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US Rates Strategy

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GSIB risk score changes

Along with the Basel III proposal, the Federal Reverse is considering changes to the formulas large banks use to calculate their systemic risk, freeing up bank capital.[1] In particular, we expect changes to the short-term wholesale funding (STWF) component could increase GSIB repo lending against Treasury collateral although they already do a significant volume of these trades.

- Large banks are required to hold an extra cushion of capital to account for the systemic risk their size and activities pose to the economy and markets. Required capital is determined by a score across five dimensions of risk.
- The Fed plans to update the component risk weights to account for economic growth since 2019. **This one-time adjustment would lower aggregate risk scores by 12%**. However, the Fed is not indexing its capital tailoring thresholds for growth.
- **The Fed will also reduce the weight applied to the STWF component**. This would lower aggregate risk scores by an additional 15%. **Most of the STWF component is made up of Treasury repo**.
- **At the margin, we think changes to the STWF component could increase the repo intermediation capacity of these banks**. However, they reported over $2.2trn in Treasury repo borrowing at the end of last year.[2]
- Averaging and the removal of scoring cliff effects should reduce the effects of seasonal risk dieting in the repo and cross-currency markets. These changes will increase risk scores and offset some of the indexing and STWF reductions.
- The Fed estimates that cumulatively across all eight GSIB banks, these changes will reduce capital surcharges by 40bp, or $23bn (10%) from their 2024 surcharge.

While we think changes to the STWF framework could increase GSIB Treasury repo lending, these banks are already active in the sponsored repo market. Instead, averaging and the removal of score cliff effects may make this activity steadier and less prone to seasonal spikes.

[1] The changes would take effect two calendar quarters after the rule is adopted. Depending on the timing that might mean Q4 26 or Q1 27.
[2] Out to 30d.

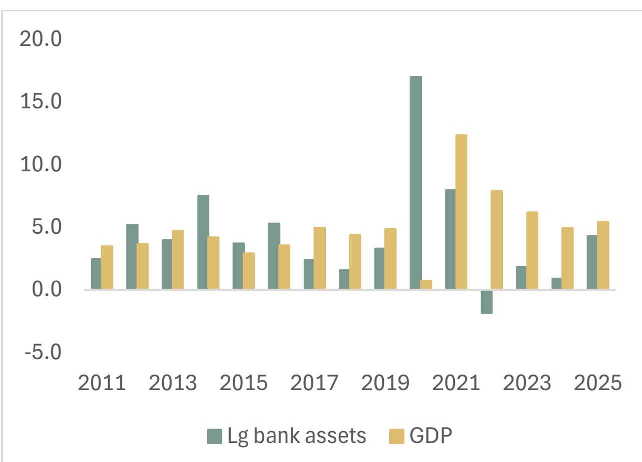
Risk scoring

The Fed and other bank regulators recently released proposed rule changes to the Basel III bank capital framework. As we wrote, the changes will reduce bank capital requirements at large banks by 5%.[3] Most of this reduction comes from changes to the regulatory frameworks for stress testing and systemic risk scores. In this update we focus on the latter.

The Basel bank capital rules require large banks to hold an extra capital cushion to account for the systemic risk their size, complexity and activities pose to the economy and markets. **The GSIB risk surcharge is based on a score calculated across five dimensions of bank risk**. Currently, the Fed uses the bank's Q4 score to calculate its capital surcharge using a prescribed schedule where each 100bp increase in the score increases the surcharge by 50bp.

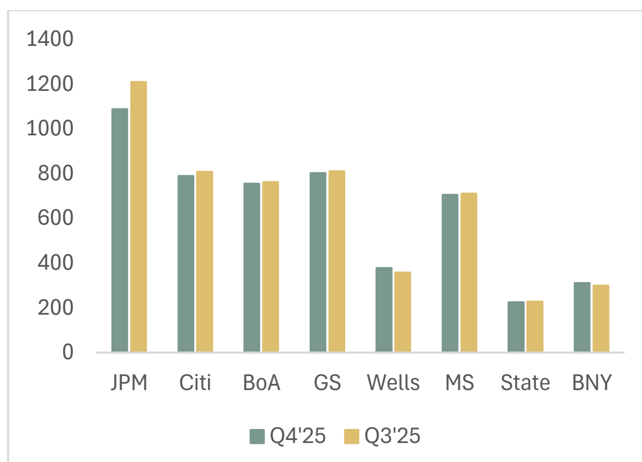
These five subcomponents are the bank's size, its interconnectedness, its cross-jurisdictional activity, its complexity as well as its reliance on short-term wholesale funding (STWF).[4] Size reflects the banks' on and off-balance sheet exposures including derivatives. Interconnectedness includes cross holdings of bank debt and financial derivatives. It also includes the value of their outstanding debt as well as the market price of their own equity. Cross jurisdictional exposures are similar although across borders. The complexity measure reflects banks' cleared and uncleared derivatives activity as well as their trading and available for sale securities (AFS). Finally, the STWF component includes all financing – secured and unsecured - less than 1y. While some of a bank's exposures are captured in multiple components of the overall score, they are often calculated differently to account for balance sheet offsets and risk formulas.

