BETTER MARKETS

June 21, 2022

To: The Honorable Jerome H. Powell
Chair

Michael Gibson
Director, Division of Supervision and Regulation

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: The Federal Reserve's involvement in the decision by the Basel Committee on Banking Supervision to lower capital requirements for global systemically important banks in the European Banking Union

Dear Chairman Powell and Director Gibson,

At a perilous time of multiple, unprecedented shocks rocking the global economy and financial systems that are threatening the livelihoods and living standards of all Americans, we are writing to express our deep concerns regarding the Federal Reserve's ("Fed") role in ***lowering capital requirements*** **at certain European too-big-to-fail banks** ("TBTF")[1] (also known euphemistically as "global systemically important banks" or "GSIBs"). As you know, the only thing standing between a failing bank and yet more taxpayer backed bailouts is the quantity and quality of a bank's capital cushion. Once capital is depleted, a TBTF GSIB either goes bankrupt like Lehman Brothers (precipitating a global financial catastrophe) or is bailed out by taxpayers like the other TBTF GSIBs in the US were in 2008 (precipitating political, financial, economic, and social turmoil).

The Fed's involvement in the modification to the calculation of the GSIB capital surcharge for TBTF GSIBs within the so-called European Banking Union ("EBU") that was announced on May 31, 2022 by the Basel Committee on Banking Supervision ("BCBS")[2] is unclear other than it is a member of the BCBS. What is clear, however, is that the modification will directly lower capital requirements for Europe's largest and most complex TBTF GSIBs. That alone would be troubling, but it is made substantially worse given that such an important action was implemented without support or justification clearly establishing that the EBU (at least in material part) is a robust banking union in fact, as is required. Most alarmingly, the modification was made without consultation of the public, which is one of the key principles within the charter of the BCBS. Thus, not only does this action appear to lack a

[1] As you know, TBTF is a misnomer because these banks are not just too big, but are also too complex, too interconnected, too leveraged, and too opaque, which, combined, make them individually and collectively a threat to the financial system and the economy.

[2] Basel Committee on Banking Supervision press release, "Basel Committee finalises principles on climate-related financial risks, progresses work on specifying cryptoassets' prudential treatment and agrees on way forward for the G-SIB assessment methodology review," May 31, 2022, https://www.bis.org/press/p220531.htm.

valid basis, but it also appears that the BCBS did this in secret presumably hoping the public would not notice.

The American people deserve to know the details of the Fed's involvement in those decisions and actions and what, if any, analysis was done regarding the implications arising from or related to the BCBS's decision to lower capital requirements at TBTF GSIBs.

As you know, the Fed is a member of the BCBS along with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). However, given that the Fed has supervision and regulation authority for bank holding companies in the U.S. – which includes the holding companies of the U.S. GSIBs – and is responsible for executing monetary policy and maintaining financial stability, the Fed is the most prominent and influential member of the BCBS among U.S. financial regulators. In its representation on the BCBS, the American public expects the Fed to uphold the same principles of protecting the public and ensuring accountability that are expected here in the U.S. That is all the more true where those principles are the same as one of the key principles in the BCBS charter. However, those expectations and requirements appear not to have been met here, and the Fed needs to explain why and how that happened.

The BSBS's modification to the GSIB assessment methodology that was finalized allows for 66% of cross-border exposures within the EBU to be considered as domestic exposures rather than as foreign exposures. This has the effect of reducing the so-called GSIB score, which is based on five factors. In particular, it would reduce the score computed for the factor of cross-jurisdictional exposures for TBTF GSIBs based in the EBU that have cross-border exposures to other countries within the EBU.

Critically, this modification by the BCBS would reduce not only the GSIB capital surcharge but also ***reduce the capital requirement*** **imposed by their enhanced supplementary leverage ratios ("eSLR")**, which is an additional leverage-based capital requirement specifically for GSIBs that in Europe (and proposed but not finalized in the U.S.[3]) has been set to be half of the GSIB capital surcharge. The updated consideration for intra-EBU exposures most directly affects BNP Paribas, whose most recent cross-jurisdictional score is the second highest of all GSIBs, but also likely would affect Santander and Deutsche Bank.[4] For the many obvious and well-known reasons, capital requirements for these banks should not be reduced and, if capital was ever reduced, it simply cannot be done without robust, independent support and justification as well as consultation of the public.

It is inexplicable that there was no support or justification provided in the BCBS press release or anywhere else publicly as to why it is the case that the EBU can now be treated, at least in material part, as a true banking union. There have been no notable recent advancements to the structure of the EBU that would change its status from an aspiration to a reality. For example, there is still no unified deposit insurance program for the EBU, a critical and essential component to any banking union.

Since the aftermath of the 2008 Global Financial Crisis, when discussions were occurring to establish an EBU, deposit insurance was considered one of the four major components, as noted by then-IMF Managing Director Christine Lagarde who called for "[1] unified supervision, [2] a single bank

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[3] 83 FR 17317

[4] The most recent GSIB scores by bank and factor are available at https://www.bis.org/bcbs/gsib/.

