Regulatory brief

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Basel & prudential standards: US moving faster than world

Overview

US regulators are eager to complete rulemakings implementing Basel III and Dodd-Frank's Enhanced Prudential Standards. This desire is compounded by public and congressional criticism of the delay in establishing a post-crisis supervisory framework – criticism that has been getting louder every year since Dodd-Frank's passage.

The evolving urgency is best illustrated by the recent public statements of Treasury Secretary Jack Lew. Just before the summer, he stated that it was too early to judge Dodd-Frank's efficacy at curbing "Too Big To Fail" (TBTF) because many of Dodd-Frank's rules were not yet finalized. However, last month he indicated that time may be running short by suggesting that additional rules would be in the offing if TBTF is not addressed by year-end.

In our view, regulators are driven to finalize at least two sets of rules this year, namely:

- Dodd-Frank's Enhanced Prudential Standards for large domestic and foreign banks
- A heightened Supplementary Leverage Ratio (SLR),[1] applicable to global systemically important banks (G-SIBs) – i.e., those with over $800 billion in assets

Furthermore, US regulators will propose four other rules this fall, which we believe will be fast tracked for finalization in early 2014. These are:

- Basel's Liquidity Coverage Ratio
- Basel's capital buffer for G-SIBs
- Bail-in debt and equity capital requirements for G-SIBs, to facilitate an orderly resolution
- Capital charges for firms which are heavily reliant on wholesale funding

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[1] This rule was proposed in July and went beyond the implementation of Basel III's quantitative capital and liquidity standards that US regulators had just finalized the prior week. For more information, see PwC's *Financial Services Regulatory Briefs* entitled *Heightened Leverage Ratio: US regulators unveil next act for regulating large banks – a long way until the end* (July 2013) and *Basel III capital rules finalized by Federal Reserve: But much more to come for the big banks* (July 2013).

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While some of this upcoming regulation is currently only applicable to the US's eight G-SIBs, we believe that the heightened SLR and bail-in debt proposals may be broadened to include those firms which are subject to the Advanced Approaches under Basel – i.e., those with greater than $250 billion in assets.

A key uncertainty is whether the rest of the world will follow the US where the US is going further than the coordinated approach of Basel (e.g., the heightened SLR, debt bail-in, and wholesale funding proposals). Regarding the heightened SLR in particular, the US regulators indicated they would sacrifice "coordinated efforts" and a "level playing field" for "more robust" approaches, even if that means going it alone. US regulators did not believe Basel's SLR went far enough, and they expressed concern that Basel views the SLR as a "backstop" to risk-based capital ratios (rather than as an equally important form of prudential capital requirements).

Our **Financial Services Regulatory Brief** issued in June predicted that the second half of 2013 would be busy with a host of key rulemakings related to prudential standards.[2] That viewpoint has been confirmed. Our updated perspective of the US regulatory timeline for the remaining proposals is contained in this **Financial Services Regulatory Brief**, along with our view as to whether other countries will follow suit.

[2] See PwC's *Financial Services Regulatory Brief: US regulatory outlook: second half of 2013 – Final enhanced prudential standards and Basel III rules* (June 2013).

Prudential regulation timeline

The following chart conveys the prudential regulations that are expected to be proposed (NPR) or finalized (FR) in 2013 and 2014.

	Prudential regulation	NPR released	2013 expected action	2014 expected action
Enhanced Prudential Standards *(under Dodd-Frank sections 165 & 166)*	US firms	**2011**	**FR**	
	Foreign firms (including establishing intermediate holding companies)	**2012**	**FR**	
	Single counterparty credit limits	**2011**		**FR**
Prudential enhancements *(announced July 2013)*	Heightened SLR	**2013**	**FR**	
	Debt bail-in		**NPR**	**FR**
	Wholesale funding		**ANPR**	**NPR**
Basel III implementation	Liquidity Coverage Ratio		**NPR**	**FR**
	Capital buffer for G-SIBs		**NPR**	**FR**
	Net Stable Funding Ratio			**NPR**

Will Basel follow the US?

With many US prudential rulemakings expected, an important question is whether the rest of the world will be willing to adopt similar standards. With respect to the heightened SLR, the answer is likely to be no. The push for a global 4% standard leverage ratio[3] and a heightened SLR has been driven by the US, and Basel does not seem inclined to go beyond minimum standards.

Furthermore, the data coming out of EU banks shows that these institutions would have more trouble meeting the heightened SLR than US banks – in fact, many EU banks are still working to reach the 3% baseline SLR proposed by Basel. Meanwhile, US regulators have effectively readied US banks for the heightened SLR through stress testing and modification of banks' capital plans.

[3] The SLR differs from the standard 4% leverage ratio by capturing derivatives and other off-balance exposures (i.e., the denominator of the SLR is larger than that of the standard leverage ratio). The *heightened* SLR proposal in the US adds a 2% buffer on top of the baseline SLR for the eight US G-SIBs.

Importantly, however, Basel's SLR proposal uses a more conservative treatment of securities financing transactions which considerably impacts the SLR's denominator by increasing exposure. Alternatively, the US's SLR employs a more favorable treatment for securities financing transactions. If the US alters its approach to synchronize with Basel, US banks will have difficulty meeting the heightened requirements.

Regarding the other two prudential enhancements, we believe Basel will likely follow suit:

- **Debt bail-in**: Some EU regulators are already moving in the US's direction with respect to the debt bail-in proposal by granting favorable capital treatment for debt securities that would convert to equity in times of financial distress.
- **Wholesale funding**: The EU recognizes the risk of short-term wholesale funding, and global progress in this area fits well with Basel's push for global liquidity standards (by serving as a bridge between capital and liquidity capital standards).

To move the world along, Governor Tarullo will not only be working to influence Basel, but will likely also use his position in the Financial Stability Board to press for global agreement.

Additional information

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