standardized measurement (described below) serves as the default method for determining trading-related Market Risk capital charges, and the use of internal models of market risk is restricted solely to specific "trading desks" that receive prior supervisory approval. To receive supervisory approval for internal modeling of market risk, a trading desk must demonstrate the appropriateness of its modeling capabilities through rigorous quarterly testing. This supervisory testing consists of two separate standards, designed to measure both the accuracy and conservatism of the trading desk's internal models:

- *Profit and Loss Attribution ("PLA") Test*: Measures the *accuracy* of a trading desk's models by comparing the potential future profits and losses estimated by a trading desk's models to those estimated by the bank's front-office models used to report actual profits and losses for financial reporting purposes. By

comparing these two distinct views of risk, the PLA test identifies the "materiality of the simplifications" within trading-desk models, such as omitted risk factors or differences in valuation techniques. To satisfy the PLA test, the statistical distributions of the profits and losses estimated by the trading desk model and those estimated by the financial reporting model must be within specified bands of proximity.

- *Backtesting Requirements*: Measures the *conservatism* of a trading desk's models by comparing the models' predicted potential daily losses (Value-at-Risk estimates) to actual and hypothetical profits and losses over a rolling 250-day period, ensuring that the models are sufficiently conservative and have sufficient predictive reliability to capture historical tail risks. To satisfy the backtesting requirements, a trading desk model must remain within a prescribed number of "exceptions" (or days on which the actual loss exceeds the predicted Value-at-Risk) at various statistical confidence intervals.

STANDARDIZED MEASURE FOR MODEL-INELIGIBLE TRADING DESKS

Failing either of the PLA test or backtesting requirements would cause a trading desk to be ineligible to use internal models to calculate its Market Risk capital charges. A trading desk that fails backtesting requirements would become model-ineligible immediately upon completion of the agencies' quarterly review of backtesting data and would be required to immediately transition to using standardized calculations to determine its Market Risk capital requirements.

A trading desk that has unsatisfactory PLA testing results could become model-ineligible or, if the PLA test results are deficient but not so material as to be disqualifying, may instead become subject to an intermediate "add-on." Under this add-on requirement, trading desks in the intermediate PLA testing "amber zone" would have a portion of the capital benefit that they otherwise would realize from internally modeled (rather than standardized) Market Risk calculations reversed. The portion of modeling-based capital savings being reversed would generally scale to the portion of the bank's trading desks in the PLA testing "amber zone."

For the first three years following the effective date of the Proposed Rules, a trading desk would not suffer any automatic consequences due to deficient PLA test results. Accordingly, during this three-year transition period, a trading desk would not be subject to any PLA "add-on" for PLA test results in the "amber zone," and would remain eligible to continue using internal models even if its PLA test results were in the normally disqualifying "red zone."

A model-ineligible trading desk (*i.e.*, one that fails backtesting requirements after the Proposed Rules' effective date, or one that enters the PLA test "red zone" after the three-year transition period) would be required to switch from internal modeling to an agency-prescribed standardized calculation of Market Risk capital. The banking agencies noted that the standardized approach to market risk uses conservative calibrations of risk weights and correlations to market risk, likely resulting in higher capital charges for trading desks compared to the bank's internal models.

Once a desk has been disqualified from internal modeling and moved to the standardized Market Risk approach, it can only return to internal modeling if it remediates the internal model deficiencies such that the trading desk successfully passes both backtesting and PLA testing.

SCOPE OF "TRADING BOOK" VS. "BANKING BOOK" BOUNDARY

The boundary between an institution's "trading book" (subject to Market Risk capital requirements) and its "banking book" (subject to Credit Risk capital requirements) is critical for determining capital adequacy because the two capital risk frameworks use fundamentally different exposure measurement methods: the Market Risk framework applies stress-test-like shocks to measure market-based price exposure, while the Credit Risk framework uses standardized risk weights to measure the probability of a counterparty's default. Given these fundamentally different exposure measurement methods, the capital impact of an exposure can vary significantly depending on which risk framework is applied.

