ISDA Safe, Efficient Markets

ISDA Submits Responses to US Basel III and G-SIB Surcharge Consultations

NEW YORK, January 16, 2024 – The International Swaps and Derivatives Association Inc. (ISDA) has submitted a response with the Securities Industry and Financial Markets Association (SIFMA) on the US Basel III 'endgame' notice of proposed rulemaking (NPR), warning that the resulting increases in capital for bank trading activities do not reflect underlying risks and could impact the liquidity and vibrancy of US capital markets, increasing costs and reducing choice for US businesses.

Based on an industry quantitative impact study (QIS) with input from eight US global systemically important banks (G-SIBs), the introduction of the Fundamental Review of the Trading Book (FRTB) and the revised credit valuation adjustment (CVA) framework would result in a 129% increase in market risk and CVA risk-weighted assets (RWAs) under the new expanded risk-based approach (ERBA) versus the current US standardized approach.

An increase of this magnitude would constrain bank balance sheets, forcing banks to scale back or withdraw from certain activities and businesses that become uneconomic, the associations state. This will impact the availability and cost of financing, hedging and intermediary services, as well as lead to less liquid and vibrant capital markets, negatively affecting US businesses and households and weighing on US economic growth.

The response proposes a number of calibration changes to ensure the rules are appropriate and risk sensitive and avoid adverse consequences to US capital markets. More specifically, the response makes the following recommendations:

- **A comprehensive evaluation of how the proposal would interact with other prudential requirements, particularly the stress testing framework and the G-SIB surcharge (and related calibration), is needed.**
- **The proposal would have a negative effect on the liquidity and vibrancy of capital markets.** In response, US agencies should make certain critical revisions detailed in the letter to improve the recognition of diversification when calculating market risk RWAs under the ERBA to reflect actual risk exposure and effective risk management practices.
- **The proposal would increase capital requirements for markets where that outcome would not be aligned with underlying risks.** The agencies should mitigate adverse effects by making key changes set out in the letter for market risk and CVA RWAs under the proposal.

-More-

- **The proposal would adversely affect derivatives end users, including commercial end users, corporate and banking organizations, resulting in negative effects on investors.** To avoid these significant impacts to derivative end users, as well as knock-on consequences to consumers, the agencies should enhance the risk sensitivity of the capital framework in the proposal.
- **Aspects of the proposal would result in excessive volatility or material increases in capital in a manner that is not aligned with the risks and would disincentivize banking organizations from adopting the FRTB internal models approach.** In response, US agencies should make key revisions to the proposal's market risk framework, as detailed in the letter.

If material changes to the calibration cannot be achieved without further consultation, a re-proposal of the rules may be necessary, ISDA says. To ensure banking organizations have sufficient time to implement the requirements, the response recommends the rules should become effective no earlier than 18 months from the publication of the final rule.

ISDA and SIFMA also submitted a response to a separate consultation by the US Federal Reserve on proposed changes to the G-SIB surcharge.

The response raises concerns that the revised G-SIB surcharge would lead to inappropriately high capital requirements for banks offering client clearing services, potentially discouraging them from participating in this business and contravening a long-standing policy objective to promote central clearing.

Specifically, the response argues that client derivatives transactions cleared under the agency model should not be included in the complexity and interconnectedness categories of the G-SIB surcharge calculation. Failure to make this change would raise capital requirements across six G-SIBs that contributed to a QIS by $5.2 billion.

The response also recommends:

- The standardized approach for counterparty credit risk alpha factor should not be included in the interconnectedness indicator calculations.
- Cross-jurisdictional activity indicators should not include derivatives exposures. At a minimum, derivatives exposures should be net of cash and non-cash collateral in the cross-jurisdictional activity indicators.

The Basel III NPR response is available here.

The G-SIB surcharge consultation response is available here.

-More-

For Press Queries, Please Contact:
Nick Sawyer, ISDA London, +44 20 3808 9740, nsawyer@isda.org
Lauren (Dobbs) Springer, ISDA New York, +44 212 901 6019, ldobbs@isda.org
Joel Clark, ISDA London, +44 20 3808 9760, jclark@isda.org
Christopher Faimali, ISDA London, +44 20 3808 9736, cfaimali@isda.org
Nikki Lu, ISDA Hong Kong, +852 2200 5901, nlu@isda.org

About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on X, LinkedIn and YouTube.