January 16, 2024

VIA ELECTRONIC SUBMISSION

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R—1813; RIN 7100—AG64

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Attention: Comments/Legal OES (RIN 3064—AF29)

Chief Counsel's Office
Office of the Comptroller of the Currency (OCC)
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219
Attention: Comment Processing, Docket ID OCC—2023—0008

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC") and the Office of the Comptroller of the Currency (the "OCC," and collectively with the FRB and the FDIC, the "Agencies") regarding their proposal (the "Proposal") to revise the capital requirements for large banking organizations to implement the Basel Committee on Banking Supervision's ("BCBS") revisions to the Basel III framework ("Basel

[1] The Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace and a sound financial system.

Framework") finalized in 2017.[2] The proposed changes would apply to all of our member institutions, the U.S. global systemically important bank holding companies ("GSIB").

Our member institutions are expected to experience an increase in required capital of over 25%, far higher than the 19% the Agencies project based on incomplete and outdated data and representing the largest increase among affected banks. The increase would be even larger, 30%, when incorporating the impact of expected changes to the GSIB surcharge. This significant expansion in capital requirements necessitates a rigorous assessment of how the Proposal would impact businesses and households, which the Agencies have not yet done.

Forum member institutions are essential to the economy

Our member institutions play an essential role in providing credit, liquidity and a range of key financial services that benefit corporates, asset managers, smaller banks, investors, savers and a wide range of consumers, and are fundamental to the continued growth and prosperity of the U.S. economy. Collectively, Forum member institutions account for roughly 40% of all bank lending, which supports the needs of businesses and households, and 70% of securities underwriting, which supports the needs of companies to invest and grow.[3] Our member institutions also play a critical role in providing liquidity to a wide array of financial markets, ranging from the U.S. Treasury market to the IPO market for innovative start-up companies and manage over $15 trillion in financial assets for families and businesses to support long-term investment goals such as retirement, education and business expansion.

Ultimately, the ability of our member institutions to serve as a leading source of lending and investment for U.S. consumers, businesses, investors and communities critically depends on the efficient calibration of regulation that accounts for and balances effective costs and benefits.

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[2] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64028 (Sept. 18, 2023).

[3] Forum, "Essential to the U.S. Economy" (last visited Dec. 29, 2023), https://fsforum.com/our-impact/essential-to-the-u-s-economy ("Forum members hold $4.55 trillion in loans, accounting for 38 percent of total lending by banks to businesses and households"); David M. Solomon, "Testimony of David M. Solomon," Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs (Dec. 6, 2023), https://www.banking.senate.gov/imo/media/doc/solomon_testimony_12-6-23.pdf ("As of the third quarter, the institutions most impacted by this proposal accounted for two-thirds of both lending and capital markets activities in the U.S.").

As FRB Vice Chair for Supervision Michael S. Barr noted in his statement on the Proposal, "capital requirements[] must be aligned with actual risk."[4] Financial regulations that do not adhere to this key principle result in an inefficient financial system that misallocates capital in a way that can have a detrimental effect on the businesses and households that our member institutions serve.

The Proposal would harm the real economy, households, and businesses

As Chair Powell and Vice Chair Barr noted, the Agencies must consider the costs of high capital.[5] Of all these costs, the most concerning may be the potential effect on the American economy as a whole.[6] Increased capital requirements directly increase the cost for banks of providing financial services, which are an essential part of supporting the U.S. real economy. Therefore, the cost of increased capital would be borne not just by banks but also by individuals, families and businesses.

The breadth of this Proposal would materially increase the cost of <u>all</u> financial services provided by our member institutions. Among other things, the Proposal would decrease the availability and increase the cost of: (1) lending to households to finance an array of important purchases such as a home or automobile and even everyday purchases made via credit cards; (2) lending to small businesses to support their ability to remain active in local communities and provide employment; (3) providing credit and liquidity to asset managers, pension funds and other financial institutions that manage money on behalf of retail investors, employees and retirees; and (4) hedging products for commercial and financial end users (including pension funds, insurance companies and regional/community banks), such as derivatives and financial insurance, increasing the cost of goods and services for consumers. Credit cards are also a vital part of the retail credit ecosystem that consumers rely on to build their credit scores and thereby gain access to other forms of credit, and the Proposal would negatively impact their ability to do so.

The Proposal also would impede market functioning by discouraging our member institutions from intermediating in financial markets for the benefit of, for example: (1) corporations that raise funding from public debt and equity markets to fund investment and support jobs; (2) municipalities that raise funds from public debt markets to fund critical public services and infrastructure that Americans rely on; (3) insurance companies that invest in securities to provide income that is necessary to

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[4] FRB, "Statement by Vice Chair for Supervision Michael S. Barr" (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm [hereinafter, the "Barr Statement"].

[5] *Id.*, FRB, "Statement by Chair Jerome H. Powell" (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20230727.htm [hereinafter, the "Powell Statement"].

[6] Chair Powell specifically identified this issue as the first area in which he particularly invited public feedback. Powell Statement.

provide households with home, auto and life insurance protection; and (4) households that invest in public securities to fund their retirement savings goals as well as other important life goals such as saving for a home or sending their children to college. In addition, the Proposal would impede the provision of asset and wealth management services that are important for households that are planning for life events ranging from retirement to the purchase of a home and funding the educational needs of their family members.

Our estimates of the Proposal's impact suggest that the Proposal would increase required capital by roughly 25% (30% when considered together with increases in the GSIB surcharge), significantly more than the Agencies' 19% estimate the Agencies provided (which excludes the impact of GSIB surcharge growth). Relying on independent academic research, we also estimate that this increase in required capital would cost the economy over $100 billion *per year*. As changes to capital regulation are intended to be durable, the cost would be borne by the economy each and every year that the heightened requirements are in effect and over a thirty-year timeframe would cost the economy in excess of $1.5 trillion.

Moreover, these cost estimates are likely *under*estimates of the actual economic cost, as they do not consider potential multiplier effects, particularly with respect to asset and wealth management or the intermediation of financial markets. Accordingly, the available cost estimates should be viewed as a lower bound on the cost to the economy. In total, these costs would directly reduce the productivity, growth and vibrancy of the U.S. economy.

Increasing capital is not free. In the case of the proposed changes, these costs would inevitably be paid not just by U.S. banks but by every American family and business.

The Proposal would harm U.S. competitiveness

The Proposal's many inconsistencies with the Basel Framework and Basel III endgame proposals in other jurisdictions – which Chair Powell acknowledged in his statement on the Proposal – would worsen, rather than improve, already substantial international discrepancies in capital requirements and undermine the BCBS's objective of enhanced comparability.[7] These proposed divergences from the Basel Framework do not serve American interests – rather, they would impose additional requirements on U.S. banks that would harm the American economy and the ability of U.S. banks to compete internationally.

U.S. GSIBs are already subject to standards that are more stringent than the Basel requirements and the requirements of foreign jurisdictions such as the European

[7] Powell Statement (noting that "the proposal exceeds what is required by the Basel agreement, and exceeds as well what we know of plans for implementation by other large jurisdictions" and cautioning that the Agencies will need to weigh the potential costs of these choices).

Union ("EU") and United Kingdom ("UK"). For example, U.S. GSIBs are bound by the stress capital buffer ("SCB"), the method 2 GSIB surcharge and limitations on internal credit models, which result in *significantly* higher levels of capital than foreign peers are required to maintain.

The Proposal's implementation of the Basel III endgame would exacerbate this disparity, primarily because of the elimination of the use of internal models for credit risk and the addition of operational risk into the binding capital stack. This disparity is also exacerbated by multiple contributing factors, including the specific calibration of residential mortgages and retail credit, which are substantially more stringent than the requirements being proposed for Basel III endgame in foreign jurisdictions. In the Proposal, the Agencies also declined to make several changes relative to the Basel Framework that have been proposed in European jurisdictions, further reinforcing international divergence. The UK Prudential Regulation Authority ("PRA") estimates that its implementation of Basel III endgame would only result in a 3.2% increase in tier 1 capital requirements[8] for major UK firms,[9] while the European Banking Authority estimate increased tier 1 minimum capital requirements for EU firms of 5.6%.[10] Moreover, whereas the PRA intends to further mitigate the impact on UK firms by adjusting firms' Pillar 2 capital requirements to address "double counts," and "rebase firms' variable Pillar 2A requirements and PRA buffer" where the relevant risk level has not changed, U.S. regulators have declined to acknowledge any potential overlap. These international discrepancies would only increase the already wide gap between the capital requirements of U.S. banking organizations and those of their foreign peers.

As a result, the ability of U.S. companies to compete both within the U.S. and abroad would be diminished, as U.S. companies rely on large U.S. banks to provide them with the banking and risk-management tools, such as currency hedges, that are a precondition to successful international operations. Altogether, the inconsistencies with both the Basel Framework and Basel III endgame proposals in other jurisdictions would result in higher prices for American families, weaker U.S. markets and economic activity being pushed outside the United States.

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[8] The cited percentage increases in the EU and UK are in terms of tier 1 capital. Translating the percentage change results in Table 1 of Section I.B.1 of this letter to tier 1 terms would result in an immaterial change due to the fact that SCB losses are unrelated to the denominator changes.

[9] PRA, "PS17/23 – Implementation of the Basel 3.1 standards near-final part 1 (Dec. 12, 2023), https://www.bankofengland.co.uk/prudential-regulation/publication/2023/december/implementation-of-the-basel-3-1-standards-near-final-policy-statement-part-1?secureweb=Symphony.

[10] European Banking Authority, "Basel III Monitoring Exercise – Results Based on Data as of 31 December 2022" (Annex – Analysis of EU Specific Adjustments)" (Sept. 26, 2023), https://www.eba.europa.eu/risk-and-data-analysis/risk-analysis/risk-monitoring/quantitative-impact-studybasel-iii-monitoring. The 5.6% increase is based on the EU's transitional arrangements. Non-transitional (end state) increases are estimated to be 9.9%.

The Proposal would increase the size of the nonbank sector and create financial stability risks

The Proposal would exacerbate the movement of financial activity outside the regulated banking system, undermine consumer protections in place at banks and weaken financial stability. As Chair Powell specifically acknowledged, the proposed increases in market risk capital in particular threaten "a movement of some of these activities into the shadow banking sector."[11]

U.S. GSIBs compete directly with nonbanks across an array of business segments. Since 2008, the size and scope of nonbanks relative to banks have increased substantially. According to data collected by the Financial Stability Board ("FSB"), in 2008, nonbanks owned or controlled roughly 43% of global financial assets.[12] By 2022 (the latest year available) that proportion had grown to roughly 47.2%.[13] For example, banks have specifically lost ground to nonbanks in mortgage lending and servicing, where most activity is now conducted outside the regulated banking system, and equity market intermediation, where approximately 50% of all equity trading is executed by nonbanks.[14] Quantitative analysis estimates that $40 billion, or approximately 13%, of U.S. GSIB revenues could transition to foreign banks and nonbanks.[15] U.S. financial history is replete with other examples of how inflexible regulation creates regulatory arbitrage opportunities for nonbanks.[16]

Heightened bank regulation relative to nonbanks is a clear and primary driver of this shift. Nonbanks are neither comprehensively regulated, nor subject to bank-style capital regulations, nor overseen by prudential supervisors. The increased capital requirements of this Proposal would only hasten and exacerbate this well-established

[11] Powell Statement.

[12] FSB, "Global Monitoring Report on Non-Bank Financial Intermediation 2023" 6 (Dec. 18, 2023), https://www.fsb.org/wp-content/uploads/P181223.pdf.

[13] In addition, the data also underscores the concern that in times of stress, nonbank financial institutions tend to withdraw from the market, potentially exacerbating market volatility. The data shows sharp drops in market share following stress periods, i.e., the share dropped by 4.3% in 2008, 1.2% in 2011 and 1.3% in 2020. In each of these examples, the drop in nonbank financial intermediation was partially offset by a market share increase by banking organizations.

[14] Johannes Breckenfelder, "How does competition among high-frequency traders affect market liquidity?," European Central Bank Research Bulletin No. 78 (Dec. 15, 2020), https://www.ecb.europa.eu/pub/economic-research/resbull/2020/html/ecb.rb201215~210477c6b0.en.html.