Figure 1: Large bank assets and GDP (% Q4/Q4)



Source: Federal Reserve, BEA, SMBC Nikko

Figure 2: GSIB scores (bp)



Source: Federal Reserve, SMBC Nikko

[3] See, "Basel III: Market Implications", March 25, 2026.

[4] Large US banks calculate their scores using two different frameworks – Method 1 and Method 2. The first determines whether a bank is a GSIB and is the global standard. The second (used after the Method 1 framework) determines a US GSIB's capital surcharge. It uses the same components as Method 1 but reweights them and replaces the substitutability component with a measure of STWF.

Risk inertia

Under the Basel systemic risk framework (method 1), a bank's capital surcharge reflects its *relative* risk. Each of the bank exposures that make up the five components in a bank's score is weighted by its relative share of global bank exposures. **As a result, while a bank may grow over time, it may not become any more systemically important**. By contrast, the Fed's method 2 framework uses fixed weights. When method 2 was introduced in 2015, the Fed planned to update the weights from time to time to reflect economic growth. But the weights have never been adjusted. As a result, as large banks have grown proportionally with the economy, their risk scores have drifted higher (Figure 1).[5] **Indeed between 2019 and 2024, US bank GSIB risk scores have increased 18%, but measured using the *relative* weights in method 1, their scores have fallen 3%.** Put differently, these banks are not any more systemically significant than they were in 2019 despite the increase in their risk scores and capital surcharges.

The Fed is proposing to make a one-time adjustment to the coefficient weights (of 1.2) to account for economic growth since 2019. And going forward, it will regularly adjust all the weights by the 3y average of nominal GDP growth. **It expects the revised weights would have lowered the 8 GSIBs' scores by 12%** (Figure 2).[6]

Interestingly, the Fed is not proposing to apply the indexing to its tailoring rules. Recall that large banks are split into 5 regulatory categories based on their size. The largest or Category I banks are the GSIBs. But the other four categories depend on size, and the amount of cross-jurisdictional activity, non-bank assets, weighted STWF amounts or off-balance sheet exposures. These thresholds have not been indexed higher to reflect nominal GDP growth.

Short-term wholesale funding

The Fed is also proposing to change the STWF in banks' risk scores. The STWF measures a bank's use of secured and unsecured funding shorter than one year. Since bank assets typically have longer maturities, heavy reliance on repo or deposits such as brokered and sweep accounts creates a maturity mismatch that can lead to a funding shock.

In the current GSIB framework, the STWF component is a relative measure; banks measure their STWF exposures relative to their average risk weighted assets. However, the Fed argues that this may inadequately reflect the risk they could face from a financing shock. For example, two banks may have the same amount (and mix) of STWF, but one may have more risk-weighted assets so that its STWF risk metric is lower. The Fed is proposing to replace the existing weighting with the absolute dollar amount of financing less than 1y. It also plans to reduce the weighting applied to STWF from around 30% to 23% based on information on funding shocks since 2015. These changes are expected to lower GSIB risk scores; **the Fed estimates that revamping STWF would have reduced the GSIB banks' 2024 risk scores by almost 15%**.

Averaging and scoring cliffs

The Fed will make additional technical changes to the risk scoring framework. First, it will base the capital surcharge on the annual average score rather than the Q4 level. Within the components, the quarterly score will use averages of daily values for on balance sheet entries. It will use the average of the three

[5] Average Q4/Q4 growth of the largest 25 US banks has averaged 4.4% while GDP has averaged 4.9% over the period.
[6] See p. 78

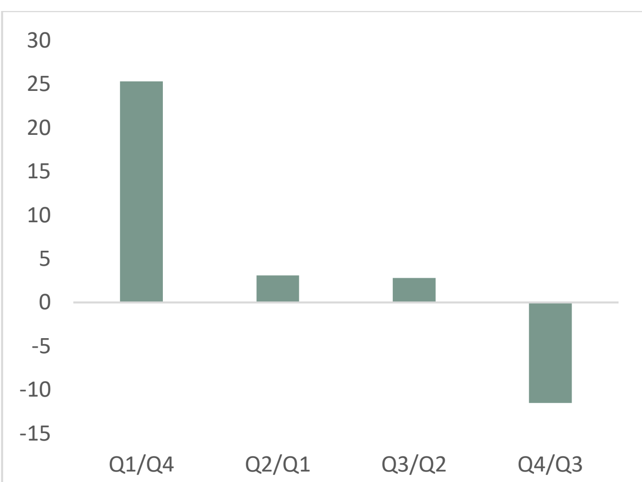
month-ends in the quarter for off balance sheet entries. Second, the Fed is revising how it translates the score into a capital surcharge. Currently, scores are bucketed in 100bp increments – the capital surcharge increases 50bp for each 100bp gain in the score. Under the new methodology, the score buckets will be reduced to 20bp and the capital increments will be 10bp. Thus, a 100bp increase in the score still boosts the capital surcharge by 50bp.