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resolution authority with [3] a common backstop, and [4] a single deposit insurance fund."[5] Unified supervision and a single resolution authority have been established through the Single Supervisory Mechanism and the Single Resolution Fund respectively, but as noted a unified deposit insurance program is still missing. Also, the parliaments of member countries have not approved yet the amendments to the treaty of the European Stability Mechanism,[6] amendments which would provide a mandate for the European Stability Mechanism to serve as the common backstop to the Single Resolution Fund, another component considered necessary by Lagarde and others. In fact, the absence of those two components was cited back in a 2018 report by the International Monetary Fund as being a major factor in their conclusion that "work remains to complete and unify the [European Banking Union] regime."[7]

Importantly, the updated consideration of intra-EBU exposures in the GSIB capital surcharge calculation was finalized without public consultation, even though that is supposed to be a key operating principle of the BCBS. Section 8 of the BCBS charter states:

> "In principle, the BCBS seeks input from all relevant stakeholders on policy proposals. ***The consultation process will include issuing a public invitation to interested parties to provide comments in writing to the Secretariat on policy proposals issued by the Committee, within a specified timeframe***."[8]

This principle was ignored. That is indefensible.

It appears telling that the BCBS, in July 2021, did seek public consultation on a technical amendment to the process to review the GSIB assessment methodology,[9] but notably not the methodology itself. It also subsequently issued a press release in November 2021 finalizing its proposed amendment to the process (on which it sought consultation),[10] and in that release the BCBS merely cryptically noted that "the Committee will review the implications of developments related to the European Banking Union for the G-SIB methodology…[including] a targeted review of the treatment of cross-border exposures within the Banking Union on the G-SIB methodology." However, the release did not explicitly or clearly indicate what the BCBS was considering doing, and it did not include an associated public consultation as required by the BCBS charter. The BCBS merely subsequently issued

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[5] Christine Lagarde, "IMF/CFP Policy Roundtable on the Future of Financial Regulation: Opening Remarks by Christine Lagarde," April 17, 2012, International Monetary Fund, https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp041712.
[6] For more information regarding the reform to the European Stability Mechanism including its status, see the European Stability Mechanism's site dedicated to the reform, available at https://www.esm.europa.eu/about-esm/esm-reform.
[7] International Monetary Fund, "IMF Country Report No. 18/232," July 2018, https://www.imf.org/en/Publications/CR/Issues/2018/07/19/Euro-Area-Policies-Financial-Sector-Assessment-Program-Technical-Note-Bank-Resolution-and-46106.
[8] Basel Committee on Banking Supervision, "Basel Committee Charter," updated June 5, 2018, https://www.bis.org/bcbs/charter.htm (emphasis added).
[9] Basel Committee on Banking Supervision consultative document, "Technical Amendment: GSIB assessment methodology review process," July 2021, https://www.bis.org/bcbs/publ/d522.pdf.
[10] Basel Committee on Banking Supervision press release, "Basel Committee advances work on addressing climate-related financial risks, specifying cryptoassets prudential treatment and reviewing G-SIB assessment methodology," November 9, 2021, https://www.bis.org/press/p211109.htm.

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the press release noted above containing the finalization of the modification to the GSIB capital surcharge calculation without any notice or consultation.[11]

Neither the content of the BCBS's discussions regarding the modification to the GSIB surcharge nor the votes of the members have been made public. It is therefore impossible to determine the Fed's input, analysis, or position on this matter. However, if the Fed opposed the modification, it has made no statement against the lowering of capital requirements for EBU GSIBs or against the BCBS doing so without supporting evidence or public consultation. This leaves the public to conclude that the Fed, as an influential if not often decisive member of the BCBS, was in support of the actions taken. There is no doubt that now the U.S. TBTF GSIBs will use this action as an argument to push for the lowering of their GSIB-related capital requirements – indeed, the Financial Services Forum has already begun this process.[12] Given the importance of capital to the stability of the U.S. and global financial systems, there must be a full public accounting of the Fed's actions and decisions.

The American public deserves to know how the Fed considered this issue, and therefore we urge the Fed to release promptly a detailed statement disclosing the rationale around either its support for or opposition to the modification and the process that led to it. If the Fed supported the action, the rationale must include detailed support for why it believes cross-border exposures within the EBU should be considered as domestic exposures, at least in part, why it did not feel public consultation was necessary in this case, and whether the Fed intends to conduct a review of GSIB-related capital requirements for U.S. TBTF GSIBs that may result in a lowering of their capital requirements.

We appreciation your attention to this issue and look forward to your prompt response.

Sincerely,

Dennis M Kelleher

Dennis M. Kelleher
President and CEO

PGB

Phillip G. Basil
Director of Banking Policy

Cc:
Dr. Lael Brainard
Vice Chair, Board of Governors of the Federal Reserve System

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[11] *See*, *supra*, n. 2.

[12] *See* Sean Campbell, "The Unlevel Playing Field Gets Even Steeper: Changes to the GSIB Surcharge for European Banks and Implications for the United States," June 9, 2022, Financial Services Forum, https://fsforum.com/news/the-unlevel-playing-field-gets-even-steeper-changes-to-the-gsib-surcharge-for-european-banks-and-implications-for-the-united-states.

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