[15] Morgan Stanley and Oliver Wyman, "Into the Great Unknown" (2023), https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2023/nov/Morgan-Stanley-Oliver-Wyman-Wholesale-Banking-Report-2023.pdf.

[16] *See, e.g.*, Nicholas K. Tabor, et al., "A Brief History of the U.S. Regulatory Perimeter," Finance and Economics Discussion Series (Aug. 2021), https://www.federalreserve.gov/econres/feds/files/2021051pap.pdf. For example, money market funds were born in response to rising interest rates and the interest rate cap set by Regulation Q.

disparity. Further, a move towards a larger nonbank footprint outside the regulated bank perimeter would result in greater financial stability risks, because as discussed in this letter, non-banks are subject to heightened liquidity risks and are more likely to pull back in times of stress.[17] Therefore, the net effect of the Proposal would be a growing nonbank sector, resulting in a riskier financial system overall.

The Proposal ignores the existing strong state of capital levels and bank prudential standards for U.S. GSIBs

As Chair Powell and Secretary of the Treasury Janet Yellen have confirmed, the U.S. banking system has "strong" levels of capital and liquidity.[18] For no institutions is this more true than the U.S. GSIBs, which already hold historically high levels of capital. As Chair Powell said in his confirmation hearing, "capital and liquidity levels at our largest, most systemically important banks are at multi-decade highs."[19] Similarly, the 2023 Financial Stability Oversight Council Annual Report also emphasized that, for U.S. GSIBs, "the Common Equity Tier 1 Capital (CET1) ratio has trended up since early 2022 and is now on par with the highest levels observed in more than 20 years."[20] By the Agencies' own admission, our member institutions are already well capitalized and an essential source of strength to the economy.

U.S. GSIBs have more than tripled their common equity tier 1 capital since 2008; in 2008, the U.S. GSIBs collectively maintained slightly less than $300 billion in CET1, while today, that amount stands at over $900 billion.[21] U.S. GSIBs also are subject to annual supervisory stress testing and have maintained capital well in excess of amounts required by those stress tests. Since 2012, stress test losses determined by the FRB have averaged only about 15% of available capital resources, demonstrating the extremely strong capital position of U.S. GSIBs.

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[17] As Governor Waller said, "a safe but needlessly narrow *banking* system doesn't necessarily result in a safe *financial* system and vibrant economy." FRB, "Statement by Governor Christopher J. Waller" (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/waller-statement-20230727.htm. *See also* BCBS, "Newsletter on bank exposures to non-bank financial intermediaries" (Nov. 24, 2022), https://www.bis.org/publ/bcbs_nl31.htm.

[18] Powell Statement. Janet Yellen, "Remarks by Secretary of the Treasury Janet L. Yellen at Independent Community Bankers of America (ICBA) 2023 Capital Summit" (May 16, 2023), https://home.treasury.gov/news/press-releases/jy1484.

[19] Jerome Powell, "Nomination Hearing," Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs (Jan. 11, 2022), https://www.federalreserve.gov/newsevents/testimony/powell20220111a.htm [hereinafter, the "Powell Nomination Hearing"].

[20] Financial Stability Oversight Council, "Annual Report 2023" at 52 (2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.

[21] According to data from FR Y-9C reports, U.S. GSIBs maintained $297 billion in "common equity" on December 31, 2008. According to data as of the second quarter of 2023, aggregate U.S. GSIB CET1 is $914 billion (third quarter data is not yet available).

Beyond capital regulation, U.S. GSIBs are also subject to a host of additional prudential requirements that interact with various parts of the capital framework and further support and strengthen their resilience, including quantitative liquidity ratios, total loss-absorbing capacity ("TLAC"), long term debt ("LTD") and recovery and resolution planning requirements and enhanced supervision under the Large Institution Supervision Coordinating Committee (LISCC) program. The presence of these additional layers of (sometimes conflicting) prudential regulation directly contradicts the Agencies' contention that the Proposal is necessary to level the playing field with smaller banking organizations.[22]

The Proposal as it relates to U.S. GSIBs is wholly unrelated to the 2023 regional banking turmoil

Regulators have explicitly cited the 2023 regional banking turmoil as an impetus for the Proposal.[23] As they were during the COVID-19 pandemic, the U.S. GSIBs were an essential source of strength to the industry. Despite that, inexplicably, the Proposal would penalize U.S. GSIBs more than any other banks in a number of ways, not least of which is the compounding effect of the GSIB surcharge requirement on higher risk-weighted assets ("RWA") resulting from the Proposal.

First, as it relates to U.S. GSIBs, there is no connection between the current Proposal and the recent regional banking stresses. In fact, the Proposal's starting point is a capital framework adopted by the BCBS in 2017 – six years before the regional banking turmoil occurred.

Second, there is no evidence that higher levels of capital at the U.S. GSIBs would have had any impact on the spring 2023 regional bank instability, the backdrop against which the Agencies have framed the Proposal. None of the instabilities present in regional banks earlier in 2023 have any relation to the capital or financial position of U.S. GSIBs. Rather, available evidence demonstrates that business and households moved their deposits *to* U.S. GSIBs during the regional banking turmoil in light of their clear and convincing capital strength and stability. Additionally, U.S. GSIBs actively contributed $30 billion in the form of unsecured deposits to shore up one troubled lender to provide much needed time for the resolution of that lender in an orderly and cost-effective manner.

Finally, and critically, the aspects of this Proposal that may have some nexus to the regional bank turmoil are wholly unrelated to U.S. GSIBs. For example, the Proposal changes the extent to which non-GSIBs must reflect accumulated other comprehensive income ("AOCI") in their capital levels. However, U.S. GSIBs capital levels already fully reflect AOCI (including unrealized losses on available-

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[22] Proposal at 64170.

[23] Barr Statement.

for-sale securities) and hence do not bear any relation to this aspect of the Proposal. In fact, given that U.S. GSIBs are the primary market makers in derivatives that regional banks use to hedge these risks, penalizing this type of intermediation (as the Proposal would) may exacerbate vulnerabilities in the banking sector that the events of March and April 2023 revealed.

The Proposal is not justified

The Agencies contemplate a significant increase in capital despite regulatory statements in recent years and academic literature that have largely suggested capital levels are appropriate. This is particularly true for the U.S. GSIBs, which, as discussed above, have record high levels of capital. Any proposal to substantially raise capital requirements must clear a very high bar to justify such an increase in the face of clearly demonstrated strength and resiliency, particularly among our member institutions. To the contrary, the Proposal offers no compelling analysis, data or evidence to suggest that the proposed changes for U.S. GSIBs are at all warranted or necessary.

The economic analysis provided by the Agencies is cursory and does not provide a rigorous and comprehensive cost-benefit analysis of the proposed requirements that considers the impacts on end users and the economy as a whole. In many instances, the Proposal makes assertions that are not supported by evidence and that our analysis shows to be incorrect. Moreover, the Proposal does not provide a conceptually consistent analytical framework or explain key assumptions and data. The public should have the ability to understand and respond to the Agencies' analysis of bank capital that presumably serves as the key motivation for this Proposal.

Finally, as we have previously noted,[24] the Proposal is based on incorrect data. Any assessment of the Proposal's impact on capital must be informed by up-to-date data pertaining to the Proposal itself, and we believe it must also take into account all components of the Agencies' regulatory capital framework. Moving forward with this Proposal on the basis of such a lack of justification would represent a clear public policy error that would only serve to weaken our economy.

The Proposal must be re-proposed

As discussed at greater length in the remainder of this letter, given the significant analytical gaps in the Proposal and its incongruous implementation of the Basel III endgame as compared to other jurisdictions, the Agencies must make available a

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[24] *See* Kevin Fromer, et al., "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity" (Dec. 22, 2023), https://fsforum.com/a/media/associations-letter-re-b3e-impact-on-u.s.-gsibs.pdf.

more comprehensive analysis justifying the proposed requirements and re-propose the rule in full, providing for a new 120-day comment period.

The re-proposal should articulate clearly the specific problem that needs to be addressed by such large increases in required regulatory capital and explain specifically how the proposed solution directly addresses the identified problem in a manner that is not already addressed by the existing regulatory framework. Moreover, the re-proposal must contain a robust economic analysis that clearly and convincingly demonstrates the net social benefit of the Proposal in a data-based and transparent fashion that can be subjected to meaningful review and comment. That analysis must appropriately match the breadth and detail of the proposed capital requirements.

To the extent that the Proposal is informed by, and is adjusted as a result of, ongoing quantitative analysis being provided by affected banks, regulators have a public policy obligation to make that analysis public, communicate how the Proposal would be adjusted in light of that analysis and provide the public with an opportunity to comment on the analysis and the proposed adjustment.

In this letter, we identify specific concerns and observations regarding the Proposal and offer recommendations that would improve the calibration of the framework as the Agencies consider how to re-propose the rule.

EXECUTIVE SUMMARY

The Proposal would increase capital requirements for our member institutions by $225 billion, which represents roughly 30% increase in required capital relative to current requirements inclusive of the GSIB surcharge and 25% increase in required capital disregarding increases in the GSIB surcharge, in each case significantly higher the Agencies' estimate of 19%. This significant increase appears to be premised on the assumption that "there is room to increase capital requirements from their current levels while still yielding positive net benefits."[25] As explained in Section I.A, the analysis presented in the Proposal fails either to provide a transparent, evidence-based justification for this assertion or to explain key assumptions and data necessary to allow the public to understand and critically evaluate the Agencies' claims.

Any re-calibration of the current capital framework must be informed by both (1) a top-down, evidence-based view of bank capital that ensures that any increases in overall levels of capital are ultimately justified in light of their costs to U.S. business and households and, ultimately, the economy and (2) a rigorous, bottom-up approach that seeks to ensure that individual components are appropriately calibrated within and across frameworks.

Our analysis, presented in Section I.B, demonstrates that the premise of there being "room to increase capital" is incorrect. The Agencies' economic analysis significantly understates the Proposal's potential economic impacts, which extend beyond affected banking organizations, bank "lending activity" and bank "trading activity" to the broader U.S. economy, with significant implications on the availability of credit and other financial services for American households and businesses. In the aggregate, estimates from leading academic studies suggest that a capital increase of the magnitude contemplated by the Proposal would cost the economy over $100 billion *per year*. Over a thirty-year timeframe, this would cost the economy in excess of $1 trillion. Similarly, our analysis also demonstrates that the calibration of various individual components is flawed as a result of: (1) adoption of flawed methodologies that are not supported by analysis and (2) adoption of the Basel Framework without proper regard for unique characteristics of the U.S. markets.

In this letter, we raise concerns, offer observations and make recommendations that should inform a re-proposal. Certain key recommendations are summarized below.

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[25] Proposal at 64169.

Structural and Overall Calibration Recommendations

Our analysis in Section I demonstrates that the Proposal is fundamentally over-calibrated. The following key recommendations would help to mitigate some of the most significant drivers of the over-calibration.

- As discussed in Section I.A, the Agencies should undertake a comprehensive quantitative analysis of the interactions that the Proposal would have with all of the Agencies' prudential regulatory requirements (including TLAC, LTD, GSIB surcharge and SCB, among others) and publish the results of that analysis. The results of this analysis should inform any revision to the current framework for calculating RWA and must avoid overstatement of risk.

- Operational risk charges are the single largest source of capital increases under the Proposal. Based on the Forum's analysis, operational risk RWA would account for 64% of the total increase in Forum member institutions' RWA.[26] These significant increases are the result of the proposed standardized methodology for capitalizing operational risk, which we respectfully submit has significant conceptual flaws as outlined in Section VII below. In addition, the Agencies provide no basis for including credit valuation adjustment ("CVA") RWA in the binding expanded risk-based approach ("ERBA") capital ratio to which the SCB (which would include CVA losses) would be applied. One way to resolve these issues would be to not apply the SCB to capital ratios determined under ERBA. As an alternative, the Agencies could:

    - Remove operational risk losses in the supervisory stress tests from the Business Indicator or exclude operational risk losses from the SCB;

    - Exclude CVA losses from the SCB; and

    - Fundamentally recalibrate operational risk RWA, as described in Section VII below.

