Meeting Between Chair Powell and Staff of the Federal Reserve Board and Representatives of American Express
July 17, 2024

Participants: Chair Jerome H. Powell and Nancy Riley (Federal Reserve Board)

Steve Squeri and Amy Weiss (American Express)

Summary: Chair Powell and staff of the Federal Reserve Board met with representatives of American Express to discuss their concerns regarding the agencies' Basel III endgame notice of proposed rulemaking. Representatives of American Express raised concerns about the treatment of charge cards and the proposal not to net fee expenses against fee income with respect to operational risk.

Attachment

Basel III Endgame Proposal Discussion

July 17, 2024

Executive Summary

- American Express is a payments company that offers credit and charge card products to consumers and businesses around the world. We have a simple business model. Our products generate interest and non-interest revenues while facilitating payments for our customers.
- As written, the US Basel III Endgame Proposal (“Proposal”) would have a disproportionate impact on AXP’s capital requirements relative to the industry and that is not consistent with the underlying risks. Two areas present the most significant and distinct impact, largely driven by our unique charge card offering and our fee-focused business model.

Charge Card Off-Balance Sheet (OBS) Exposure

- The Proposal would require us to hold capital for the “OBS Exposure” of charge cards that is double the corresponding requirement for credit cards, which is inconsistent with the risks of these products. The Proposal’s proxy methodology for “OBS Exposure” is a departure from Basel Standards for a product that does not have a contractual commitment to extend credit. The prescribed Credit Conversion Factor (CCF) is also misaligned with actual experience.
- We recommend aligning with Basel Standards and eliminate the proxy methodology for “OBS Exposure” on charge cards to reflect their actual product design. Alternatively, treat charge card no worse than credit card. This can be achieved by lowering the proxy multiplier for charge cards and setting the CCF based on historical data.

Operational Risk

- The operational risk framework broadly attributes higher capital requirements to all fee revenues. This approach misaligns the risk of products that generate both interest income and fee revenues that are underpinned by the same operational elements.
- We appreciate the Federal Reserve’s public statements around changes it plans to make to the operational risk framework. Specifically, we support the idea of allowing the netting of fee income and fee expenses – similar to the netting of interest income and interest expenses – for card products in the operational risk framework.

Comment Letter

American Express identified a number of solutions to elements of the Proposed Rules that produce capital requirements which are misaligned with risk. Highlighted items appear to only impact American Express.

Credit Risk

1. Eliminate the proposed off-balance sheet “exposure” proxy methodology for charge cards and similar products with no pre-set spending limit (collectively, “NPSL Products”). The credit risk associated with NPSL Products should not be assigned a proxy off-balance sheet exposure amount that is subjected to a CCF.

2. To the extent the Agencies determine it is necessary to retain an off-balance sheet methodology for NPSL Products, historical data suggests the current 10% CCF is over-calibrated and should be at most low single digits.

3. Eliminate the gold-plating on retail risk weights and align with the Basel standards.

4. Revise the definition of Transactor to refer to an exposure that is 95% paid for the prior six months, consistent with the commonly used U.S. credit card industry definition. The credit risk profile of a customer that pays at least 95% for the prior six months is substantially identical to a customer that pays 100% for the trailing 12 months.

Operational Risk

- Allow the netting of fee income and fee expenses associated with fee-generating products. Netting these expenses would provide consistency across firms to avoid divergent capital outcomes based solely on the basis of permitted U.S. GAAP accounting positions (*e.g.*, firms that report fee revenue on a gross basis based upon GAAP guidance relative to firms who report fee revenue for comparable businesses net of expenses as a matter of industry practice).

Market Risk

- Eliminate the $100 billion asset threshold and simply make the $5 billion combined trading assets and liabilities threshold for application of the market risk capital rules generally applicable across banking organizations. Requiring firms with de minimis or immaterial trading operations to build systems and dedicate resources to implement the market risk capital rules would create unwarranted operational complexity.

Proposal Has A Disproportionate Impact on AXP

As currently written, the Proposal would have a disproportionate impact on our capital requirements that shows no apparent analytical correlation to the risk and resiliency of our business model.

Areas of Most Significant Impact

Credit Risk

Prescribes a methodology that significantly overstates the risk of charge cards, also requiring higher capital.

1. Off-Balance Sheet Exposure Proxy for Charge – there is no 'Open To Buy' line on charge cards
2. Credit Conversion Factor – does not reflect actual credit card balances under stress

Operational Risk

Broadly attributes higher capital requirements for fee revenues (including credit card and payment fees).

Risk-Weighted Assets Increase

↑ >2X Industry

We have a Differentiated Business Model

Premium Customer Base

End-to-End, Integrated Payments Platform

Revenue Mix

Global Footprint

Operating Leverage

World Class Brand & Service

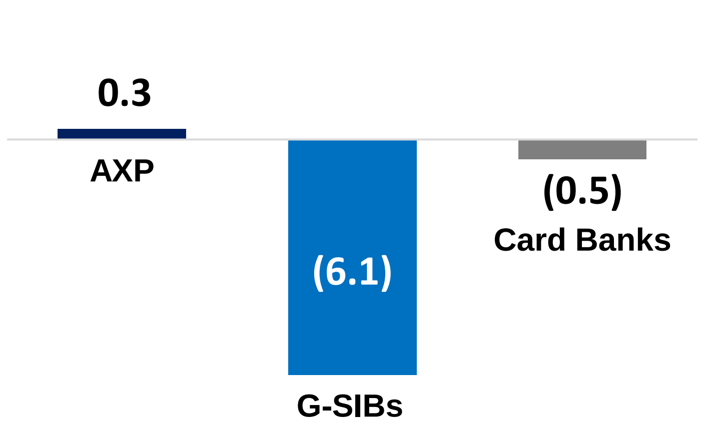
Our Business Has a Proven Record of Stress Resilience

AXP has a resilient business model that has remained profitable through periods of actual stress including the Great Financial Crisis and COVID. We are also consistently the most profitable bank across all CCAR participants based on Fed's modeling[1].