The Fed notes that banks' risk scores tend to cluster at the upper end of the score buckets in Q4. We looked at the quarterly changes in GSIB scores since 2018. Risk scores fall from Q3 to Q4 and then recover in Q1 (Figure 3). Scores do not change much in Q2 or Q3. The dieting effect in Q4 typically takes several forms. Banks lower their scores by trimming their cleared (and uncleared) derivatives activity. They also step back from cross-border transactions and reduce their holdings of trading and AFS. Risk dieting has occasionally caused repo rates to spike and some short-term cross currency bases to widen. Banks quickly ramp up these activities at the start of Q1.

We expect averaging and the smoothing out of cliff effects to reduce seasonal risk dieting. It is harder to diet if the calculation is based on an average of daily observations than simply the last day of the quarter. And by reducing the capital "cliff" from a higher risk score, it is possible that banks may be less inclined to reduce their score by aggressively (and temporarily) turning away business.

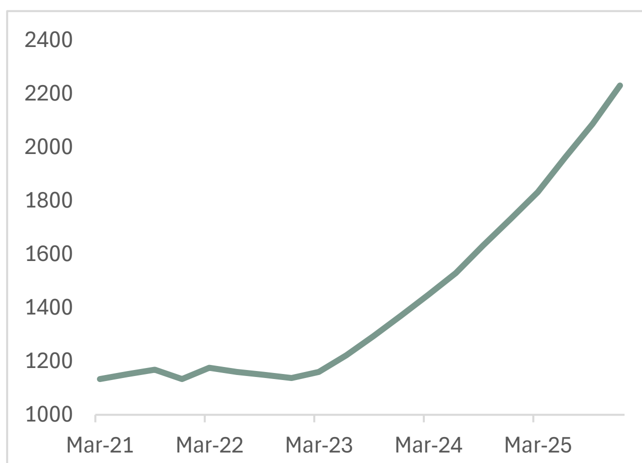
Separately, the Fed plans to make a few other adjustments to the composition of bank risk scores. Banks will be required to include their offshore derivatives in the cross-jurisdictional activity. The Fed will also change the treatment of non-cash collateral in OTC derivatives and expand the definition of financial companies in banks' interconnectedness measures. **Cumulatively, averaging and these compositional changes are expected to add 2-3% to banks' risk scores**.

Figure 3: Quarterly GSIB score changes (bp)



Note: Average score change across all 8 banks; 2018-25. Source: Federal Reserve, BEA, SMBC Nikko

Figure 4: Repo against tier 1 collateral, <30d ($bn)



Note: Sum across all 8 banks; 2018-2025. Source: Federal Reserve, SMBC Nikko

Net effects

The Fed estimates that these changes will cumulatively reduce aggregate GSIB scores across all eight banks by just over 22%. This translates into a 40bp average reduction in GSIB surcharge – releasing $23bn (or 10%) in capital surcharges across all eight banks.

We expect this freed-up capital could have two effects on financial markets – particularly, from the changes to the STWF score. **First, the lighter capital requirement *might* increase the willingness of the GSIB banks to intermediate in repo markets**. That said, these banks already report significant Treasury repo volumes. These have grown significantly in the past two years; increasing 63% to $2.2trn (Figure 4). This amount includes term transactions out to 30d. Data from money fund holdings points to a similarly sized percentage increase in their overnight Treasury repo borrowings. Much of this is likely tied to sponsored (cleared) activity. Money fund sponsored repo volumes have doubled to $910bn in the last two years. But their activity is intermediated through a relatively narrow set of US bank counterparties. Most funds have fewer than three sponsors and three large custody banks (who are also GSIBs) account for half of the money funds' sponsored repo volume. Since sponsored repo *already* allows these banks to net down their balance sheets, freeing up lending capacity, it is not clear how much additional Treasury repo these banks will provide given changes to their risk scores.

Our sense is that a second effect from the GSIB score changes may be more significant**. Shifting to annual averaging and smoothing out cliff effects could mean that GSIB repo lending (together with the cross currency activity) is steadier**. All things equal, this should remove the seasonal tendency for spikes in Q4.

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