- As set out in the Forum's letter comment letter on the GSIB surcharge proposal, the FRB should, among other things, recalibrate the GSIB surcharge to take into account the increase in RWA that would result from the Proposal.

- In addition to the revisions recommended above, the FRB should revise its supervisory stress testing framework by:

[26] The Agencies' analysis implies 78% of the increase across Category I and II banking organizations is due to significant underestimation of increases in credit risk RWA, which in turn underestimate overall RWA increases. *See* Proposal at 64168.

  - Recalibrating the Global Market Shock ("GMS") (including by modifying the assumption of no liquidity over an extended period of time to one of limited liquidity and by removing private equity) and Large Counterparty Default ("LCD") components or excluding the impact of GMS- and LCD-related losses from the SCB calculations; and

  - Adjusting the calibration of the assumptions related to loss-given-default ("LGD") in supervisory stress test projections to align with banks' own loss experience and risk-mitigating actions taken during stress periods.

- As discussed in Section VII, the total capital requirement for operational risk must be recalibrated to address both the broad-based over-calibration and the specific over-calibration related to banks with high-fee income.

- Translation of a banking organization's capital charges into RWA amounts, or vice versa, should involve application of a yearly institution-specific factor, rather than a static 8% assumption.

- The Agencies must calibrate the credit risk elements of ERBA to be consistent with the actual risk, by basing them on the outputs of the advanced approaches.

- The FRB should address timing considerations that could result in unintendedly high SCBs.

Key Technical Recommendations

As we discuss in Sections III through VIII of this letter, specific components of the Proposal also contribute to over-calibration. Below, we summarize certain key recommendations that would improve the overall calibration of the framework and the risk sensitivity of specific components.

- The final rule should not restrict the availability of the lower 65% risk weight for investment-grade corporate exposures to companies that have (or with a parent company that has) publicly traded securities outstanding. Banking organizations should be permitted to make use of alternative options that accomplish the Agencies' objectives of increased consistency, transparency and market discipline.

- The final rule should retain the 100% risk weight for effective hedge pairs.

- The Agencies should retain the 100% risk weight "bucket" for non-significant equity exposures and expand the 100% risk weight category to include equity

investments made pursuant to a nationally legislated program, such as renewable tax credit equity financing.

- The "p-factor" under Securitization Standardized Approach ("SEC-SA") should be reduced from 1.0 to 0.5, and the p-factor for certain securitization transactions should be set at 0.25.

- The minimum haircut floor framework for securities financing transactions ("SFT") should not be implemented in light of significant conceptual and operational issues.

- The Agencies should redevelop risk weights for residential mortgage and other retail exposures based on a risk-based, empirical analysis such as the advanced approaches; at a minimum, risk weights should be aligned to the Basel Framework.

- The higher credit conversion factor for undrawn credit card lines should not be adopted.

- The final rule should adopt a 20% risk weight for more-than-well-capitalized banks, short-term bank exposures and regulated financial institutions to better align with risk.

- We recommend that the capital markets components of the Proposal be revised materially.

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I. Economic Impact of the Proposal

We respectfully submit that the Proposal is not economically justified. As the Agencies recognize in including an "Impact and Economic Analysis," significant changes to the Agencies' risk-based capital framework must be motivated by comprehensive, transparent and rigorous analyses that the public can objectively and critically evaluate as a part of the comment process. The analysis presented in the Proposal fails to provide a transparent, evidence-based assessment of the Proposal's anticipated impact on banking organizations, businesses, households and, ultimately, the economy that might justify the proposed changes.

As described in Section I.A below, the Agencies' economic analysis: (1) is incomplete and insufficiently granular and fails to consider the cumulative impact of the prudential framework to which our member institutions are subject; (2) does not provide a conceptually consistent analytical framework or explain key assumptions and data necessary to allow the public to understand and critically evaluate the findings presented; and (3) in certain areas, is based on incorrect data or flawed reasoning. The results of a Forum analysis, which seeks to address some of these shortcomings, are presented in Section I.B below. We conclude that, based on the best available data and academic literature on bank capital, the Proposal would result in costs to the real economy that are not empirically justified.

A. The Agencies' impact and economic analysis does not justify the Proposal

1. The Agencies' impact and economic analysis is incomplete

The Proposal's Impact and Economic Analysis is incomplete in a number of respects.

First, the Proposal fails to consider the full range of potential impacts the Proposal could have on the broader U.S. economy as well as on entire categories of activities and the broad range of stakeholders that will be impacted, including U.S. businesses and households.

Although the Impact and Economic Analysis alludes to "possible implications for economic growth" and the "important roles that financial intermediaries play in lowering transaction costs and improving market efficiencies," the Agencies' otherwise narrow focus on the potential impact on bank lending activity and bank trading activity understates the potentially significant impacts that the Proposal could have on the macroeconomy and makes it difficult to rigorously evaluate the Proposal's economic costs and benefits. Although Forum member institutions comprise only a small fraction of the 4,000 banking organizations in the United

States,[27] our institutions play a critical role in the U.S. economy as financial intermediaries and conduits for monetary policy implementation. Forum member institutions hold $4.55 trillion in loans, accounting for 38% of total lending by banks to businesses and households in the United States, provide nearly half of all consumer loans by banks in the United States and underwrite nearly three-quarters of debt and equity transactions among large financial institutions.[28] Any putatively economic analysis of the Proposal must therefore consider potential macroeconomic impacts, including on the availability of credit for businesses and households, investment behavior, the liquidity and depth of capital markets, implementation of monetary policy and systemic risk, including movement of activity into the non-bank financial sector.

The Proposal's narrow focus on bank lending and bank trading activity also eschews any analysis of potential impacts on important categories of activities and stakeholders. For example, the Agencies state that "lending" and "trading" activities together account for an increase of $1.260 trillion in RWA. Yet the Agencies' analysis presented in Table 11 to the Proposal indicates that standardized RWA would increase by $2.2 trillion under the Proposal.[29] The Proposal thus fails to consider nearly $1 trillion in increased RWA. While lending and trading are important, core bank activities, this nearly $1 trillion gap encompasses a wide range of products and services for which significant increases in required capital have not been justified or even analyzed. These activities include advisory services, payment and card services, private banking, cash and securities clearing, custody services, corporate trust and agency, asset management and retail brokerage services. Similarly, other key traditional banking activities, such as secondary market activity in the mortgage market (e.g., originate-then-sell), would see significant increases in capital requirements that are not commensurate with their risks.

As to impacts beyond affected banking organizations, the Proposal should at a minimum (but does not) seek to identify and understand the potential impacts of the Proposal, including on American consumers, investors, retirees, small and large businesses and other end users of financial products and services. For example, any analysis should explore:

- the impact that the proposed mortgage risk weights would have on the availability and pricing of home loans, particularly to low- and moderate-income ("LMI") borrowers (given the Agencies' stated intention that the

[27] FDIC, BankFind Suite, https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew_Char&selectedEndDate=2022&selectedReport=CBS&selectedStartDate=2022&selectedStates=0&sortField=YEAR&sortOrder=desc (shows 4,136 commercial banks in 2022).

[28] Based on most recently available Forum data. Forum, "Essential to the U.S. Economy" (last visited Dec. 24, 2023), https://fsforum.com/our-impact/essential-to-the-u-s-economy.

[29] Proposal at 64168.

Proposal not "diminish home affordability or homeownership opportunities" for such buyers);

- the impact of the increase in the credit conversion factor for credit cards would have on U.S. households', and particularly LMI borrowers', ability to obtain credit for everyday purchases and gain access to mortgages and other forms of retail credit;

- the extent to which increased mortgage servicing costs resulting from increased mortgage risk weights and operational risk capital requirements may accelerate the continued shift of mortgage origination and servicing outside of the regulated banking sector, given regulators' systemic risk concerns regarding non-bank financial institutions;

- the impact that the calibration of operational risk capital requirements for fee- and services-based businesses could have on pension and other regulated investment funds' ability to access core banking services, which in turn could influence employee and retiree investment behavior; and

- the effect that significant increases to market risk capital requirements and the addition of a new CVA capital requirement could have on commercial end users' ability to hedge risks.

Second, the Agencies propose significant changes to specific methodologies that are not substantiated by any data, analysis or other facts that can be reasonably evaluated by the public. Other than a brief discussion of the calibration of risk weights for residential mortgage and retail credit exposures, the Proposal does not discuss the economic impacts of any specific proposed changes. In fact, the Proposal does not provide <u>any</u> justification for the vast majority of the proposed changes to its risk-weighting methodologies, other than alluding to consistency with the Basel Framework. <u>Appendix A</u> includes a list of changes to the treatment of asset classes discussed in our letter that are not addressed at all in the Impact and Economic Analysis section.

Examples of particularly significant changes that are not addressed in the Impact and Economic Analysis section or otherwise justified by presenting evidence, include the securities listing requirement for investment-grade designations, the flooring of the operational risk requirement's internal loss multiplier at 1.0, the imposition of minimum haircut floors for SFTs, the removal of the 100% risk weight for certain non-significant equity exposures and the revised treatment of securitization exposures.

Third, although the Agencies state that they "expect that the benefits of strengthening risk-based capital requirements for large banking organizations outweigh the costs,"[30] the Agencies do not offer any further explanation or analysis. Effectively, the Agencies assume the answer to the cost-benefit calculus before any substantive data or analysis has actually been presented.

Ultimately, the cost of increased capital is shared among banks, businesses and households. As FRB Chair Jerome Powell noted in his statement on the Proposal, the regulatory regime should "[impose] no more burden than is necessary."[31] Any increase in costs must therefore have a clear, corresponding benefit to the resilience of the financial system.

Fourth, the analysis of how the Proposal would impact other related regulatory requirements, including LTD, TLAC, the GSIB surcharge and single-counterparty credit limits, is incomplete. As our analysis in Section I.B below demonstrates, GSIB surcharges interact with increased RWA in a multiplicative fashion.

As an example, the FRB's supervisory stress tests, which are calibrated based on the current standardized approach, include projections of operational risk losses, as well as supplementary GMS (for our six of our member institutions) and LCD (for all of our member institutions) components that seek to capture tail risks resulting from market risk (including CVA) and counterparty credit losses. Currently, the SCB requirement does not apply to a banking organization's advanced approaches capital ratios. When the FRB proposed the SCB requirement in 2018, the FRB justified the (current) bifurcated approach to the capital conservation buffer ("CCB") in part by noting that both the supervisory stress test and the advanced approaches were "calibrated to reflect tail risks" and that "it could be duplicative to require a firm to meet the requirements of the advanced approaches on a post-stress basis."[32]

As another example, increasing LTD requirements would force banks to shift more of their debt financing to longer-term, and generally more expensive, debt instruments. To credibly assess the combined impact of all these related regulatory changes, the Agencies must provide an assessment of the total increase in the cost of bank funding resulting from the entire set of regulatory changes. Although the Agencies provide some information that would inform such an analysis, e.g., the size of the increase in TLAC and LTD requirements, the Agencies omit key inputs, as we discuss in Section I.A.3 below. Moreover, the analysis excludes altogether potential interaction with other certain key relevant frameworks, including the FRB's supervisory stress testing framework.

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30 *Id.* at 64167.

31 Powell Statement.

32 Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18160, 18164 (Apr. 25, 2018).

Accordingly, without such a comprehensive and holistic cost analysis, any economic impact assessment does not provide the public, or the Agencies for that matter, with sufficient data and information to assess the overall cost of the proposed reforms irrespective of their perceived benefits.

2. The impact analysis does not provide a comprehensive and conceptually consistent analytical framework to evaluate the impact of the Proposal

The Agencies' economic analysis must be based on a clear and consistent analytical framework in which the relevant assumptions, data, models and evaluation standards are disclosed. Examples of such an analytical framework include the FRB's economic analyses of the original calibration of the GSIB surcharge[33] and single-counterparty credit limits.[34] In each of these cases, the FRB presented a rigorous analytical framework and specific features of the rule were combined with existing data and clearly articulated assumptions to assess the impact of the rule in a conceptually consistent and systematic fashion.