Pretax Income, $B

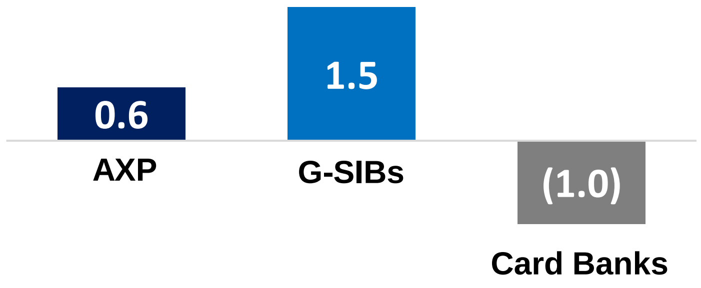
Actual Stress Events[2]

Great Financial Crisis (Q4 2008)



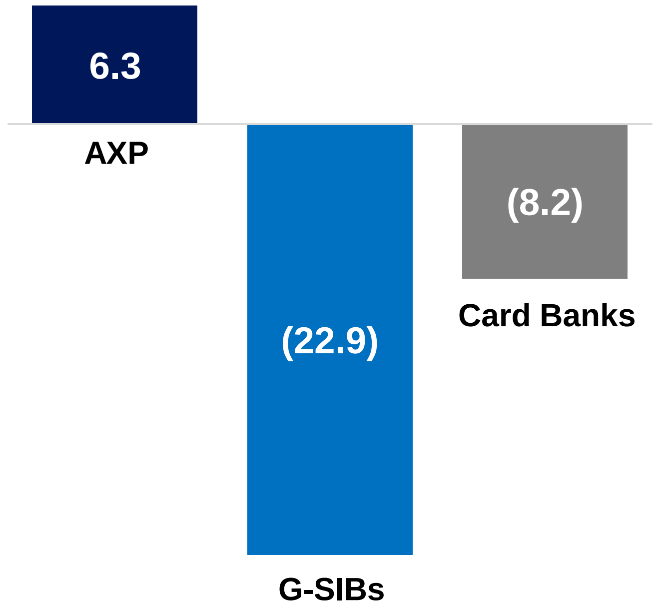
Maintained Dividend	Cut Dividend
AXP, GS	BAC, BK, C, COF, DFS, JPM, MS, STT, WFC

COVID Pandemic (Q2 2020)



Maintained Dividend	Cut Dividend
AXP, BAC, BK, C, DFS, GS, JPM, MS, STT	COF, WFC

Federal Reserve CCAR Results[3]



Notes:
1. Based on CCAR results from 2014 – 2024. Profitability is measured based on Net Income before Taxes (as % of 9 qtr. average assets) under the Severely Adverse Scenario for all CCAR participating banks.
2. Actual results of AXP and averages of US G-SIBs (BAC, BK, C, GS, JPM, MS, STT, WFC) and Card Banks (COF, DFS).
3. CCAR 2024 results under the Severely Adverse Scenario for AXP and averages of US G-SIBs (BAC, BK, C, GS, JPM, MS, STT, WFC) and Card Banks (COF, DFS).

Charge Card
Off-Balance Sheet Exposure

Every Charge Card Transaction is Authorized based on Real-Time, Card Member-Specific Data. There is no 'Open To Buy' Line of Credit

Authorization Decision Criteria

Charge Card

- **No Pre-Set Spending Limit**

Credit Card

- Primarily based on **Contractual Limit**

Ensure cardmember is in good standing
(e.g., past due, returned payments, suspicious activity)

Key Factors of Authorization Decision

Charge Card	Credit Card
Internal Credit Model	Unused Credit Limit
Account Balance	
Out-of-Pattern Spending	

Each transaction is individually underwritten

Charge Authorization Fundamentally Differs from Credit Card

Any concern regarding a sudden ramp-up in spending on charge cards is substantially mitigated – if not eliminated – by the dynamic authorization process for charge cards. Rather than assigning a credit limit and generally permitting spend up to that limit provided the account is otherwise in good standing, each transaction by a charge card is evaluated and can be declined based on multiple factors, including out-of-pattern spending.

Authorization Decision Criteria

Charge Card

Credit Card

Each transaction is individually underwritten

Example: *$5,000 transaction* - DECLINED[1]

Product:	**Platinum Charge Card**
Transaction Amount:	$5,000
Current Account Balance:	$1,000
Credit Limit:	No Pre-Set Spending Limit
FICO:	725
Approve/Decline Rationale:	Out-of-Pattern Spending

Example: *$5,000 transaction* - APPROVED

Product:	**Blue Cash Everyday**
Transaction Amount:	$5,000
Current Account Balance:	$1,000
Credit Limit:	$10,000
FICO:	725
Approve/Decline Rationale:	Within Contractual Limit

Note:
1. For illustrative purposes only. Credit underwriting decisions are made on a transaction-by-transaction basis.

Charge Card Does Not Have OBS Commitment Under Basel

Under the Basel Standards, capital is required for off-balance sheet exposure where there is a contractual commitment to extend credit. Charge cards do not provide an equivalent to a committed line of credit because charge card transactions are dynamically authorized, and each transaction is individually underwritten. The card member is not entitled to spend any additional amount beyond their current spend, and we can disrupt and decline any problematic or out of pattern spending.