Under current capital rules, this boundary between the "trading book" and "banking book" is often ambiguous because it relies heavily on a bank's subjective intent for holding a position—such as short-term resale or price arbitrage—rather than the objective characteristics of the instrument itself. This ambiguity can lead to regulatory arbitrage concerns (*e.g.*, crisis-era instances of banks reclassifying certain instruments from the "trading book" to the "banking book" in response to fair-value reductions following market liquidity shocks).

To demarcate the "trading book" from the "banking book," the Proposed Rules would move away from the current subjective standard toward more objective criteria. While retaining the current rules' coverage of positions held for regular dealing or market-making purposes or for other short-term intent, the Proposed Rules would also add a list of specific instrument types that must be included in the Market Risk "trading book," regardless of whether they are classified as trading assets or liabilities for accounting purposes. This objective list would include foreign exchange and commodity positions (and their hedges); publicly traded equities without tradability restrictions; equity positions in transparent investment funds; net short risk positions of at least $20 million; embedded derivatives; securities underwriting commitments and trading desk segments of certain internal risk transfers.

While a bank's management could decide to re-designate a position from the "trading book" to the "banking book" (or vice versa), that decision would be subject to rigorous governance requirements, supervisory notification and—if the re-designation would result in a lower total capital requirement—a capital "add-on" equal to the difference between the capital requirements under the two risk frameworks. This add-on would thus eliminate any capital benefit from re-designating a position. The banking agencies note that they expect re-designations to be "extremely rare," and any such re-designations would be irrevocable given the limited circumstances under which they would occur.

Securities Underwriting and Capital Raising Services

OPERATIONAL RISK FOR UNDERWRITING AND INVESTMENT BANKING REVENUE

Consistent with the Basel international standards, the Proposed Rules would introduce a standardized Operational Risk capital requirement applicable to banks subject to the ERBA framework. This framework would replace the internal models-based "Advanced Measurement Approach" to Operational Risk (currently applicable to Category I and II banks under "advanced approaches" standards) with a standardized methodology based on the "business indicator," a financial statement proxy for a bank's volume of different component businesses.

While the 2023 NPR included a punitive scalar—the "internal loss multiplier"—that could have increased (but never decreased) Operational Risk capital charges based on a firm's ten-year loss history, the Proposed Rules eliminate this multiplier (effectively setting it to one). Instead, the Proposed Rules incorporate historical losses as a direct (dollar-for-dollar) additive input to the business indicator's noninterest component. As a result, despite removing the 2023 NPR's loss multiplier, the Proposed Rules would still adjust Operational Risk capital requirements upward by the amount of a firm's average operational losses over a three-year period.

The Proposed Rules also recalibrate the measurement of the "business indicator" to mitigate impacts of Operational Risk capital charges on fee-based businesses like securities underwriting, investment banking advisory and corporate treasury services. For example, while the 2023 NPR would have measured services income and expenses on a gross basis without any netting or cap (for purposes of determining the scale of a bank's service-related operational risk), the Proposed Rules measure service-related operational risk using fee income and expenses on a net basis. The Proposed Rules would also simplify the "business indicator" calculation by collapsing the separate business indicator subcomponents from three to two (interest and non-interest components).

The Proposed Rules would also introduce a targeted reduction in Operational Risk capital requirements for certain fee-earning business lines that have been determined to exhibit lower historical loss rates relative to their revenue. In particular, the Proposed Rules would apply a *70% discount* for a bank's net income attributable to certain corporate treasury services (including businesses related to cash management, global payments, and deposit services), among other businesses. However, this discount would not apply to the Operational Risk charges for equity and debt capital markets activities, sales and trading and investment services, merchant banking or investment banking advisory services.

UNDERWRITING INVENTORY

As noted above, securities underwriting commitments are specifically designated as "trading book" positions subject to Market Risk capital requirements. However, this automatic "trading book" designation would not apply to underwritten securities that, upon acquisition, the bank expects to classify as longer-held securities under applicable accounting standards (*i.e.*, as "held-to-maturity" or "available-for-sale"). Instead, these longer-held securities, such as those acquired in "hung" deals or securities intentionally held for long-term investment rather

than immediate resale, would be designated as "banking book" positions subject to the Credit Risk capital framework.