Regardless of whether commenters ultimately agree or disagree with the findings, the use of a clearly communicated and transparent analytical framework facilitates feedback on the economic impact, allowing commenters to provide targeted commentary with respect to: (1) the overall analytical framework; (2) how the rule's requirements are mapped into the chosen analytical framework; (3) the data used by the Agencies to operationalize the analytical framework; and (4) the suitability of maintained assumptions employed by the framework.

The Proposal's limited analysis of bank "lending" and bank "trading" activities is insufficient in this regard and does not provide the public an objective means by which to assess the relative costs and benefits of the Proposal. For example, the discussion states that "[w]hile this increase in requirements could lead to a modest reduction in bank lending, with possible implications for economic growth, the benefits of making the financial system more resilient to stresses that could otherwise impair growth are greater."[35] Commenters cannot credibly assess this type of statement, which raises additional questions regarding: (1) how "modest" the resulting reduction in bank lending would be; and (2) by what metric or standard would benefits be measured against the decline in bank lending and economic growth.

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[33] FRB, "Calibrating the GSIB Surcharge" (July 20, 2015), https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.

[34] FRB, "Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions" (Mar. 4, 2016), https://www.federalreserve.gov/aboutthefed/boardmeetings/sccl-paper-20160304.pdf.

[35] Proposal at 64169.

As another example, the Agencies assert that:

> the proposal would slightly decrease marginal risk-weighted assets attributable to retail and commercial real estate exposures and slightly increase marginal risk-weighted assets attributable to corporate, residential real estate and securitization exposures. From the marginal risk-weighted assets, the agencies derive the marginal required capital for each asset class under the proposal.[36]

This statement does not provide relevant detail on the specific calculations performed or the specific data and assumptions used to perform the calculations. It is unclear whether the analysis suggests that exposures to commercial real estate would decline by 1%, 5% or 10% relative to a baseline of no change in capital requirements. It is also unclear what assumption the Agencies make about the relative cost of debt and equity financing in assessing the marginal cost of funding, an input that is critical to assess the potential for asset reallocation resulting from changing risk weights. Without transparency into these assumptions, it is not possible to critically evaluate the Agencies' claims.

Thus, in addition to the quantitative results of any analysis (e.g., the projected amount of commercial real estate exposure decline), it is important that the Agencies disclose their analytical framework, i.e., the specific methodologies and data used to perform those calculations.

3. <u>The Proposal's economic analysis is based on faulty data and, in certain instances, flawed reasoning</u>

Beyond lacking a transparent and conceptually consistent analytical framework, the Proposal's discussion of economic impact relies on data that the Agencies themselves identify as being faulty and insufficient. Specifically, the Agencies note that the data collection on RWA was based on bank submissions to the BCBS prior to the Proposal, based on banking organizations' assumptions on how the Basel III reforms would be implemented in the United States.[37] As a result, the estimates are unlikely to reflect instances in which the Agencies' Proposal is significantly more stringent than the Basel framework, which would then be expected to significantly underestimate any potential impacts. As described in Section I.B below, this is indeed the case.

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[36] *Id.* at 64170.

[37] *Id.* at 64168 ("First, these estimates heavily rely on banking organizations' Basel III QIS submissions. The Basel III QIS was conducted before the introduction of a U.S. notice of proposed rulemaking, and therefore is based on banking organizations' assumptions on how the Basel III reforms would be implemented in the United States").

Moreover, the collected data are too coarse and aggregated to be useful to assess important and specific features of the Proposal. As the Agencies note, the data "do not include sufficient granularity for precise estimates."[38] For example, it is not possible for the Agencies to measure and assess the impact of the proposed operational risk capital requirements on wealth management services and retail brokerage because the data referenced in the Proposal only measure broad, enterprise-wide aggregates that are too coarse to reliably attribute to any particular activity.

The Agencies appear to be acutely aware of these shortcomings as they launched a renewed effort to quantitatively assess the impact of the Proposal. Unfortunately, the results will not be available to the public for review prior to the comment deadline. Any additional impact analysis that is generated from this future quantitative impact study ("QIS") must be made available to the public for its review and comment before any aspects of the Proposal are finalized so that the Agencies can benefit from comments on data that specifically pertains to the Proposal.

In addition, while much of the Agencies' discussion of the proposed requirements is too opaque to elicit any substantive comment, other portions of the analysis rely on flawed reasoning. For example, in discussing the Agencies' decision to increase the risk weights on residential mortgage and retail credit exposures beyond those agreed to in the Basel Framework, the Agencies write "[w]ithout the adjustment relative to Basel III risk weights in this Proposal, marginal funding costs on residential real estate and retail credit exposures for many large banking organizations could have been substantially lower than for smaller organizations not subject to the proposal."[39]

The marginal funding cost for a bank subject to the Proposal must be calculated by reference to all aspects of the capital framework to which it is subject. For example, smaller banking organizations (i.e., those with less than $100 billion in total consolidated assets) are not subject to an SCB requirement that may include scenarios that contemplate significant declines in housing prices, or enhanced prudential standards (including liquidity requirements) that would otherwise increase banking organizations' cost of funding. Even under the Proposal, residential mortgages and retail credit exposures each would be subject to both credit risk weights and new standardized operational risk requirements, the latter of which represent a significant increase in RWA. Critically, these new operational risk capital requirements do not apply to banks that are not subject to the Proposal. Accordingly, the marginal funding cost for banks subject to the Proposal relative to banks not subject to the Proposal depends on (1) the difference in risk weights for the specific exposure between the proposed requirements and existing requirements that apply to banks not subject to the Proposal and (2) the incremental operational risk

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[38] *Id.*

[39] *Id.* at 64170.

capital requirements that result from the specific exposure. Any comparison regarding marginal funding costs that omits a discussion of incremental operational risk capital requirements (with respect to which the Agencies' prior QIS did not collect data) is fundamentally incomplete.

* * *

In summary, the Proposal's "Impact and Economic Analysis" does not justify the contemplated increases in capital. The discussion presented assumes the Agencies' desired outcome that "the benefits of strengthening risk-based capital requirements for large banking organizations outweigh the costs"[40] without presenting an analytical framework or any data-based evidence to support that assertion. Moreover, the discussion is overly broad and fails to analyze manifold key aspects of the Proposal that would be expected to have a material impact on the cost and availability of credit. The limited data that does inform the analysis is, by the Agencies' own admission, insufficient and incomplete for the desired purpose. Similarly, the discussion and broad qualitative statements provided for commenters in this section are too high level and vague for commenters to credibly evaluate and rigorously assess. Finally, some of the analysis presented in the section is simply incorrect and supports incorrect conclusions. The Agencies have at least partially recognized these shortcomings in launching a new data collection effort, but an enhanced data collection is only one of many improvements that are required to conduct a credible and holistic economic analysis of the Proposal. Ultimately, the Agencies must conduct an entirely new economic impact analysis and give the public an opportunity to comment on that new analysis before any rule can be finalized.

B. Impact of the Proposal on Required Capital, Related Requirements and the Economy

As part of the Forum's analysis of the Proposal, the Forum has conducted an extensive, data-based assessment of the impact of the Proposal on Forum member institution capital requirements, related regulatory requirements, as well as its potential impact on the economy. In this section, we review the findings of our analysis and discuss the implications for the economy. Finally, throughout the comment letter, we provide data on the impact and cost of the Proposal that is based on the Forum data analysis that is described below.

1. Impact on Required Capital

Table 1 documents the impact of the Proposal's requirements on the aggregate required CET1 capital for Forum member institutions. Specifically, the table summarizes required risk-based capital amounts based on Forum member institution

[40] Proposal at 64030.

balance sheet exposures as of the second quarter of 2023. Further, required capital amounts depend on the specific SCB and GSIB surcharge applicable to each Forum member institution. The analysis presented below uses the SCB requirement and GSIB surcharge that were applicable to each member institution in the fourth quarter of 2023 as well as the GSIB surcharge that would apply once (1) changes resulting from the rule's backwards-looking dependence on balance sheet variables take effect in 2024 and (2) changes resulting from the FRB's recently released GSIB surcharge proposal take effect. We describe precisely how SCB and GSIB surcharges are incorporated into the analysis in more detail below.

Table 1 presents four separate estimates of required capital. The first estimate, "Current," shows required capital under the current large bank capital regime, i.e., pre-Proposal. The second estimate, "Proposal," shows what required capital would be under the Proposal. The third estimate, "Modified," shows required capital assuming a number of modifications to the proposed risk weights (discussed in greater detail in the remainder of this comment letter and summarized in Table B1 in Appendix B to this letter). Finally, the fourth estimate, "Output Floor," shows the required capital that would result if the Agencies adopted the "output floor" approach to required capital in a manner consistent with the Basel Framework. Specifically, the Output Floor calculation allows the use of model-based "advanced approaches" in the calculation of RWA so long as the resulting level of RWA is no less than 72.5% of ERBA RWA. The table then shows the required level of capital, as well as the dollar and percentage change relative to current requirements ("Current").

In the case of current requirements, we use the level of the SCB and GSIB surcharge that was in effect in the fourth quarter of 2023. In the case of the three additional scenarios, we calculate the required capital level in two ways. In the "Pre-GSIB" column of Table 1, we report the required capital level that would result assuming the same level of the SCB and GSIB surcharge that is used for the "Current" estimate. In the "Post-GSIB" estimate, we report the required capital level that is expected following the finalization of the FRB's GSIB surcharge proposal. As discussed, GSIB surcharges are expected to increase once the GSIB surcharge proposal is finalized, because (1) GSIB surcharges for some Forum member institutions are set to increase in 2024; and (2) the FRB GSIB surcharge proposal indicated that the proposed changes are expected to increase GSIB surcharges by 13 basis points, on average, across Forum member institutions. In assessing the increase in capital under the Proposal, it is crucial to consider all relevant factors that could lead to higher capital requirements to ensure that the analysis is appropriately holistic. Importantly, GSIB surcharges interact with increased RWA in a multiplicative fashion. Accordingly, failing to account for the impact of heightened GSIB surcharges leads to a measurable understatement of the increase in capital associated with this Proposal. Accordingly, the total impact of the Agencies' capital proposal is appropriately measured with reference to the "Post-GSIB" calculations, though the "Pre-GSIB" calculations are helpful for reference.

As shown in Table 1, required capital under the Proposal, inclusive of all expected increases in GSIB surcharges, would increase by roughly $225 billion (Proposal\Post-GSIB), which represents roughly a 30% increase in required capital relative to current requirements.[41] Ignoring the additional impact of increased GSIB surcharges results in roughly a 25% increase in required capital. The substantial increase in required capital under the Proposal can be traced to two drivers. First, as further detailed in Table 3 below, the Proposal's new ERBA RWA methodology would substantially increase standardized RWA by nearly 33%. Second, as discussed, GSIB surcharges are expected to increase in the near term due to planned increases as well as additional increases related to the Federal Reserve's GSIB surcharge proposal.

Table 1: Impact of Proposed Capital Requirements

	Current	Proposal		Modified		Output Floor	
		Pre-GSIB	Post-GSIB	Pre-GSIB	Post-GSIB	Pre-GSIB	Post-GSIB
Required CET1 ($BN)	750.9	937.5	975.6	765.1	794.5	717.1	745.9
Change ($BN)	N/A	186.6	224.7	14.2	43.6	(33.8)	(5.0)
Change (%)	N/A	24.9	29.9	1.9	5.8	(4.5)	(0.7)

Calculations based on Forum member institution data submissions as of Q2 2023. Required capital for "Current" assumes a level of the SCB and GSIB surcharge that applied for each Forum member institution in Q4 2023. The remaining columns reflect future required capital levels. "Proposal" reflects the impact of the Proposal's requirements. "Modified" reflects the impact of the Proposal's requirements after making several modifications that are discussed in the letter and summarized in Appendix B. "Output Floor" reflects required capital that would result if Forum member institutions were permitted to use Advanced Approaches RWA subject to a 72.5% floor as per the 2017 BCBS framework. Finally, future required capital levels are computed assuming Q4 2023 levels of the GSIB surcharge (Pre-GSIB) as well as the level of the GSIB surcharge that will result once 2024 GSIB surcharge changes take effect and the Federal Reserve's GSIB surcharge proposal is finalized (Post-GSIB). The SCB remains at its Q4 2023 level.