Basel Standards on Off-Balance Sheet Exposure[1]

Off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCF). In the case of commitments, the committed but undrawn amount of the exposure would be multiplied by the CCF. ***For these purposes, commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit,*** *purchase assets or issue credit substitutes.*

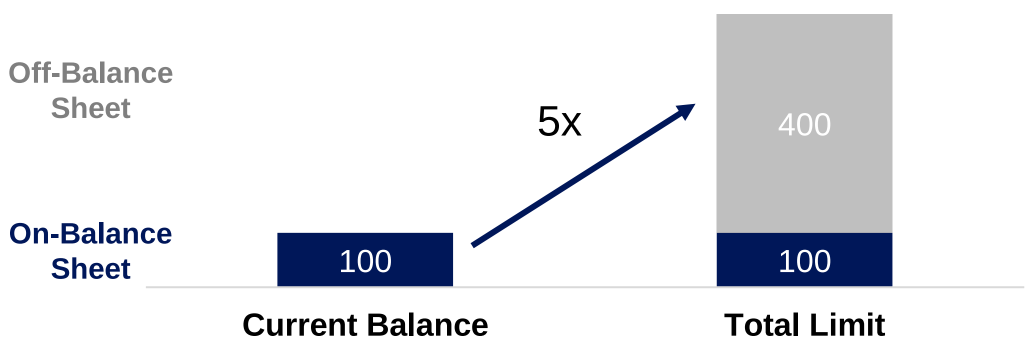
Product	Key Terms and Conditions	Off-Balance Sheet Commitment
Charge Card	▪ No pre-set spending limit ▪ No commitment to extend credit ▪ Point of sale authorization	✗
Credit Card	▪ Contractual arrangement to extend credit up to a committed, communicated line	✓

Note:
1. *"Basel Committee on Banking Supervision Basel III: Finalising Post-Crisis Reforms". December 2017,* page 25.

The 10X Proxy "Total Limit" for Charge Card is Significantly Higher than Credit Card Industry Average and is Not Based on Data …

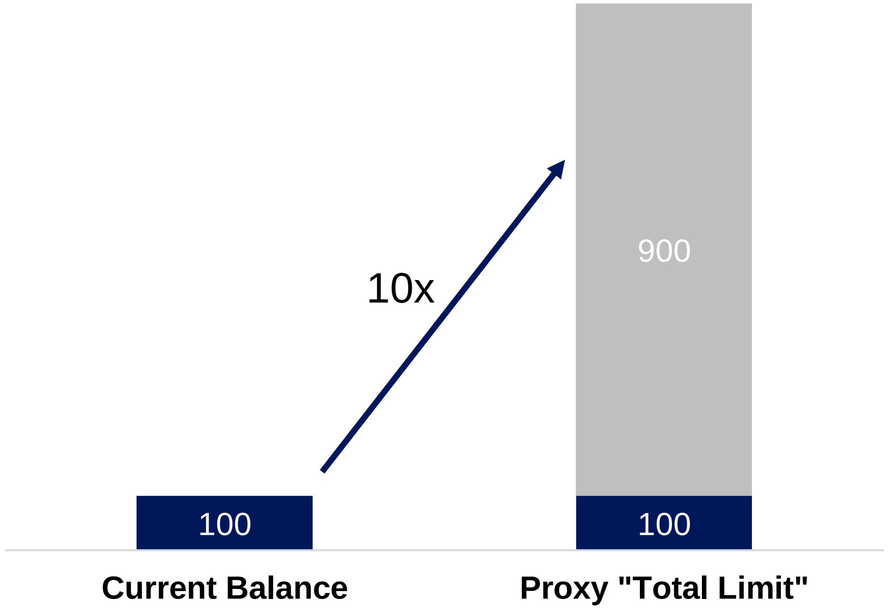
Credit Card

Historical Industry Average[1]



Charge Card

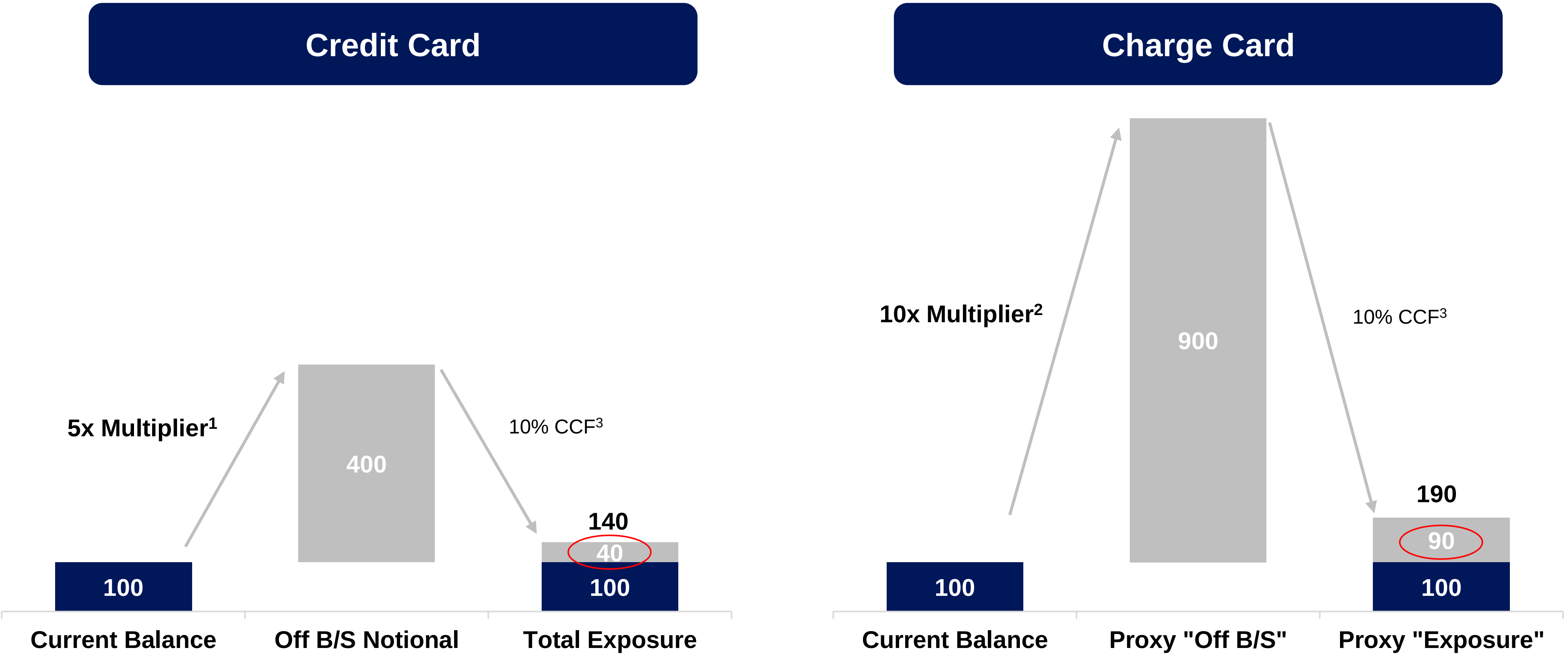
Proxy "Total Limit" Under Proposal[2]