For GSIBs, however, the Proposed Rules would separate the volume of the firm's "underwritten transactions" from its "trading volume" for purposes of calculating the Method 1 GSIB surcharge score and resulting capital add-on. This change would result in a bank's underwriting activities impacting the bank's Method 1 GSIB surcharge score by only half of their current effect. Meanwhile, any separate "trading volume" would be incorporated into the GSIB surcharge score using separate weightings. This change is intended to make the GSIB surcharge score more targeted to the extent of a bank's primary market (underwriting) vs. secondary market (trading) activities.

Derivatives and Securities Financing

COUNTERPARTY CREDIT RISK

Bank capital rules account for two distinct categories of risk that a bank faces when entering into derivatives and certain other types of contracts:

- First, the rules account for "counterparty credit risk"—the risk that a bank's counterparty to the contract *actually* defaults on its obligations prior to the contract's expiration. Transactions that give rise to counterparty credit risk include derivatives, repo-style transactions and eligible margin loans.

- Second, the rules account for the risk of loss to a bank due to valuation changes on derivative contracts resulting from the market's *perception* of a counterparty's creditworthiness, even if no actual default occurs. These valuation changes due to perceived counterparty creditworthiness—"credit valuation adjustments" or "CVA"—reflect the risk that the contract's value will decline as the counterparty becomes more likely to default, and are further discussed below.

A bank's exposure to counterparty credit risk is determined by both the current market value of the transaction and the potential for that value to increase in the future. Current capital rules generally provide three alternatives for determining counterparty credit risk exposures under derivative contracts, repos and margin loans:

- *Less Risk-Sensitive*: For derivative contracts, most non-advanced approaches banks apply the "current exposure methodology," which generally applies broad and imprecise conversion proxies to determine a bank's potential future exposures to a derivative contract based on different underlying asset classes.

  For repos and margin loans, all banks have the option of applying the "simple approach" (essentially a method of substituting counterparty risk weights with the underlying collateral's risk weight).

- *More Risk-Sensitive*: For derivative contracts, Category I and II banks are required to apply the "Standardized Approach for Counterparty Credit Risk" ("SA-CCR"), which generally uses more precise

supervisory factors to determine future exposures on a contract with more granularity, and accounts for other extraneous risks such as interconnectedness or model uncertainty.

For repos and margin loans, banks have the option of applying the "collateral haircut approach" (essentially a method of netting gross exposure amounts against the value of collateral supporting the contract, subject to regulatory "haircuts" to the collateral value's netting benefits that account for potential price volatility and currency mismatches).

- *Internal Models*: For derivative contracts as well as repos and margin loans, Category I and II banks may (with prior supervisory approval) use internal models to estimate expected exposure and determine the exposure at default.

Significantly, the Proposed Rules would eliminate the option for banks to use internal models to determine counterparty credit risk exposure on derivatives, repos and margin loans. While the Proposed Rules would continue permitting ERBA banks to opt between the Simple Approach and Collateral Haircut Approach for repos and margin loans, all ERBA banks would be required to use SA-CCR to determine exposure amounts under their derivative contracts.

The Proposed Rules would, however, for the first time recognize cross-product netting benefits under SA-CCR, allowing non-cleared repo exposures to offset derivative exposures to the same counterparty. The Proposed Rules would also adjust the Collateral Haircut Approach for repos and margin loans to (i) use a more risk-sensitive weighted exposure method, (ii) reward diversification by adjusting a transaction's gross exposure based on the number of unique instruments underlying the transaction, and (iii) recalibrate the balance between simplicity and risk sensitivity of collateral "haircut" amounts by enhancing haircut granularity with respect to residual maturity while streamlining other estimates of market price volatility.

Also, in a significant reversal from the 2023 NPR (which would have tightened capital rules applicable to repos and margin loans by applying mandatory minimum haircut floors to financial collateral exchanged with an "unregulated" financial institution), the Proposed Rules do *not* include minimum haircut floors for collateral backing repos and margin loans with funds and other non-bank financial firms.