The Modified capital estimate in Table 1 shows that required capital would increase by roughly $44 billion (Modified\Post-GSIB), which represents roughly a 6% increase in required capital. The attenuated increase in required capital under the Modified calculation relative to the Proposal calculation results solely from reductions in RWA that relate to specific policy suggestions that are discussed in the

[41] The roughly $225 billion increase in required capital resulting from the Proposal (Proposal\Post-GSIB) that is reported in Table 1 is potentially an underestimate of the capital impact. Specifically, the analysis in Table 1 is based on estimates of RWA that pre-suppose a certain amount of model approvals for market risk. Affected firms may find that the cost of maintaining models prohibitive or may find that obtaining model approvals to be considerably more difficult that what has been assumed in their estimates. Assuming that no models are approved for market risk would result in a level of required capital under the Proposal of $989 billion (Proposal/Post-GSIB) which represents an increase of over $238 billion relative to current requirements of $750.9 billion.

remainder of this comment letter and are summarized in Appendix B. The changes to the Proposal that are embedded in the Modified capital calculation are intended to broadly align the Proposal with the international standard, while improving the risk sensitivity of the framework. Accordingly, this analysis confirms that it is feasible to implement the proposed capital reforms in a manner that does not raise capital requirements substantially.

Finally, the Output Floor capital estimate shows that required capital would be roughly unchanged if the Agencies adopted the output floor approach that is consistent with the Basel Framework (Output Floor\Post-GSIB). To be clear, the impact of the output floor itself would be to lower required capital, as indicated by the $717.1 billion in required capital (Output Floor\Pre-GSIB), but this decline is offset by the resulting increase in GSIB surcharges described above. The required capital under the Output Floor approach demonstrates the extent to which the Proposal does not align with the international standard. More specifically, the Proposal represents roughly a $230 billion increase in required capital ($975.6 - $745.9 = $229.7) relative to what would be required under the Output Floor approach. The Proposal's prohibition against the use of internal models (other than for market risk) creates a significant competitive disadvantage for Forum member institutions relative to their European counterparts as they are permitted to adopt the output floor approach to capital requirements.

2. Impact on the Economy

The broad economic impact of the Proposal's increase in required capital would be significant. A wide body of academic research has investigated the impact of increased capital requirements on economic activity and output. And while specific estimates vary, research produced by academics, standard-setting bodies such as the BCBS and central banks such as the FRB broadly conclude that increasing required capital reduces economic output. A review of thirteen different studies that consider the impact of increasing capital on economic output was used to assess the impact of the Agencies' proposed requirements on the economy.[42] The economic impact estimates are presented in Table 2.

[42] Sean Campbell, "Fixing What Ain't Broken: The Real and Hidden Costs of Excessive Bank Capital Regulation," Forum (Jan. 29, 2023), https://fsforum.com/news/fixing-what-ain-t-broken-the-real-and-hidden-costs-of-excessive-bank-capital-regulation. *See also* Anil Kashyap, Jeremy C. Stein, and Samuel G. Hanson. "An Analysis of the Impact of 'Substantially Heightened' Capital Requirements on Large Financial Institutions" (May 2010), https://scholar.harvard.edu/files/stein/files/impact_of_substantially_heightened.pdf; Federal Reserve Bank of Minneapolis, "The Minneapolis Plan To End Too Big To Fail" (Dec. 2017), https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-final.pdf; Simon Firestone, Amy Lorenc and Ben Ranish, "An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the US, Finance and Economics," Finance and Economics Discussion Series 2017-034, Washington:

Table 2: Economic Cost of Proposed Capital Requirements

	Forum Member Institutions	Sector-Wide
Annual Cost ($BN)	75	100-150
Long-Run Cost ($BN)	1,200	1,500-2,300

Calculations based on impact estimates from 13 separate research studies relating increased capital to economic output. The Long-Run costs are calculated assuming a 30-year time horizon and a discount rate of 5%.

Required capital for Forum member institutions is estimated to increase by roughly $225 billion as a result of the Proposal. This increase in required capital is roughly equivalent to an increase in risk-based capital ratios of 3.1% for Forum member institutions. Economic research suggests that increasing required capital by this amount would lead to an economy-wide reduction in output of roughly $150 billion per year. These estimates are based upon an economy-wide increase in capital and the estimates we report only pertain to Forum member institutions. Moreover, the precise impact of the Proposal on non-Forum banks is likely to differ from that of Forum member institutions. As Forum member institutions account for roughly 55%

Board of Governors of the Federal Reserve System, (Mar. 31, 2017), https://www.federalreserve.gov/econres/feds/files/2017034pap.pdf; Douglas Elliott, "Quantifying the Effects on Lending of Increased Capital Requirements," Brookings, (Sept. 24, 2009), https://www.brookings.edu/articles/quantifying-the-effects-on-lending-of-increased-capital-requirements/; Malcolm Baker and Jeffrey Wurgler, "Do Strict Capital Requirements Raise the Cost of Capital? Banking Regulation and the Low Risk Anomaly," National Bureau of Economic Research, Working Paper 19018 (May 2013), https://www.nber.org/papers/w19018; BCBS, "An assessment of the long-term economic impact of stronger capital and liquidity requirements," (Aug. 18, 2010) https://www.bis.org/publ/bcbs173.htm; Pablo D'Erasmo, "Are Higher Capital Requirements Worth It?" Federal Reserve Bank of Philadelphia, (June 2018), https://www.philadelphiafed.org/-/media/frbp/assets/economy/articles/economic-insights/2018/q2/eiq218-capital_requirements.pdf; Martin Brooke, Oliver Bush, Robert Edwards, et al., "Measuring the macroeconomic costs and benefits of higher UK bank capital requirements," Financial Stability Paper No. 35, (Dec. 2015), https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of.pdf; Thomas F. Cosimano and Dalia S. Hakura, "Bank Behavior in Response to Basel III: A Cross-Country Analysis," IMF Working Paper 11/119, (May 2019), https://www.imf.org/external/pubs/ft/wp/2011/wp11119.pdf; Michael R. King, "Mapping capital and liquidity requirements to bank lending spreads," BIS Working Papers, No 324 (Nov. 2010), https://www.bis.org/publ/work324.pdf; Peter Slovik & Boris Cournede, "Macroeconomic Impact of Basel III," OECD Economics Department Working Papers, No. 844 (Feb. 14, 2011) https://www.oecd-ilibrary.org/docserver/5kghwnhkkjs8-en.pdf?expires=1703477690&id=id&accname=guest&checksum=FD2F475E586DF74721962B015D798794; Macroeconomic Assessment Group, "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements" (Dec. 2010), https://www.bis.org/publ/othp12.pdf.

of all U.S. banking sector assets, the Forum-specific impact is roughly a $75 billion reduction in output per year.

At the same time, however, the Agencies cannot lose sight of the broader impact; these requirements would affect other banking organizations that are directly impacted by the Proposal, as well as banking organizations that are not directly impacted by the Proposal, but are indirectly impacted to the extent that they rely on larger banking organizations for critical financial services such as borrowing, hedging and securities dealing. All told, available estimates suggest that the impact of the Proposal on the entire U.S. banking sector is expected to result in an economy-wide reduction in output of between $100 and $150 billion per year.

Finally, the impact cited above refers to the loss in economic output that would result each year the heightened requirements are in place. Changes to the capital regime are intended to be long-lived and durable. Accordingly, the long-run impact of the requirements must account for the impact of the requirements on the economy over an extended period. Assuming that future costs are discounted at a rate of 5% per year, the 30 -year economy-wide cost of these requirements is projected to range from $1.5 to $2.3 trillion.

The projected cost to the economy is large and expected to be felt broadly. More specifically, the Proposal is sweeping and affects every financial service offered by large banks, ranging from lending, to market making, to wealth management. As a result, the economy-wide cost estimates provided above would be expected to reduce economic output across a wide range of economic sectors, negatively impacting households, businesses and communities throughout the country.

3. Impact on RWA

As discussed above, a considerable factor driving the measured increase in required capital is the large increase in RWA that is expected to occur under the Proposal. Below, in Table 3, we provide insight into the sources of increased RWA by comparing (1) current standardized RWA (as of Q2 2023), (2) the Agencies' proposed ERBA RWA and (3) a modified version of ERBA RWA that includes a number of specific suggestions that are intended to more closely align the Proposal with the international standard and improve its risk sensitivity.

The data in Table 3 is helpful to identify the largest RWA-centered drivers of increased capital requirements as well as those modifications to the proposed RWA requirements that would reduce the overall increase in required capital.

Table 3: Impact of Proposed and Modified Requirements on RWA ($BN)

Risk Category	Current Standardized RWA	Proposed ERBA RWA	% Increase	Modified ERBA RWA	% Increase
Credit	**6,532.4**	**6,851.7**	**4.9**	**5,391.6**	(17.5)
Credit Risk	4,879.5	4,561.4	(6.5)	4,101.2	(15.9)
Securitization	179.3	243.0	35.5	138.6	(22.7)
Equity	287.0	793.9	176.6	304.3	6.0
Counterparty	1,186.7	1,253.5	5.6	847.4	(28.6)
Market	**382.7**	**660.5**	**72.6**	**474.4**	24.0
CVA	**N/A**	**216.7**	**N/A**	**166.6**	**N/A**
Operational	**N/A**	**1,454.3**	**N/A**	**939.3**	**N/A**
Total	**6,915.1**	**9,183.2**	**32.8**	**6,971.9**	**0.8**

Calculations based on Forum member data submissions as of Q2 2023.

Under the Proposal, standardized credit and market risk each would increase under ERBA relative to the current standardized approach. Overall, credit risk RWA would exhibit a modest increase of roughly 5%, but that broad aggregate includes some components of standardized credit risk, such as banking book equity, that would see a substantial increase in RWA (+176.6%) and associated capital costs. As discussed elsewhere, the significant increase in banking book equity RWA would result in a large increase in the cost of certain bank activities such as certain renewable energy investments that are otherwise incentivized through existing government policy. Market risk would see a pronounced increase under the proposed ERBA standard of roughly 73% over current RWA levels. As discussed in greater detail in the remainder of this letter, such a sharp increase in RWA associated with trading and market making would substantially increase the cost, and reduce the availability, of market making services, which would increase the cost for public companies and municipalities to raise funding from public markets and limit corporations and pension funds from hedging, while also increasing the cost to households that save and invest in the capital markets.

In addition, the proposed requirements would create new, untested, standardized RWA approaches for CVA and operational risk. The new, standardized CVA requirements would largely impact the cost and availability of derivatives transactions, thereby increasing the cost of hedging and risk management for financial and non-financial entities. The new, standardized, operational risk RWA requirements represent the bulk of the overall increase in RWA between the current standardized and new (ERBA) RWA. Total RWA across the current and the proposed ERBA RWA requirements would increase by roughly $2.3 trillion. The new, standardized operational risk RWA account for fully $1.5 of the $2.3 trillion

increase. As discussed in greater detail in what follows, operational risk has an impact on every financial service provided by large banks. Specifically, operational risk capital requirements impact business lending, mortgage lending, market-making, hedging and wealth management activities. Moreover, to the extent that operational risk capital would need to be maintained against all banking activities such as small business and residential mortgage lending, the increases in RWA attributed directly to "credit risk" and "market risk" represent a significant understatement of the total increase in RWA and capital costs, because the large increase in operational risk RWA must also be allocated to these activities.

The final set of columns in Table 3 show how RWA would be affected by certain proposed modifications that are discussed at greater length in the remainder of this comment letter. Overall, as can be seen in the final columns of Table 3, a number of modifications to the Agencies' proposed ERBA requirements would substantially reduce the increase in RWA while still resulting in an overall increase in RWA of roughly 1%. As shown in Table 3 above, these modifications improve the risk sensitivity and international alignment of the requirements without reducing overall RWA and ultimately required capital.

As discussed, the proposed modified ERBA RWA include a large number of specific policy recommendations across the entire capital framework discussed in detail elsewhere in this comment letter. In Appendix B, Table B1, we provide detailed estimates of the impact of the recommended mitigants on both RWA as well as required capital.