Notes:

1. *Source: Federal Reserve Board of New York Household Debt Data 2019–2022.*
2. *Based on methodology prescribed under Proposal – Avg Balance over prior 8 quarters x 10 less current outstanding.*

… and Produces an "Off-Balance Sheet Exposure" and Corresponding Capital Requirements that are 2X those of Credit Cards



Notes:

1. *5X Multiplier based on historical industry average. Source: Federal Reserve Board of New York Household Debt Data 2019–2022.*
2. *Based on methodology prescribed under Proposal – Avg Balance over prior 8 quarters x 10 less current outstanding.*
3. *Off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCF); Source: Basel Committee on Banking Supervision Basel III: Finalising Post-Crisis Reforms. December 2017,* page 25

Charge Cards Present Approximately Half the Risk of Credit Cards but Under the Proposal would be Assigned a Capital Charge Approximately Twice as High

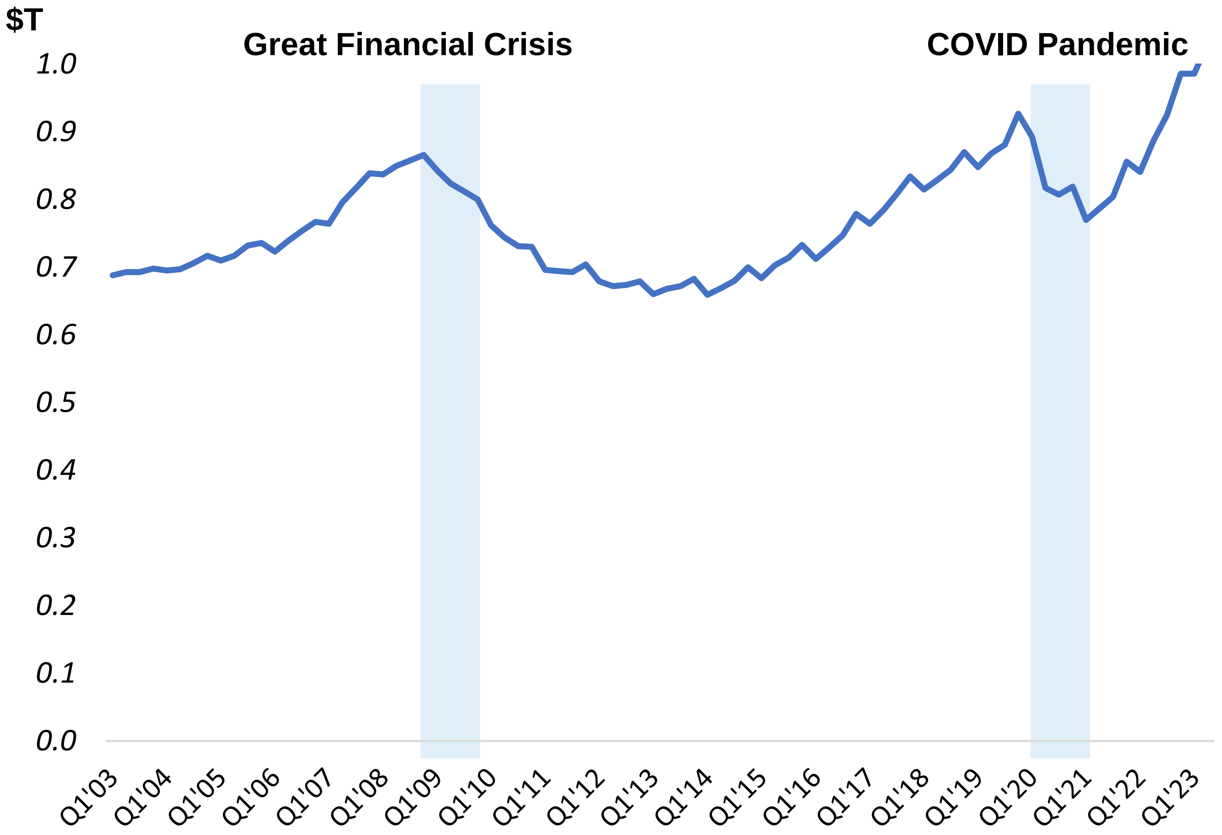
	Credit Card	Charge Card
On-Balance Sheet	$100	$100
Limit	5x based on Industry Average	10x based on Proxy “Total Limit”
Total “Limit”	$500 ($100 x 5)	$1,000 ($100 x 10)
Off-Balance Sheet Notional Amount	$400 ($500 - $100)	$900 ($1000 - $100)
Credit Conversion Factor Prescribed in Proposal (CCF)	10%	10%
Off-Balance Sheet Exposure	$40 ($400 x 10%CCF)	$90 ($900 x 10%CCF)
Risk Weight[1]	55%	55%
Off-Balance Sheet Risk Weighted Asset (RWA)	**$22** ($40 x 55%)	**$50** ($90 x 55%)
Ratio of Off-Balance Sheet RWA	2.3X	
Historical Write-off Rate[2]		
Peak	11.3%	5.4%
Average	4.4%	1.9%

Notes:
1. Assumes Credit Card is ‘Transactor’ for RWA comparison purpose.
2. Quarterly AXP write-off rate from 2007–2022 for US Consumer and Small Business. Competitor data sourced from quarterly earnings of issuers: JPMorgan, Citi, Bank of America, Capital One and Discover.