NEW STANDARDIZED CVA RISK CAPITAL REQUIREMENT

The second risk category for bank derivative contracts—credit valuation adjustment risk—is currently accounted for as a component of the "advanced approaches" stack of risk-weighted asset calculations. In some cases, CVA Risk calculations under current rules rely on internally modeled "value at risk" simulations of the impact that changes in counterparties' credit spreads have on the CVA. The existing "standardized approach," by contrast, does not include any standalone CVA Risk capital charge. Because the standardized capital "stack" currently "produces the binding risk-based capital requirements for nearly all banking organizations," most banks are not currently subject to a binding standalone CVA Risk capital requirement.

With the elimination of the dual stack "advanced approaches" requirements, the Proposed Rules establish CVA Risk capital requirements as a standalone—and newly binding—component of the ERBA. As noted above, in addition to Category I and II banks, the ERBA's CVA Risk capital framework would apply to any other banks that meet the Market Risk trading activity thresholds and have at least $1 trillion in average aggregate OTC derivative notional exposures. The banking agencies estimate that banks meeting this $1 trillion threshold account for over 98% of all OTC derivative exposures held by U.S. banks as of June 2025.

Similar to current "advanced approaches" rules, the proposed ERBA would provide two distinct methodologies for measuring CVA Risk requirements, although neither would rely on internal modeling:

	Basic CVA Approach	Standardized CVA Approach
Risk Components	Recognizes only the counterparty credit spread component of CVA Risk (*i.e.*, focuses exclusively on the risk of losses arising from changes in a counterparty's perceived creditworthiness, while treating the bank's expected future exposure to the counterparty as static)	Accounts for both credit spread and exposure components of CVA Risk (*e.g.*, risk that fluctuations in interest rates, FX rates or other market factors cause the bank's expected future exposure to a counterparty to rise)
Methodology	Uses a formula based on various simplifying assumptions, such as a flat term structure and normal distribution for credit spreads	Uses a sensitivities-based calculation method, similar to the "market risk" capital framework of applying stress-test-like shocks to measure price exposure, resulting in CVA capital fluctuations based on risk factor sensitivities
Operational Requirements	Simpler to implement; required for firms using the "current exposure methodology" for derivative counterparty credit risk	Requires prior supervisory approval and a dedicated CVA Risk management desk
Hedge Recognition	Only recognizes hedges that specifically mitigate "credit spread" risk, such as single-name and index credit default swaps, and does not recognize hedges against the "future exposure" component (*e.g.*, interest rate swaps or FX forwards)	Recognizes a broader set of hedging instruments, including those that mitigate the "future exposure" component of CVA Risk (*e.g.*, interest rate or FX hedges)
Hedge Effectiveness	Limits hedge effectiveness by applying a 25% haircut on hedges (*i.e.*, as a proxy for the market-driven exposure risks not explicitly incorporated in the Basic Approach)	Recognition of hedges is generally broader, subject to small hedging disallowance in certain instances

The agencies project that CVA capital requirements would increase substantially under the Proposed Rules—by approximately 96%—due to CVA Risk becoming a binding capital requirement in the "single stack" approach for ERBA banks, although CVA Risk would continue to represent a small share of total risk-based capital requirements, on average, compared with Credit Risk and Operational Risk.

CLIENT-FACING LEGS OF CLEARED DERIVATIVES

Financial regulators have frequently highlighted various policy benefits of central clearing for derivatives, including reduced contagion risk, settlement benefits through increased multilateral netting, enhanced transparency and regulatory visibility compared to complex bilateral trades, and robust risk-management practices required of central clearinghouses.

Since the initial implementation of Basel III reforms more than a decade ago, the banking agencies have sought to promote these policy benefits of central clearing through bank capital incentives. Most notably, existing capital rules allow for low risk weights and an exemption from CVA Risk capital requirements for derivative transactions that *directly face* a central clearinghouse, such as when the bank enters into a clearinghouse-accepted derivative transaction for its own account.