4. Comparison Between Forum and Agency Impact Analysis

The discussion of the estimated capital impact thus far has focused on the Forum's own data analysis. It is instructive to compare the estimated impact from the Forum's analysis and the analysis in the Agencies' proposal. The Proposal provides an analysis of the proposed requirements in the capital and RWA levels for Category I and II banks. While the population of Category I and II banks does not coincide with the Forum's member institutions, the quantitative significance of the difference in the two populations is not material.[43] Below, in Table 4, we compare certain results of the Forum's analysis with that of the Proposal.

[43] An analysis of year-end 2021 data, for example, shows that the additional bank included in the Agencies' analysis accounts for roughly 1% of total standardized RWA.

Table 4: Impact Comparison: Agency vs. Forum Analysis

	Agencies' Proposal	Forum Proposal	Forum Modified
CET1 Change (%)	19.0	24.9	1.9
RWA Change			
Total (%)	24.3	32.8	0.8
Credit Risk (%)	(3.0)	4.9	(17.5)
Market Risk (%)	76.7	72.6	24.0
Operational Risk ($ BN)	1,400	1,454.3	939.3
CVA Risk ($ BN)	260	216.7	166.6

"Agencies' Proposal" refers to data provided in the Proposal. "Forum Proposal" refers to the Forum's estimated impact of the Proposal and "Forum Modified" refers to the Forum's estimated impact of the proposal after making several modifications discussed in the letter and summarized in Appendix B.

The first column of Table 4 reports certain results from the Proposal. The second column reports comparable results from the Forum's analysis of the Proposal (Pre-GSIB). Finally, the third column reports comparable results from the "Modified" calibration that makes several changes to the proposed requirements (Pre-GSIB).

Comparing required capital between the Proposal and the Forum's analysis shows a significantly larger increase in required capital than was estimated in the Proposal: 19% vs. 24.9%. To be clear, the 24.9% increase reflects the impact of the Proposal without accounting for any expected future increases in GSIB surcharges. Accounting for the expected increases in GSIB surcharges increases the impact to 29.9% (see Table 1). Also, as discussed above, implementing the Modified calibration would still result in an increase in capital of roughly 2%, again ignoring expected increases to GSIB surcharges.

Comparing RWA changes also shows that the Forum's analysis indicates a larger increase in RWA under the proposed requirements, 32.8% vs. 24.3%, than indicated by the Agencies' proposal. As shown in Table 4, this differential can be traced to the fact that estimated increases in Credit Risk and Operational Risk are larger than estimated in the Agencies' proposal.[44] Also, as in the case of required capital, the Modified calibration would result in a significantly smaller increase in RWA though it would still result in an overall increase in RWA.

The differences between the Agencies' and Forum's impact estimates are driven by a number of factors. First, the Agencies' estimates are based on stale balance sheet data that does not reflect changes in the industry or with Forum member institutions

[44] In the case of Operational and CVA Risk, the impact is reported in dollar rather than percentage terms because the current standardized approach does not include Operational or CVA risks thereby invalidating percentage change calculations.

that have taken place since the end of 2021. Importantly, 2021 was significantly influenced by the COVID pandemic, strongly suggesting that 2021 data is inappropriate for the purpose of characterizing the impact of the Proposal. Second, the Agencies' data reflects data that was collected in accordance with the Basel III framework and not the specific requirements of the Proposal. Importantly, the Proposal sets out more stringent requirements in a number of areas, such as risk weights for mortgages. As such, it is unsurprising that the Forum's analysis shows a greater increase in RWA and capital than reflected in the Agencies estimates.

Taken as a whole, the comparison between the Forum and Agencies' analysis of the impact of the Proposal indicates that the Agencies' analysis is flawed and significantly underestimates the impact of the Proposal. As a result, the economic costs of the Proposal are greater than that assumed by the Proposal and should be meaningfully and transparently revised in light of these new data.

5. Impact on TLAC and LTD Requirements

While the focus of the Proposal relates to risk-based capital requirements, the Proposal would also have effects on TLAC and LTD requirements for Forum member institutions, because these requirements are calibrated relative to total RWA and total leverage exposure, each of which would be modified as a result of the Proposal.

Below, in Table 5, we present the impact of the Proposal's requirements on required TLAC and LTD amounts inclusive of buffers. As above, the provided estimates are holistic in that they include the impact of changes in RWA and total leverage exposure under the Proposal.

Table 5: Impact of Proposed Capital Requirements on TLAC and LTD Requirements

	Current	Proposed	Modified
TLAC Requirement	1,714.4	2,037.0	1,709.1
Change ($BN)		322.6	(5.3)
Change (%)		18.8	(0.3)
LTD Requirement	775.6	825.9	772.4
Change ($BN)		50.3	(3.2)
Change (%)		6.5	(0.4)

Calculations based on Forum member data submissions as of Q2 2023. As in the case of Table 1, "Current" uses the value of the GSIB surcharge from 2023 Q4 while "Proposed" and "Modified" estimates use the value of the GSIB surcharge that is expected to apply once 2024 changes take effect and the Federal Reserve's GSIB surcharge proposal is finalized.

As presented in previous tables, we show current requirements (Current) as well as the impact of the proposed rule (Proposed/Pre-GSIB) and the impact associated with a modified version of the Proposal (Modified/Pre-GSIB). As shown in the table, the Proposal would increase TLAC requirements by roughly $323 billion dollars, which would be roughly a 19% increase. Increased LTD requirements would amount to roughly $50 billion, which represents roughly a 7% increase over current requirements. And, as in the case of the capital impacts reported in Table 1, the requirements reported above increase further once expected increases in GSIB surcharges are taken into account.

The economic impact of these increased requirements would be substantial. Increased TLAC and LTD requirements would have two broad effects on the economy. First, increased LTD requirements mean that banks must substitute LTD for deposit financing.[45] Businesses, communities and households rely on deposits as a store of value and liquidity. As such, reducing the availability of deposits would negatively impact business and consumers, while only increasing incentives to grow the size of deposit-like products offered by non-banks that are not regulated as stringently as banks, thereby potentially increasing financial stability risks. Second, longer-term funding resulting from increased TLAC and LTD requirements would necessarily increase the cost of bank funding, which would then lead to increased costs for all financial services provided to households and businesses offered by banks. Unfortunately, the academic literature is not as developed in assessing the economy-wide costs of increased bank debt costs as it is in assessing the economic costs of increased capital requirements. Regardless, the substantial increases in TLAC and LTD requirements implied by this Proposal are significant and would be expected to result in substantial economic costs to the economy.

Finally, as in the case of the required capital discussion, we note that the modified RWA proposal would result in a negligible change in overall TLAC and LTD requirements and would therefore not be expected to result in a substantial cost to the economy. Moreover, as discussed previously, these results demonstrate that there is an alternative approach to adopting revised capital requirements that is broadly in line with the Basel Framework, but that does not materially raise costs for the economy.

[45] The Agencies have proposed to revise their LTD rules. Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, 88 Fed. Reg. 64524 (Sept. 19, 2023). This analysis does not take into account the potential effects that such rulemaking could have to increase required GSIB LTD while restricting demand for LTD in certain ways. Accordingly, a holistic analysis of LTD requirements must also consider the impact of the Agencies' outstanding LTD proposal. Please see the Forum's letter for our more detailed comments, concerns and recommendations regarding that proposal.

6. Summary

The Forum has conducted an extensive, data-based assessment of the Proposal on required capital, related regulatory requirements and the real economy. The results of our analysis indicate that the Proposal would increase required capital for Forum member institutions by roughly 25%, which rises to 30% inclusive of the impact of expected GSIB surcharge increases. The Proposal also exceeds what would be required under the Basel Framework because the Proposal prohibits the use of the internal models-based approaches for RWA (other than for market risk) for Forum member institutions. Moreover, non-U.S. jurisdictions are fully expected to allow for the use of the advanced approaches, which would significantly widen the gap in required capital between Forum member institutions and their foreign counterparts. In addition to the significant increase in required capital, the Proposal would also increase the stringency of related TLAC and LTD requirements, which would further increase the cost of the proposed requirements. A review of independent, academic research suggests an economy-wide cost of these requirements of roughly $100-$150 billion per year that translates to a long-run economic cost of between $1.5 and $2.3 trillion.

Finally, the Forum has taken a thoughtful and data-based approach to considering the Proposal. In response, we have suggested a number of key modifications to the Proposal that would better align the requirements with the Basel Framework while also improving its risk sensitivity. Our findings indicate that adopting this modified version of the requirements would result in an increase in required capital of roughly 2% excluding expected increases to GSIB surcharges. The proposed modified approach would therefore substantially ameliorate the significant costs of this Proposal while still achieving the Agencies' objectives of reducing variability in RWA without reducing overall capital levels.

II. Calibration of Large-Bank Capital Requirements

As described in Section I, it is imperative that the Agencies understand and consider the holistic impact of the Proposal, both in terms of the cumulative impact on banking organizations in light of the Agencies' broader prudential regulatory framework and in terms of the potential impact on the broader U.S. economy and capital markets, the availability of credit and other financial services and relevant stakeholders, including consumers and end users.

A coherent calibration of large-bank capital requirements must therefore be informed by both (1) a top-down, evidence-based view of bank capital that ensures that any increases in overall levels of capital are ultimately justified in light of their costs to the economy and (2) a rigorous, bottom-up approach that seeks not only to ensure that individual components are appropriately calibrated but also addresses potential interactions between components at lower levels of aggregation within the rule (e.g., across credit risk, operational risk, market risk and CVA),[46] across regulatory capital frameworks (e.g., calculation of RWA, GSIB surcharge, leverage capital, supervisory stress testing, etc.) and over time (i.e., during any transition period).

The Proposal is premised on the incorrect assumption that regulatory capital levels at the largest banking organizations are suboptimal and, in furtherance of raising capital levels, understates its potential impacts by not considering interactions within or across frameworks. This approach to setting bank capital requirements results in significant over-calibration,[47] which in turn results in significant understatement of potential impacts on both affected banking organizations and the broader financial ecosystem that they inhabit.

To address this aspect of over-calibration, we make the following recommendations:

- As discussed in Section I.A, the Agencies should undertake a comprehensive quantitative analysis of the interactions that the Proposal would have with all of the Agencies' prudential regulatory requirements (including TLAC, LTD, GSIB surcharge and SCB, among others) and publish the results of that analysis. The results of this analysis should inform any revision to the current framework for calculating RWA, and must avoid overstatement of risk.

- Operational risk charges are the single largest source of capital increases under the Proposal. Based on the Forum's analysis, operational risk RWA would

[46] For example, this type of across-risk stripe analysis is implicit in the design of the standardized measure for market risk which, although over-calibrated, seeks to account for interactions between risk buckets and risk classes.

[47] By over-calibration, we mean a calibration that results in higher levels of capital than evidence would suggest is necessary.

account for 64% of the total increase in Forum member institutions' RWA.[48] These significant increases are the result of the proposed standardized methodology for capitalizing operational risk, which we respectfully submit has significant conceptual flaws as outlined in Section VII below. In addition, the Agencies provide no basis for including CVA RWA in the binding ERBA capital ratio to which the SCB (which would include CVA losses) would be applied. One way to resolve these issues would be to not apply the SCB to capital ratios determined under ERBA. As an alternative, the Agencies could:

- Remove operational risk losses in the supervisory stress tests from the Business Indicator or exclude operational risk losses from the SCB;
- Exclude CVA losses from the SCB; and
- Fundamentally recalibrate operational risk RWA, as described in Section VII below.

- As set out in the Forum's letter comment letter on the GSIB surcharge proposal, the FRB should, among other things, recalibrate the GSIB surcharge to take into account the increase in RWA that would result from the Proposal.
- In addition to the revisions recommended above, the FRB should revise its supervisory stress testing framework by:
    - Recalibrating the GMS (including by modifying the assumption of no liquidity over an extended period of time to one of limited liquidity and by removing private equity) and LCD components, or excluding the impact of GMS- and LCD-related losses from the SCB calculations; and
    - Adjusting the calibration of the assumptions related to LGD in supervisory stress test projections to align with banks' own loss experience and risk-mitigating actions taken during stress periods.
- As discussed in Section VII, the total capital requirement for operational risk must be recalibrated to address both the broad-based over-calibration and the specific over-calibration related to banks with high-fee income.
- Translation of a banking organization's capital charges into RWA amounts, or vice versa, should involve application of a yearly institution-specific factor, rather than a static 8% assumption.