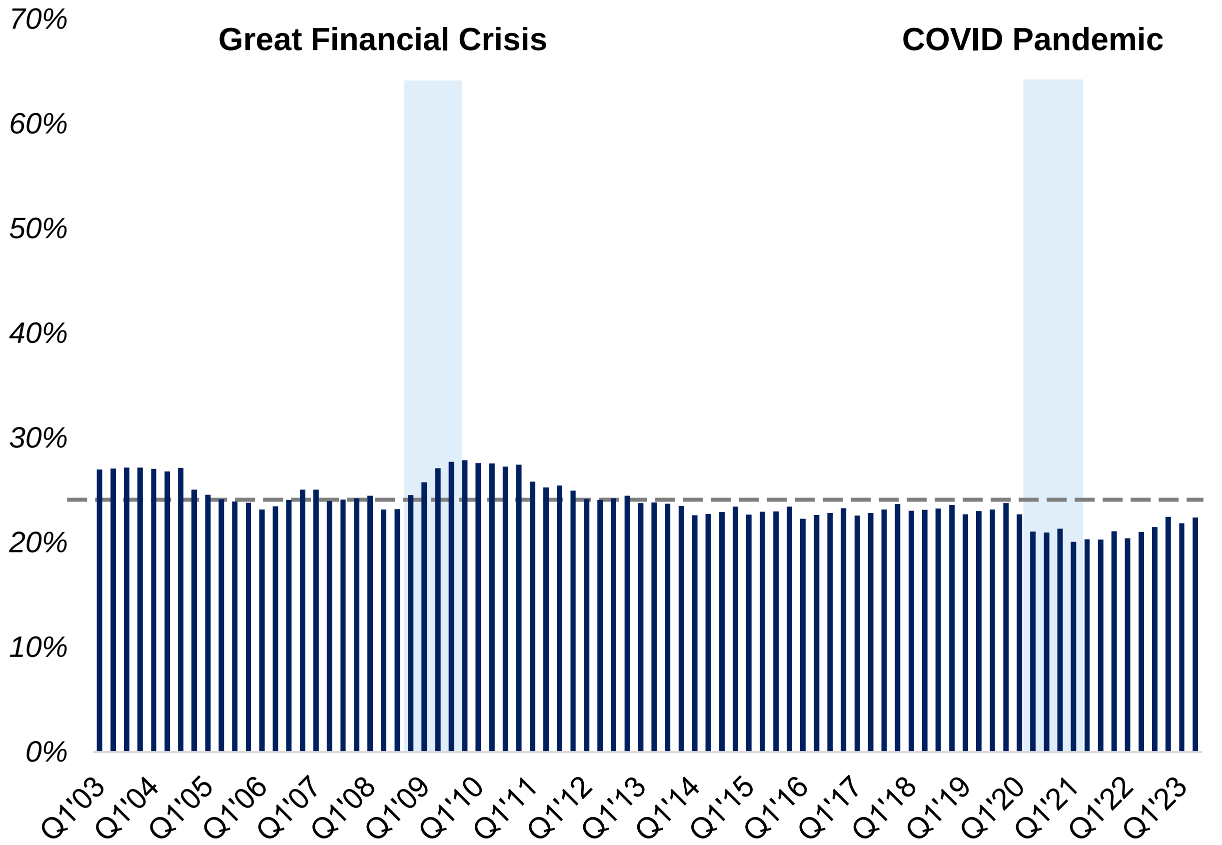
Credit Conversion Factor (CCF) for Unused Credit Line Should be Adjusted Based on Historical Data

If the agencies decide to retain a proxy for the charge “OBS Exposure”, historical data suggests the current 10% CCF is over-calibrated for lower-risk charge card products and should be at most low single digits.

Historical Industry Credit Card Balances



Historical Industry Credit Card Utilization Rate

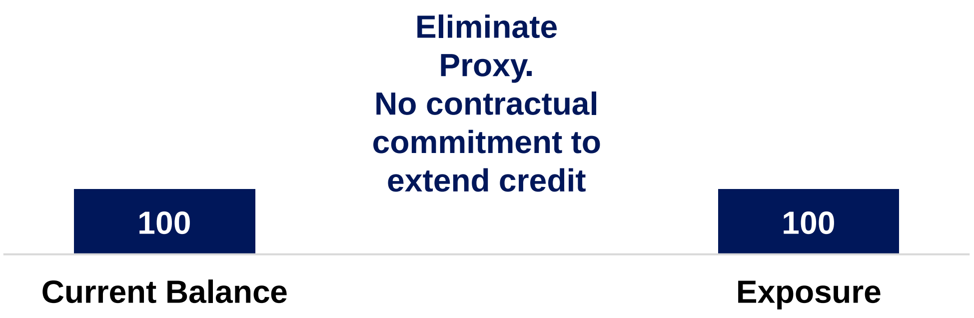


Note:
1. Source: Federal Reserve Board of New York Household Debt and Credit Report.

