21 April 2021
Investment Solutions & Products
Global

CREDIT SUISSE

Credit Suisse Economics

Global Money Dispatch

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In the January 22nd issue of Global Money Dispatch, we noted that unless reserves and U.S. Treasury securities get a permanent exemption from the SLR at the bank operating subsidiary level, J.P. Morgan and some other G-SIBs would have to increase capital at the bank opco by issuing debt at the holdco level.

Banks did indeed issue debt after last week's earnings announcements, but in amounts far greater than what was anticipated by the debt market or by us. What did we miss? TLAC, or total loss-absorbing capacity requirements…

To understand why banks have been issuing debt since Thursday, we need to consider three ratios: the holding company SLR, which is set at a minimum of 5%; the bank operating subsidiary SLR, which is set at a higher minimum of 6%; and the holding company TLAC minimum, which is set at an even higher 9.5%.

The SLR is calculated as the ratio of Tier 1 capital and total leverage exposure (or TLE, where total leverage exposure is average on balance sheet assets plus derivatives and repo-style transactions), and TLAC is calculated as the ratio of Tier 1 capital plus term (longer than one year) unsecured debt and TLE.

Our Dispatch from March 16th noted that ending the exemption of reserves and Treasury securities won't make the holding company SLRs binding. In fact, J.P. Morgan and Bank of America reported that their holding company SLRs would be 5.5% and 6.1% without the exemption, well above the 5% minimum.

The bank subsidiary SLRs are a different matter: as our second chart shows, J.P. Morgan and Bank of America ended last year with only a sliver of a buffer, which translated into a capacity to add about $150 and $100 billion of assets during the first quarter, respectively. But based on first quarter earnings reports, these banks added around $200 and $150 billion of assets at the bank level, respectively, which means their SLRs likely reached the regulatory minimum.

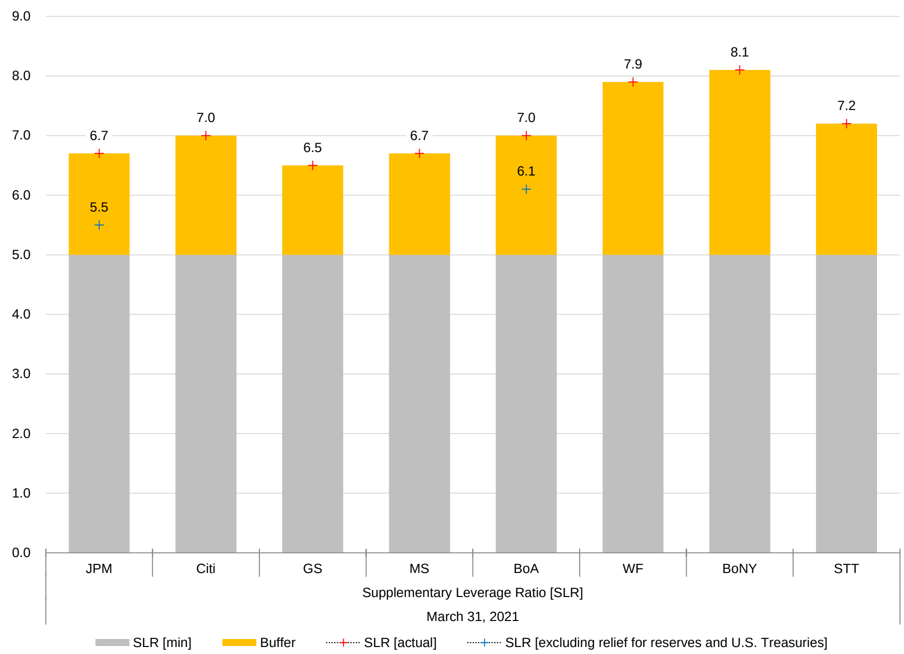
To fix the banks' SLR, the holding company had to issue debt, *as expected*, but the issuance size – $13 and $15 billion, respectively – was too big for that: at the bank level, that much capital would add over $200 billion of capacity, which was more than the $50 billion or so needed to re-up the banks' buffers.

The balance was needed for TLAC buffers. When SLR exemptions ended, holdco level TLE at the two banks exploded by at least $900 and $400 billion, respectively, and this "shock" eroded the two banks' TLAC buffers considerably, which made the larger-than-expected issuance necessary. Chart four shows that the post-expiry TLE "shock" for J.P. Morgan and Bank of America was bigger than for all others, which explains why these two banks issued the most.

In the end, low holdco SLRs weren't binding, but higher TLAC minimums were.