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[48] The Agencies' analysis implies 78% of the increase across Category I and II banking organizations is due to significant underestimation of increases in credit risk RWA, which in turn underestimate overall RWA increases. *See* Proposal at 64168

- The Agencies must calibrate the credit risk elements of ERBA to be consistent with the actual risk, by basing them on the outputs of the advanced approaches.
- The final rule and SCB each should become effective on October 1.
- To the extent that the SCB applies to an ERBA ratio, during the transition period, the SCB requirement and the method 2 GSIB surcharge should be determined based on a fully phased-in ERBA denominator.

A. The final rule must address the significant over-calibration of capital requirements resulting from adoption of flawed methodologies and failure to comprehensively consider all aspects of the Agencies' prudential regulatory framework

1. Challenges and Concerns

The Proposal represents a significant over-calibration of the capital requirements, premised on the flawed assumption that our member institutions are undercapitalized and on an incomplete assessment of the Proposal's cumulative impacts.

First, a significant portion of the over-calibration results from the conclusion that current levels of bank capital at our member institutions are sub-optimal. There is no direct evidence to support that assertion.

As Chair Powell said in his most recent confirmation hearing, "capital and liquidity levels at our largest, most systemically important banks are at multidecade highs,"[49] in large part due to post- 2008 reforms that significantly enhanced capital, liquidity and other prudential standards for U.S. GSIBs. Because of these gains, the substantial proposed additional capital charges would provide no empirically discernable benefit.

The Agencies' conclusion appears to be premised in part on a review of academic literature that the Agencies read to "conclude[] that there is room to increase capital requirements from their current levels while still yielding positive net benefits."[50] However, the Agencies concede that "quantification of the economic costs and benefits of changes in bank capital is difficult and highly contingent on the

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[49] Powell Nomination Hearing. Chair Powell reaffirmed this view in his statement on the Proposal, concluding that the "U.S. banking system is sound and resilient, with strong levels of capital and liquidity." Powell Statement.

[50] Proposal at 64169.

assumptions made" and that capital levels in the United States are within the optimal capital level ranges described in the existing literature.[51]

Despite this, the Proposal asserts that levels are at the "low end" of the range. A recent independent PricewaterhouseCoopers study that reviewed literature produced by leading academics, regulatory institutions and standard-setting bodies (the "PwC Study") cautioned that although "the existing body of literature on optimal capital levels is vast, and conclusions regarding what is optimal vary due to differences in approach and assumptions,"[52] the optimal level of (Tier 1) capital ranged from 12% to 19.5% with an average of 15.5%.[53] The same study found that the average capital ratio of large banks was roughly 15.5% and 15.2% in 2021 and 2022, respectively, well within the range presented in the academic research and certainly not at "the low end" of that range.[54]

Second, the proposed standardized operational risk capital requirements drive a significant portion of the Proposal's overall over-calibration. Unlike other aspects of the Proposal that are targeted to the risks of specific products and services, the proposed operational risk capital requirements would apply on a firm-wide basis, thereby impacting the cost and availability of all financial products and services provided by our member institutions.

As we discuss in Section VII below, we respectfully submit that the proposed approach is a conceptually flawed approach that overstates operational risk, particularly with respect to fee-based businesses and disregards specific features and risk profiles of different banking organizations, business lines and specific controls banking organizations have in place to mitigate risks.

Third, as discussed in Section I.A.1 above, some of the over-calibration results from unexplored interactions between calculation of RWA (largely calibrated based on the Basel Framework) and other elements of the Agencies' prudential framework, which include many U.S.-specific requirements.[55] In many cases, these interactions result in increases in required capital beyond those that would result from analysis of a

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[51] *Id.*

[52] PWC, "Basel III Endgame - The next generation of capital requirements" at 77 (Apr. 2023), https://explore.pwc.com/baseliiiendgame/basel-iii-end-game-report [hereinafter, the "PWC Study"].

[53] *Id.* at 75.

[54] *Id.*

[55] As the PwC Study cautions: "when policymakers consider increases in capital levels that could stem from the implementation of Basel III Endgame, it is important to not only examine the optimal levels of capital discussed in the literature but also to consider the limitations of the analysis presented, such as the partial inclusion of post-crisis regulatory reforms and the complex interactions between bank capital requirements." *Id.* at 77.

single framework in isolation. For example, the Proposal does not discuss, or presents incomplete analysis with respect to:

- The GSIB surcharge framework, which interacts with RWA in a multiplicative fashion to increase capital requirements;

- The FRB's supervisory stress tests, which are calibrated based on the current standardized approaches (rather than ERBA) and include projections of operational risk losses (not separately capitalized under the standardized approach, but that would be under ERBA) and supplementary GMS and LCD components that seek to capture tail risks that the Proposal's revised market risk and CVA frameworks are intended to address;

- TLAC and LTD requirements, the latter of which forces banks to shift more of their debt financing to longer-term, and generally more expensive, debt instruments; and

- Other examples, including: (1) uncleared margin and mandatory swap clearing requirements (inconsistent with the MPOR assumptions of the CVA framework); (2) risk retention requirements, and other post-2008 securitization market and mortgage reforms (which are not reflected in the p-factor revisions); and (3) SEC Rule 15c3-3 and FRB Regulations T, U and X (inconsistent with the proposed minimum haircuts for SFTs).

It is critical that large-bank capital requirements, including the calculation of buffers, analyze and account for these interactions to ensure that overall levels of capital are appropriately calibrated.

Finally, a significant portion of the Proposal's overall over-calibration is driven by over-calibration of specific components. As discussed elsewhere in this comment letter, there are significant deficiencies with the conceptual frameworks used to justify these and other aspects of the Proposal, which in most cases can be traced to: (1) adoption of flawed methodologies that are not supported by analysis; or (2) adoption of the Basel Framework without proper regard for unique characteristics of the U.S. markets. Elsewhere in this letter, we provide more detailed comments and recommendations regarding these individual components.

2. Recommendations

We make the following recommendations that would improve overall calibration.

- As discussed in Section I.A, the Agencies should undertake a comprehensive quantitative analysis of the interactions that the Proposal would have with all of the Agencies' prudential regulatory requirements (including TLAC, LTD, GSIB surcharge and SCB, among others) and publish the results of that

analysis. The results of this analysis should inform any revision to the current framework for calculating RWA, and must avoid overstatement of risk.

- One way to resolve over-calibrated capital requirements for operational risk and CVA would be to not apply the SCB to capital ratios determined under ERBA. As an alternative, the Agencies could:
    - Remove operational risk losses in the supervisory stress tests from the Business Indicator or exclude operational risk losses from the SCB;
    - Exclude CVA losses from the SCB; and
    - Fundamentally recalibrate operational risk RWA, as described in Section VII below.
- As set out in the Forum's letter comment letter on the GSIB surcharge proposal, the FRB should, among other things, recalibrate the GSIB surcharge to take into account the increase in RWA that would result from the Proposal.
- In addition to the revisions recommended above, the FRB should revise its supervisory stress testing framework by:
    - Recalibrating the Global Market Shock ("GMS") (including by modifying the assumption of no liquidity over an extended period of time to one of limited liquidity and by removing private equity) and Large Counterparty Default ("LCD") components, or excluding the impact of GMS- and LCD-related losses from the SCB calculations; and
    - Adjusting the calibration of the assumptions related to loss-given-default ("LGD") in supervisory stress test projections to align with banks' own loss experience and risk-mitigating actions taken during stress periods.
- As discussed in Section VII, the total capital requirement for operational risk must be recalibrated to address both the broad-based over-calibration and the specific over-calibration related to banks with high-fee income.
- Translation of a banking organization's capital charges into RWA amounts, or vice versa, should involve application of a yearly institution-specific factor, rather than a static 8% assumption.
- The Agencies must calibrate the credit risk elements of ERBA to be consistent with the actual risk, by basing them on the outputs of the advanced approaches.

B. The final rule and SCB each should become effective on October 1[56]

1. Challenges and Concerns

Under the Proposal, beginning in 2025, ERBA would transition to the next highest denominator phase-in percentage on July 1. In contrast, the SCB requirement for that year would become effective on October 1, and the GSIB surcharge would become effective on January 1. This misalignment would introduce unnecessary complexity to the capital framework, confuse the public and could confound the Agencies' objectives to provide greater simplicity and transparency in capital requirements.

As detailed in the discussion of transition in Section II.C below, these concerns are amplified during the transition period during which the SCB requirement could be calibrated on a lower phased-in (non-binding) percentage ERBA ratio but would apply to point-in-time capital ratios calculated using a more phased-in ERBA ratio.

2. Recommendations

In order to avoid sequential changes in capital requirements over the course of the transition period and during any given calendar year, in the event that the SCB requirement could be applied to an ERBA-determined capital ratio, we recommend that the transition effective date be aligned with the SCB effective date of October 1. This means that the final rule and the SCB based on Comprehensive Capital Analysis and Review ("CCAR") 2024 each would become effective on October 1, 2025.

C. To the extent that the SCB applies to an ERBA ratio, during the transition period, the SCB requirement and the method 2 GSIB surcharge should be determined based on fully phased-in ERBA denominator[57]

1. Challenges and Concerns

During the proposed transition period (and without giving effect to our other recommendations as to alignment of effective dates) the RWA that would be used to calculate the SCB requirement would lag behind the binding ERBA requirements, resulting in an inflated SCB until three quarters after ERBA is fully phased in. For example, the October 1, 2026 SCB requirement would reflect December 31, 2025 ERBA (phased in at 80%), but would apply to a capital ratio that could be based on an 85% phased-in ERBA. Even when ERBA would be fully phased (July 1, 2028), the October 1, 2028 SCB would have been calibrated based on a 90% phased-in ERBA, inflating the SCB requirement until the following SCB becomes effective on October 1, 2029.

56 This section is responsive to Question 173.

57 This section is responsive to Question 9.

Similarly for the GSIB surcharge, the denominator of the weighted short-term wholesale funding indicator (wSTWF) is average RWA, which would be based on the lower of the two risk-based capital ratios for a particular quarter, i.e., the higher of standardized RWA and ERBA RWA. For example, the January 1, 2027 method 2 score would reflect December 31, 2025 ERBA (phased in at 80%), but would apply to a capital ratio requirement based on the 85% phased-in ERBA. Together, the result would be an inflated CCB that overestimates banking organizations' actual economic exposure and fails to achieve the objectives of a transition period – to allow banking organizations to progress towards an end-state gradually and continuously.

2. Recommendations

We recommend that, during the transition period, the Agencies use fully phased-in ERBA to calculate the SCB and the method 2 GSIB scores. Beginning on October 1, 2026, the SCB would be sized based on fully phased-in ERBA from December 31 of the prior year. Similarly, beginning on January 1, 2027, the GSIB surcharge would be calculated based on fully phased-in ERBA from December 31, 2025.

Note that the Agencies would need to adjust the SCB for October 1, 2025, because no ERBA data would be available as a part of the December 31, 2024 financial statements used for CCAR 2025.[58] For example, the October 1, 2025 SCB component of the CCB could be fixed at 2.5%. Similarly, method 2 GSIB scores would be calculated using fully phased-in ERBA RWA amounts to the extent available. In particular, the December 31, 2025 GSIB score used to calculate the applicable GSIB surcharge effective on January 1, 2027 would be calculated using the limited, fully phased-in ERBA RWA amounts from 4Q2025.

Using fully phased-in ERBA for purposes of both the SCB requirement and the GSIB surcharge would result in a smoother transition to ERBA. This approach would also address any SCB inflation concerns during the transition period without introducing any unnecessary complexity to the framework. The Agencies could also adopt an approach that made incremental adjustments[59] to the SCB as ERBA is phased in, but although reasonable in principle, such an approach is likely to become unwieldy and confusing to the public.