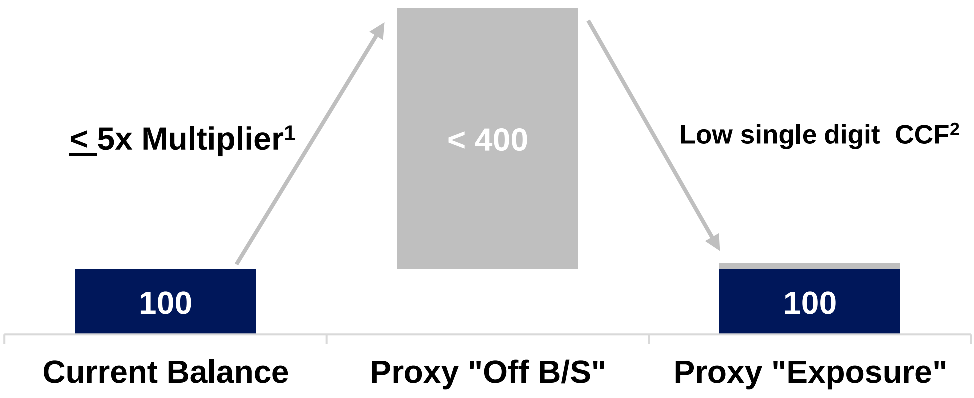
Off-Balance Sheet Exposure Rule: Proposed Solution

We recommend aligning with Basel Standards and eliminate the proxy methodology for “OBS exposure” on charge cards to reflect their actual product design. Alternatively, treat charge card no worse than credit card. This can be achieved by reducing the proxy multiplier and setting the CCF based on historical data.

<u>Solution</u>: Eliminate the off-balance sheet exposure proxy methodology for charge cards



<u>Alternative</u>: Lower proxy multiplier and recalibrate CCF for charge cards based on historical data



Notes:
1. Proxy ‘Off B/S” methodology – Avg Balance over prior 8 quarters x “multiplier” less current outstanding.
2. Off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCF); Source: Basel Committee on Banking Supervision Basel III: Finalising Post-Crisis Reforms. December 2017, page 25

Operational Risk

Operational Risk: Anatomy of Card Business

Card businesses are supported by similar processes, face similar operational risks, and generate similar types of revenues. Although the types of revenues are largely similar, the composition of revenue could differ significantly across different card products.

Card Authorization | **Cardmember Servicing** | **Credit Administration**

Operational Processes

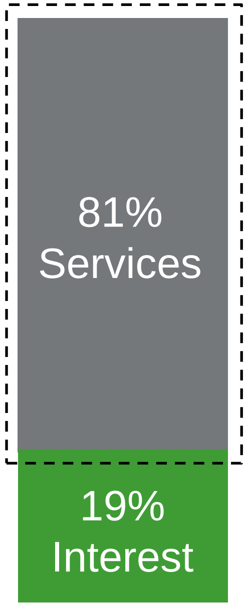
Revenues

Discount Revenue / Interchange + Card Fees + Interest Income

Note:
1. The trademarks, logos and service marks used on this slide and throughout this presentation are the property of their respective owners.

A Comparison of Card Business Models

Even within similar card products, dissimilar accounting approaches and revenue mixes would drive different capital requirements under the proposed rules attributable to providing credit and charge cards. Properly designed risk-based capital rules should assign similar capital charges to similar products with similar risk profiles regardless of the types of revenue the products generate or permissible accounting determinations.



Discount Revenue

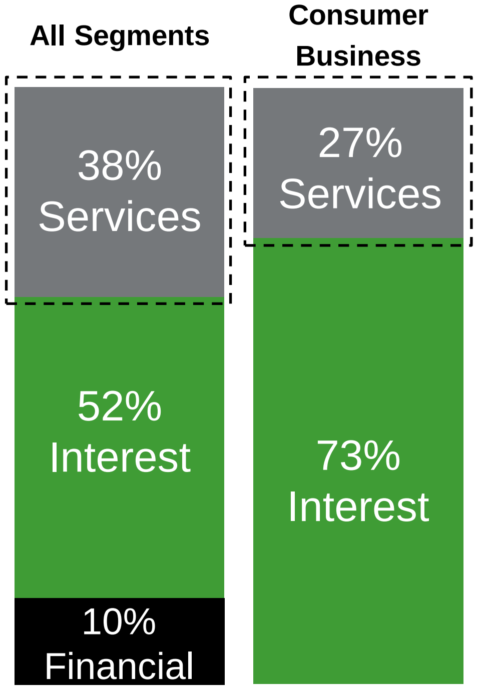
+ Card & Card-Related Fees

= Services Component Fee Revenue

No capping of Service Fee Revenue

Capped at 2.25% of interest earning assets

Revenue Mix



Issuer Revenue

+ Card & Card-Related Fees

- Rewards Costs

- Partner Payments

= Services Component Fee Revenue

Capped at 2.25% of interest earning assets

Revenue Mix

Note:
1. Sourced from AXP and JPM's 2022 10-Ks and JPM's 2022 FR Y-9C.

Different Outcomes for Same Underlying Operational Risks

American Express' GAAP accounting reflects Gross Card Revenues, which results in a meaningfully higher Service Fee revenue stream versus peers whose GAAP accounting nets card expenses from its Service Fee Revenues. The differentiated treatment of Revenue earned through the same product would result in significantly different capital requirements for comparable products with similar underlying operational risks.

Materially Different Capital Outcome from Different Mix of $100 Revenue

Proposal CET1 Requirement[1]

Notes:

1. Capital estimates are illustrative and represent the CET1 requirement for each firm, assuming:

i. Net Interest Yield of 10%

ii. 15% Business Indicator Component (BIC)

iii. 1.0 Internal Loss Multiplier (ILM)

iv. CET1 target of 8% for both firms

2. Sourced from AXP's and JPM's 2022 FR Y-9C

Operational Risk: Proposed Solution

The Final Rules should consider aligning the treatment of Interest and Services Components with respect to the netting of revenues and expenses.