In addition, bank capital rules generally provide some incentive for banks to help clients gain access to central clearing (even where the clients themselves are not clearinghouse members) by serving as a financial intermediary on client derivative transactions. For example, where a bank enters a derivative transaction with a client, it may enter an offsetting back-to-back trade facing a central counterparty, structurally linking the client's derivative to the central counterparty and allowing the client to benefit from some of the trading efficiencies of a centrally cleared transaction. Under existing capital rules, the *clearinghouse-facing half* of this back-to-back trade is entitled to the same low risk weights and CVA Risk capital exemption applicable to centrally cleared transactions that the bank enters for its own account.

However, current capital rules do *not* provide these same benefits for the *client-facing half* of this back-to-back trade (or, alternatively, where a bank provides a guarantee of its client's performance to the clearinghouse, allowing the client to enter a derivative directly facing the clearinghouse as principal). These portions of bank-intermediated derivative transactions with a central counterparty—referred to as "*client-facing legs of centrally cleared transactions*"—are currently subject to CVA Risk capital requirements under "advanced approaches" rules and, under the 2023 NPR, would have been subject to the CVA Risk capital framework for applicable banks. The additional capital charges for these client-facing legs of centrally cleared transactions resulting from the 2023 NPR's newly binding CVA Risk requirements would have possibly disincentivized banks from helping clients gain access to the benefits of central clearing through these intermediated transaction structures.

To "minimize potential unintended consequences for client clearing activities," the Proposed Rules exclude both *clearinghouse-facing legs* and *client-facing legs* of centrally cleared transactions from CVA Risk capital requirements. The banking agencies note that client-facing legs of centrally cleared transactions generally present low CVA risk, due to being highly collateralized and subject to netting, daily margin requirements, immediate close-out and significant regulatory oversight. In addition, because banks generally do not calculate CVA for client-facing legs of centrally cleared transactions under applicable accounting rules, these exclusions would more closely align the scope of instruments subject to CVA capital requirements with those subject to CVA financial reporting. The banking agencies project that the proposal's CVA Risk capital exemption for client-facing legs of centrally cleared transactions would reduce total CVA risk-weighted assets by ~9% compared to the 2023 NPR.

COMMERCIAL END-USER TRANSACTIONS

While the Proposed Rules would provide capital relief for client derivative trades involving central counterparties, the agencies stop short of accommodating public calls to provide a broad CVA capital exemption for *all* derivative

transactions—whether involving central counterparties or purely bilateral—with "commercial end-users."[3] Rather, while commercial end-user derivatives benefit from somewhat lower counterparty credit risk charges under SA-CCR calculations, ERBA banks would face additional capital charges on bilateral trades with commercial end-users under the newly binding CVA Risk capital requirement. These new bank capital charges could negatively impact the availability and affordability of hedges and other derivatives for commercial end-users and, according to several public comments to the 2023 NPR, could increase financial stability risk by disincentivizing "main street" companies from hedging commercial risk.

Corporate Treasury and GSIB Management

GSIB SURCHARGE "CLIFF EFFECTS" AND VOLATILITY

Under the existing GSIB surcharge framework, banks report most systemic risk indicators as a point-in-time value as of December 31 each year. This snapshot approach fails to capture fluctuations throughout the year (*e.g.*, due to seasonality effects) and introduces possible "window dressing" incentives to manage year-end exposure values in a manner that may not fully reflect the firm's systemic risk profile on other days of the year. Furthermore, current surcharges increase in 50-basis-point increments for every 100-point increase in a firm's GSIB score, creating significant "cliff effects" where a single-point systemic score increase into a new surcharge band could trigger a large jump in required capital.

The Proposed Rules seek to address both of these GSIB scoring shortcomings. First, the Proposed Rules would replace year-end indicator snapshots for GSIBs, requiring instead that GSIBs report certain indicators as averages of daily or monthly values over a full calendar year.[4] Second, the Proposed Rules would mitigate "cliff effects" by replacing the Method 2 score's 100-point score bands with narrower 20-point score bands, with progression into each higher score band resulting in a 10 (rather than 50) basis point increase to the firm's capital surcharge.[5]

These changes, along with other changes to the GSIB scoring methodology (including as described below), are projected to reduce GSIB surcharges by 40 basis points, on average, and reduce the dollar amount of GSIB surcharge capital requirements by 10% (~$23 billion in aggregate).