[Quarterly]: SLR at the Holding Company Level

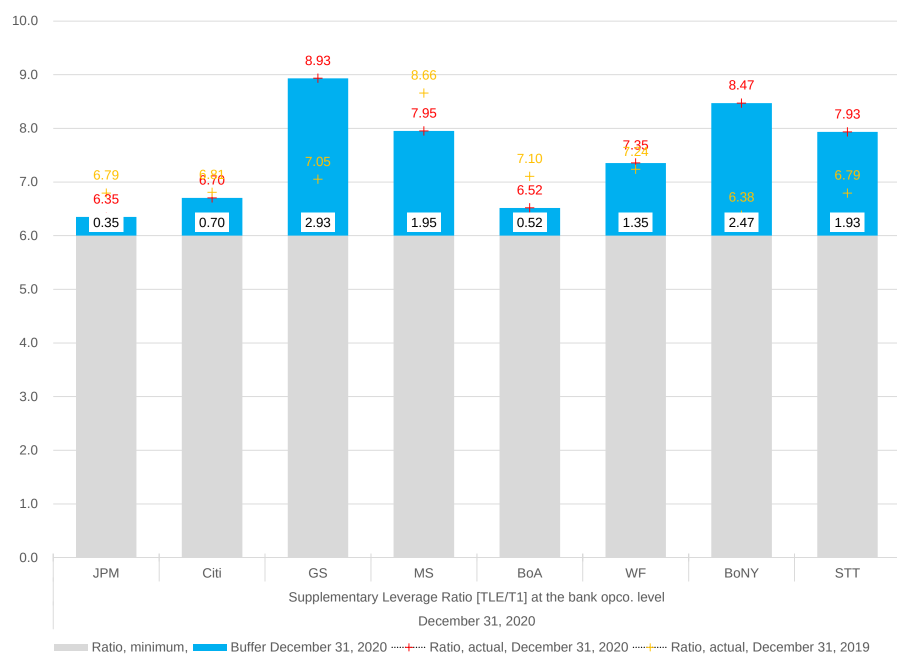
percent, as of the first quarter of 2021, minimum 5%



Source: Quarterly earnings supplements, Credit Suisse

[Quarterly]: SLR at the Bank Operating Subsidiary Level

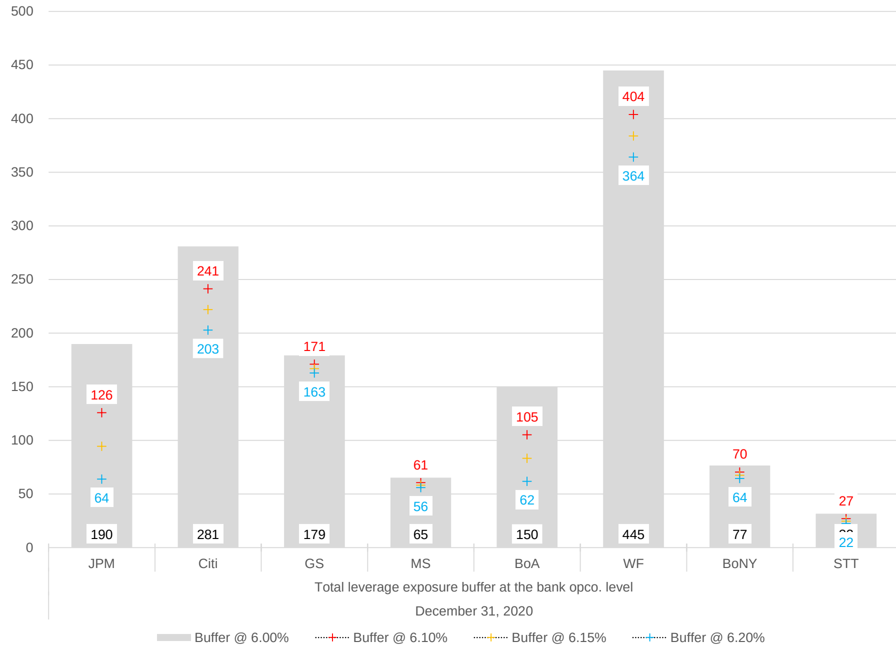
percent, as of the fourth quarter of 2020, 6% minimum



Source: FFIEC 031, Credit Suisse

[Quarterly]: TLE Capacity at the Bank Operating Subsidiary Level

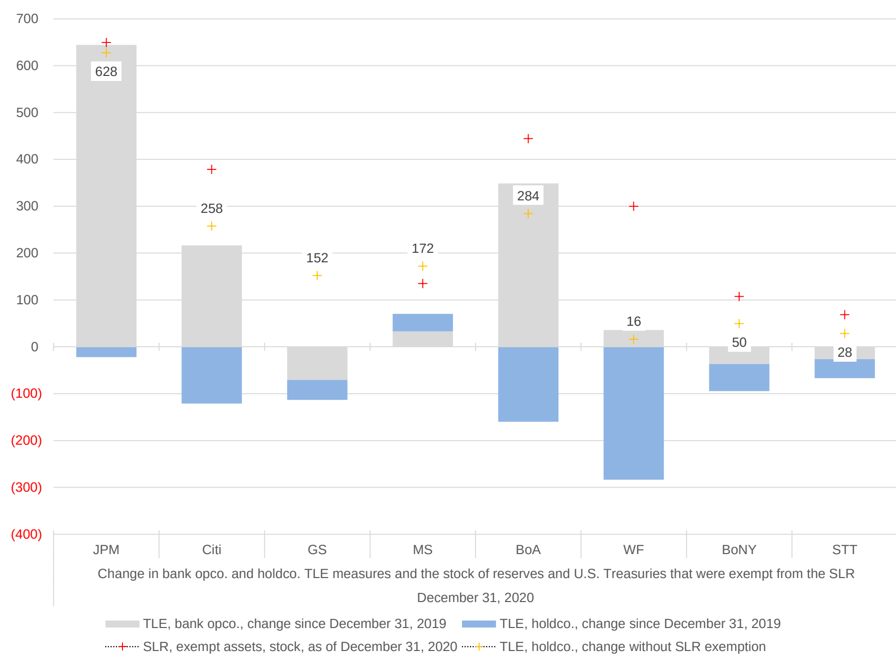
$ billion, as of the fourth quarter of 2020



Source: FFIEC 031, Credit Suisse

[Quarterly]: TLE "Shock" at the Holding Company Level on April 1st, 2021

$ billion, as of the fourth quarter of 2020



Source: FFIEC 031, Y-9C, Credit Suisse