Proposal

Business Indicator

Interest Component
- Interest income and expenses are netted
- Capped at 2.25% of interest earning assets

Services Component
- Based on higher of fee income or fee expenses

AXP Revenue

Annual Card Fees[1]

Discount Revenue

Net Interest Income

Charge Card | Credit Card

Solution: Net Card Revenues and Expenses

Business Indicator

Interest Component
- Interest income and expenses are netted
- Capped at 2.25% of interest earning assets

Services Component

Allow netting of fee income and fee expenses

AXP Revenue

Annual Card Fees[1]

Discount Revenue

Net Interest Income

Charge Card | Credit Card

Notes:
1. Card and Card-Related Fee Revenue.
2. Financial Component Indicator is not listed as it is immaterial for AXP.

Key Recommendations

Key Recommendations

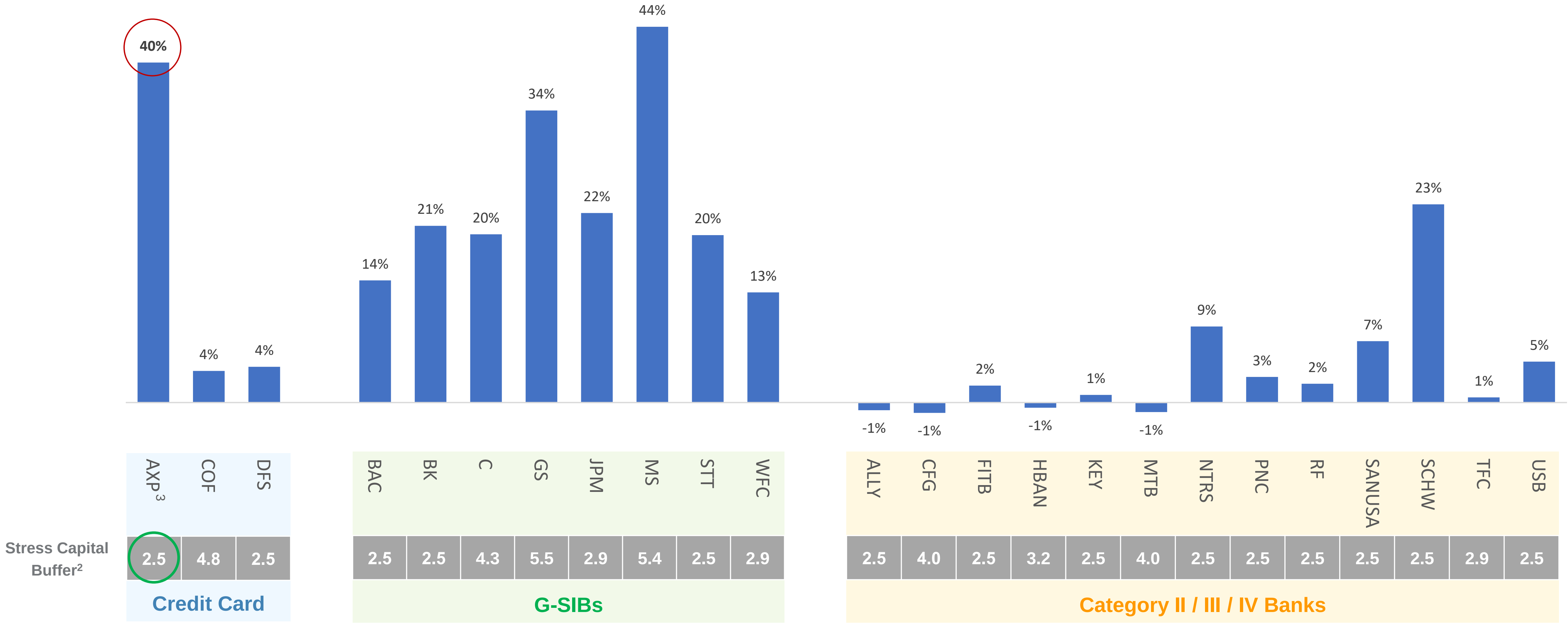
- In credit risk, the capital treatment for charge cards should be no more stringent than the treatment for credit cards to reflect the risk profile of these products. We propose the elimination of the proxy methodology for the “Off-Balance Sheet Exposure” of charge cards. Alternatively, we propose lowering the proxy multiplier and recalibrating the Credit Conversion Factor based on historical data.

- In operational risk, permit netting of fee income and fee expenses for card products to align with the current treatment for interest income and interest expenses, as these revenue streams are underpinned by the same operational elements.

Appendix

Analysts’ Estimated RWA Impact of Proposal

The disproportionate increase in capital requirements for American Express under the Proposal is not consistent with our simple business model and resilient capital profile.