[3] "Commercial end users" are generally defined as companies that are not "financial entities" as defined under federal commodities and securities laws, and that use derivatives specifically to hedge or mitigate commercial risks inherent to their business operations, rather than for other uses such as locking in arbitrage profits or betting on price movements

[4] The proposed changes to require reporting of average data would apply only to GSIBs, and not to non-GSIB banks that are nevertheless required to report GSIB surcharge indicator data on Form FR Y-15 (*i.e.*, banks in Categories II, III or IV, which would generally continue to report their systemic indicators based on point-in-time measurements).

[5] The Proposed Rules would not amend the Method 1 surcharge bands, which would continue to increase in 50 basis point increments for every 100-basis point increase in a firm's Method 1 score, primarily to promote international consistency with the Basel standards.

SHORT-TERM WHOLESALE FUNDING

Under current GSIB surcharge score calculation rules, the degree of a firm's reliance on short-term wholesale funding (which regulators view as presenting potentially heightened funding stability risks) can increase a firm's "Method 2" GSIB surcharge score, which is currently the binding surcharge score for all eight GSIBs. The Method 2 surcharge scoring methodology—and the inclusion of short-term wholesale funding as a distinct risk indicator—is specific to the U.S. implementation of GSIB capital requirements, and is not a component of the Basel international capital standards.

Heightened reliance on short-term wholesale funding generally results in a heightened "Method 2" surcharge score for a given bank. However, current rules incorporate wholesale funding reliance as a ratio to the bank's total risk-weighted assets, such that the "Method 2" wholesale funding indicator score decreases as bank size increases, even with unchanged wholesale funding levels. The banking agencies have also noted that wholesale funding was originally intended to receive an approximately equal weighting (~20%) as the other systemic indicators in determining a GSIB's "Method 2" score, but in practice the aggregate share of the short-term wholesale funding indicator has been around 30% of "Method 2" scores over the last decade.

The Proposed Rules would recalibrate the measurement and weighting of a bank's reliance on short-term wholesale funding within the GSIB surcharge framework, moving away from a ratio-based measurement relative to risk-weighted assets to instead use an absolute figure of funding volume, and applying a fixed coefficient designed to reduce the "wholesale funding" portion of Method 2 scores back down to the initial 20% target.

STRESS TESTING INTERPLAY

The Proposed Rules are intended to integrate closely with the Federal Reserve's stress testing and "Stress Capital Buffer" framework to ensure a coherent capital regime that avoids the double counting of risks. Separately proposed amendments to the Federal Reserve's stress testing procedures would revise stress test modeling of operational risk and trading positions to reduce overlap with the updated capital requirements under the Proposed Rules (*e.g.*, by improving the measurement of trading position liquidity horizons under the stress testing "Global Market Shock" component).

While certain aspects of the Proposed Rules are projected to increase particular capital requirements of ERBA banks, the banking agencies project that the cumulative impact of the Proposed Rules (including both the ERBA capital changes and the GSIB surcharge changes) as well as the separately proposed stress testing changes would generally be to provide capital relief to ERBA banks on an aggregate basis.

For example, while Operational Risk requirements are projected to increase under the Proposed Rules, the separately proposed stress test changes would "meaningfully reduce the operational risk requirements embedded in the stress capital buffer requirement" and, considering both the Proposed Rules and stress test changes together, the banking agencies expect that banks' overall Operational Risk capital requirements would be

"substantially lower" than those that currently result from banks' internal models under "advanced approaches" standards. Similarly, while the Proposed Rules (on a stand-alone basis) are projected to increase risk-weighted assets under the Market Risk framework by 20%, the cumulative Market Risk capital requirements (including stress testing expectations) are projected to decline by approximately 5.8%. This cumulative decline results from the increase in Market risk-weighted assets under the Proposed Rules being more than offset by the proposed changes to the stress test's "Global Market Shock" component.

Overall, the projected 2.4% reduction in aggregate CET1 requirements resulting from the Proposed Rules (including both the ERBA capital changes and the GSIB surcharge changes) would double to a projected 4.8% reduction in aggregate CET1 requirements when considered in combination with the proposed stress testing changes.

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