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Federal Banking Agencies Issue Proposed Rulemaking To Amend eSLR

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This week, the Federal Reserve Board ("FRB") and the Office of the Comptroller of the Currency ("OCC") issued a **notice of proposed rulemaking ("NPR")** to amend the Enhanced Supplementary Leverage Ratio ("eSLR"). At the time of this writing, the Federal Deposit Insurance Corporation ("FDIC") (together with the FRB and OCC, the "Agencies") was scheduled to meet on the issue on June 26 and is expected to also issue the NPR.

The eSLR applies to the eight U.S. global systemically important bank holding companies ("GSIBs"). As currently applicable, the eSLR requires the eight U.S. GSIBs to add an additional 200 basis points to the 3% supplementary leverage ratio, which is applicable to all banks and bank holding companies with $250 billion or more in assets. Thus, the current eSLR requirement is 5%. The NPR would adjust how the eSLR is calibrated for the GSIBs, tying the eSLR calibration to the GSIB surcharge. The GSIB surcharge requires the GSIBs to calculate the surcharge using two methods (Method 1 or Method 2), and use the higher number as the surcharge number. For most institutions, the Method 2 calculation is the higher score. Both GSIB surcharge methods look to an institutions size, interconnectedness, complexity, and cross-jurisdictional activity. The Method 1 approach (which is generally consistent with the **Basel Committee's** approach to SLR) looks at an institution's substitutability, while Method 2 replaces substitutability for average daily values of short-term wholesale funding.

The NPR proposes to use the generally lower Method 1 score and divide that score in half to produce the eSLR for each institutions. In the peramble to the NPR, the Agencies noted that this change would result in a reduction of aggregate tier 1 capital requirements for GSIB holding companies by 1.4% or $13 billion, but a $210 billion aggregate reduction at the subsidiary depository institutions level. The Agencies, noted however, that the capital at the depository institution level would generally need to be retained within the holding company structure to meet holding company capital requirements.

As we noted in our **last issue**, FRB Vice Chair of Supervision Michelle Bowman cited changes to the eSLR as the likely first change to the capital framework because it was too often becoming the binding constraint on institutions rather than the intended backstop to risk-based capital measures. Vice Chair Bowman, and the NPR preamble noted that by having a leverage ratio act as the binding constraint, they believe it was leading to disruptions in the Treasuries markets. The preamble notes that the Agencies believe this proposed change will provide more liquidity to the Treasuries market and other low-risk asset classes.

The approach in the NPR is somewhat different then the temporary approach the Agencies took in 2020, when the pandemic disrupted markets. At that time, the Agencies removed Treasury securities and reserves held at Federal Reserve Banks from the denominator of the calculation. Although the Agencies ask for comment on that approach, they note in the preamble that they are approaching the change in the numerator so as not to pick winners and losers in terms of asset classes. The NPR also would make corresponding changes to the Total Loss-absorbing capacity and long-term debt requirements.

The FRB did have two dissenting votes on the proposal. Governors **Michael Barr** and **Adriana Kugler** both voted no on the NPR noting that the reductions in capital levels were more than they were comfortable with and that the changes should be part of a more holistic approach to changes to the capital framework that also included Basel III Endgame adjustments.

Comments on the proposal will be accepted for 60 days following publication in the Federal Register.