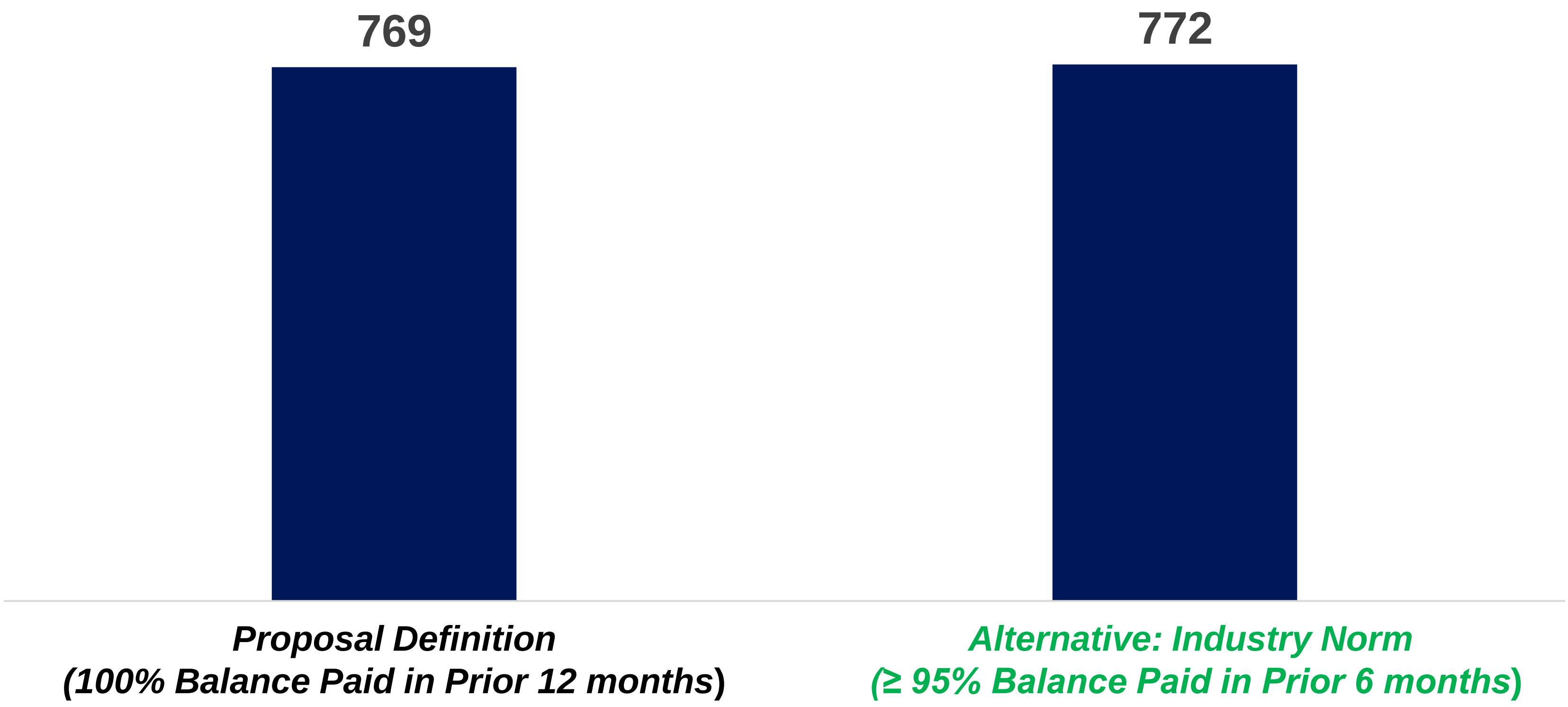


Notes:
1. All impacts except Goldman Sachs (“GS”) and Morgan Stanley (“MS”) are sourced from Barclays. GS and MS impacts are sourced from Citi.
2. Sourced from the Federal Reserve large bank capital requirements. Effective October 1, 2023.
3. Actual SCB would be ~1.7% without the mandated floor of 2.5%.

Definition of Credit Card Transactor Can Be Enhanced

The definition of credit card transactors could be refined to provide greater flexibility in identifying transactor behavior without compromising the intended improvement in risk sensitivity.

Average FICO Score by "Transactor" Definition[1]



Note:
1. Average FICO score of US Consumer and Small Business cardmembers from 2017-2023.

Different Outcomes for Same Underlying Operational Risks

American Express' GAAP accounting reflects Gross Card Revenues, which results in a meaningfully higher Service Fee revenue stream versus peers whose GAAP accounting nets card expenses from its Service Fee Revenues. The differentiated treatment of Revenue earned through the same product would result in significantly different capital requirements for comparable products with similar underlying operational risks.

Materially Different Capital Outcome from Different Mix of $100 Revenue

Proposal CET1 Requirement[1]

Notes:
1. Capital estimates are illustrative and represent the CET1 requirement for each firm, assuming:
- *i. Net Interest Yield of 10%*
- *ii. 15% Business Indicator Component (BIC)*
- *iii. 1.0 Internal Loss Multiplier (ILM)*
- *iv. CET1 target of 8% for both firms*

2. Sourced from AXP and COF's 2022 FR Y-9C

Different Outcomes for Same Underlying Operational Risks

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2. Sourced from AXP and DFS's 2022 FR Y-9C

Reference Pages: 19, 26, 27

Illustrative Example: AXP, JPM, DFS and COF Required Capital

	AXP	JPM	COF	DFS
Interest	$19	$73	$79	$85
Services	$81 *gross basis*	$27 *net basis*	$21 *net basis*	$15 *net basis*
Total Revenue:	**$100**	**$100**	**$100**	**$100**
Interest Earning Assets (IEA): Assumes Net Interest Yield 10%	$19/10%= $190	$73/10%= $730	$79/10%= $790	$85/10%= $850
Net Interest capped at 2.25% of IEA	$190 x 2.25%= $4	$730 x 2.25%= $16	$790 x 2.25%= $18	$850 x 2.25%= $19
<u>Business Indicator:</u>				
Interest	$4	$16	$18	$19
Services	$81	$27	$21	$15
Total	$85	$43	$39	$34
Total x 15% Business Indicator Component	$85 x 15% = **$13**	$43 x 15% = **$7**	$39 x 15% = **$6**	$34 x 15% = **$5**
x 1.0 Internal Loss Multiplier	**$13** x 1.0 = **$13**	**$7** x 1.0 = **$7**	**$6** x 1.0 = **$6**	**$5** x 1.0 = **$5**
Basel III Endgame Proposal CET1 Requirement	**$13**	**$7**	**$6**	**$5**

Notes:
1. Capital estimates are illustrative and represent the CET1 requirement for each firm, assuming:
- *i. Net Interest Yield of 10%*
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