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[58] In fact, no ERBA data would be available until *after* October 1, 2025, because assuming a July 1, 2025 effective date for the rule, the first ERBA data would only be available as-of September 30, 2025, which report would not be available until later in the quarter.

[59] For example, the adjustment could be made by multiplying that year's SCB by the ratio of: (i) the ERBA phase-in percentage used to calculate the SCB; and (ii) the ERBA phase-in percentage then in effect. For example, the SCB effective October 1, 2026 (calculated based on 80% phased-in ERBA) would be multiplied by 80/85, subject to a floor of 2.5%.

III. General Credit Risk

The Proposal would replace the internal ratings-based ("IRB") approach for capitalizing general credit risk with a revised standardized approach. Based on the results of our analysis and the Agencies' estimates, RWA for credit risk under ERBA would increase relative to both the current internal ratings-based approach and the current standardized approach (in the latter case, after taking into account the fact that the current standardized approach was calibrated to include a "buffer for risks not easily quantified (for example, operational risk and concentration risk)" [60]).

Moreover, while overall credit risk RWA, which includes RWA for general credit risk, securitization risk, equity risk and counterparty credit risk, would exhibit a modest increase of roughly 5%, this masks wide variation across the entire credit risk framework. In the case of banking book equity exposures, for instance, our analysis indicates that ERBA RWAs would increase by over 176.6% while ERBA RWAs for securitization exposures would increase by over 35.5%. We respectfully submit that the proposed approach to calculate RWA for credit risk is over-calibrated and insufficiently risk sensitive and would result in international competitive disparities.

First, the Agencies cite concerns regarding the transparency and comparability of credit risk RWA but present an incomplete picture of potential impacts on credit, often ignoring that the proposed changes would increase the risk weight of otherwise safe products and thereby increase the cost or availability of such products. Moreover, they do not present economic analysis for why the overall calibration of the current framework understates actual credit risk. Significant increases in capital must be economically justified by a documented lack of risk capture that is weighed against the real costs imposed on American households and businesses.

As FRB Chair Powell acknowledged, increased credit risk weights increase the cost of, and reduce access to, credit. This negatively affects our member institutions' ability to help consumers finance important economic activities, including providing access to working capital and investments and providing asset management services.[61] Beyond the availability of credit, over-calibration of credit risk requirements also negatively affects end users' ability to access critical capital markets services, including derivatives that commercial entities, asset managers, insurance companies and investment funds may use to hedge their risks, as well as

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[60] Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord, 68 Fed. Reg. 45900, 45902 (Aug. 4, 2003) ("Because the general risk-based capital rules include a buffer for risks not easily quantified (for example, operational risk and concentration risk), general banks would not be subject to an additional direct capital charge for operational risk."). Although credit risk RWA would remain relatively flat relative to the current SA, all else equal, separately capitalizing operational risk implies significant increases in RWA for credit risk.

[61] Powell Statement.

SFTs that end users such as mutual funds, pension funds and other regulated investment funds use to supplement returns for investors and beneficiaries, including employees and retirees.

Second, ERBA's coarse standardization of asset classes (particularly compared to approaches adopted or proposed in other jurisdictions) diverges significantly from established credit risk management practices, which distinguish between exposures based on loss histories, borrower/counterparty characteristics (including payment history, leverage, regulated status, industry, age, profitability/income, etc.) and collateralization. Below, we highlight certain areas in which ERBA's standardization would result in a significant overstatement of credit risk, resulting in burdens on certain activities, products and stakeholders that far outweigh any benefit to standardization.

Third, the Proposal also would result in a competitive disadvantage for U.S. banking organizations. Most notably, whereas U.S. banking organizations would no longer be permitted to model credit risk capital requirements, banking organizations in other major jurisdictions would continue to be permitted to do so, subject to a 72.5% aggregate output floor. This would result in significantly lower capital requirements for the same types of credit products offered to identical customers. This deviation from the Basel Framework and from other jurisdictions' implementation of the framework would confer a significant funding advantage to non-U.S. firms both outside and within the United States.[62]

In this Section, we identify our member institutions' specific areas of concern where the over-calibration of (general) credit risk is most acute or where there are potentially disproportionate impacts on key stakeholders. Our recommendations and concerns regarding other aspects of Proposal's credit risk framework can be found in Sections IV (Credit Risk Mitigation), V (Securitization) and VI (Equity Risk).

Of particular importance, we make the following recommendations:

- The final rule should not restrict the availability of the lower 65% risk weight for investment-grade corporate exposures to companies that have (or with a parent company that has) publicly traded securities outstanding. Banking organizations should be permitted to make use of alternative options that accomplish the Agencies' objectives of increased consistency, transparency and market discipline.

- The Agencies should redevelop risk weights for residential mortgage and other retail exposures based on a risk-based, empirical analysis such as the advanced

[62] Foreign banks can offer a range of commercial banking products through their U.S. branches and agencies without being subject to any U.S. bank capital requirements.

approaches; at a minimum, risk weights should be aligned to the Basel Framework.

- The risk-weights for retail exposures should at least be recalibrated to align with the Basel Framework for retail exposures, but ultimately should be better aligned to risk.

- The higher credit conversion factor for undrawn credit card lines should not be adopted.

- The final rule should adopt a 20% risk weight for more-than-well-capitalized banks, short-term bank exposures and regulated financial institutions to better align with risk.

A. The definitions of "defaulted exposure" and "defaulted real estate exposure" should be revised to better reflect risk management practices and capabilities

The Proposal adopts complex, multi-pronged definitions of "defaulted exposure" and "defaulted real estate exposure" that do not reflect actual credit risk management practices and that assume capabilities beyond those that are currently feasible for banking organizations. Below, we raise two concerns regarding the definitions and propose simple recommendations that would significantly improve the accuracy of the framework.

1. Challenges and Concerns

(a) *Unreasonable Assumption of Knowledge Regarding Credit Events*

Under the Proposal, the terms "defaulted exposure" and "defaulted real estate exposure" require banking organizations to determine in certain cases (non-retail, non-real estate exposures and non-residential real estate exposures) whether a particular obligor has credit obligations 90 days or more past due or in nonaccrual status to any creditor, whether any credit obligation of the obligor has been sold at a credit-related loss, whether the obligor has agreed to a distressed restructuring with respect to any creditor and whether any creditor has taken a charge-off with respect to a credit obligation for credit-related reasons. While credit risk management best practices imply ongoing credit risk monitoring of obligors and counterparties, as well as systems and processes to incorporate available information into due diligence processes, the Proposal would imply the omniscience of banking organizations with respect to these events.

In practice, even the best credit risk management and monitoring systems cannot reflect private information to which a banking organization does not have access. Other than with respect to very large public companies, or in the presence of reporting covenants, banking organizations have no reliable way to determine an

obligor's obligations to unrelated creditors or, in the case of a charge-off, write-down or other accounting adjustment, why other creditors decided to make such an adjustment. As a result, these aspects of the definitions do not reflect current credit risk management best practices and are practically impossible to monitor or enforce.

(b) *Lack of Materiality Threshold for Obligor Cross-Defaults*

Under the Proposal, the definitions also include, for non-retail exposures and non-residential mortgage real estate exposures, any exposures for which an obligor has a credit obligation to the banking organization or any creditor that is 90 days or more past due.

This would mean that de minimis past-due exposures could result in significant increases in regulatory capital that do not reflect meaningful changes in credit risk. For instance, suppose a customer with $1 billion of outstanding loans to a banking organization became more than 90 days past due on a $100 overdraft (a fairly common occurrence that does not have a meaningful bearing on the customer's overall credit risk profile). The Proposal would require the banking organization to consider all the loans to be "defaulted exposures" and apply an overly punitive 150% risk weight to the entire $1 billion. The lack of a de minimis threshold for these types of obligor cross-defaults thus creates the potential for significant variability in RWA that does not reflect actual credit risk.

Notably, each of the current IRB approach for credit risk and the Basel Framework include a materiality threshold for past-due exposures. For example, the Basel Framework defines "defaulted borrower" to exclusively include borrowers in respect of whom any <u>material</u> credit obligation is more than 90 days past due.[63]

2. <u>Recommendations</u>

In order to address the first concern regarding unreasonable imputation of knowledge, we recommend that the definition of "defaulted exposure" and "defaulted real estate exposure" be amended to remove any requirement that would require a banking organization to monitor the status of an obligor's obligations to a creditor (other than material obligations to such banking organization). This would align the definition to current credit monitoring practices. Instead, these prongs of the definition should be based solely on information required to be provided to the banking organization pursuant to a written agreement or otherwise received in connection with credit risk monitoring practices consistent with Agencies' safety and

[63] Basel Framework, CRE 20.104 ("a defaulted exposure is defined as one that is past due for more than 90 days").

soundness guidelines.[64] The banking organization should solely have to monitor and determine whether an obligor is unlikely to pay its material credit obligations.

To address the second concern regarding obligor cross-defaults, we recommend that the definition of "defaulted exposure" and "defaulted real estate exposure" be revised to provide that, for non-retail exposures and non-residential mortgage real estate exposures, only those exposures for which an obligor has a material credit obligation to the banking organization that is 90 days or more past due should be regarded as defaulted.

B. The definition of "defaulted real estate exposure" should align with the definition of "defaulted exposure" with respect to residential real estate exposures for which there has been an agreed distressed restructuring

1. Challenges and Concerns

The definitions of "defaulted exposure" and "defaulted real estate exposure" generally consider the agreement by a banking organization to a distressed restructuring for credit-related reasons to be defaulted, provided that for non-real estate exposures and non-residential real estate exposures, the definition provides the possibility of a reclassification depending on the loan's performance. On the other hand, "residential mortgage exposures" that are "defaulted real estate exposures," by virtue of such a distressed restructuring, would always be considered to be in default, regardless of future performance.

Not allowing residential mortgage loan modifications to be "cured" may discourage banking organizations from working with borrowers to equitably resolve issues and encourage banking organizations to move directly to foreclosing on homeowners. Moreover, this could lead to increased market share for lightly regulated or unregulated non-bank financial institutions, which have greater ability to offer flexible terms to borrowers when loan modifications are needed.

2. Recommendations

We recommend that the definition of "defaulted real estate exposure" be modified to provide that a distressed restructuring of a residential mortgage exposure would be deemed to be a "defaulted real estate exposure" only "until the [BANKING ORGANIZATION] has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure as demonstrated by a sustained period of prepayment performance."

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[64] *See, e.g.*, 12 CFR part 30, app. A, 12 CFR part 208, app. D-1, 12 CFR 364, app. A.

C. The final rule should adopt more risk-sensitive risk weights for more-than-well-capitalized banks and short-term bank exposures

1. Challenges and Concerns

(a) *Risk Weight for More-Than-Well-Capitalized Banks*

Although the Proposal generally adopts the Basel Framework's approach to bank exposures, the Proposal leaves out some safer categories of bank exposures, such as the 30% base risk weight for exposures to Grade A banks with a CET1 ratio of 14% or more and a Tier 1 leverage ratio of 5% or more.[65] Together with other aspects of the Proposal, these deviations from the Basel Framework would exacerbate international divergence without any apparent justification. As described further below, this could impact services that indirectly rely on interbank relationships, including correspondent banking and foreign exchange services.

Outside of the United States, including as proposed in the EU and UK, banking organizations generally would be permitted to use modelled approaches for bank exposures, subject to a standardized output floor based on an external ratings-based approach. Under an external ratings approach, exposures to banks with the credit ratings above A- or A3, as applicable, would receive a 30% or 20% risk weight, while the same exposure would be subject to a risk weight of 40% or higher in the United States.

The table immediately below illustrates the ratings of the subsidiary banks of certain of our member institutions and certain foreign banking organizations, demonstrating that Forum member institution subsidiary banks' exposures to foreign GSIBs (under the Proposal) would be higher than foreign GSIBs exposures to Forum member institution subsidiary banks (under an external ratings approach). The Agencies' analysis does not acknowledge or justify this asymmetry.

Table 6: Subsidiary Bank Long-Term Debt Ratings

Banking Organization	Moody's Investors Service	Standard & Poor's	Fitch Ratings
U.S. GSIBs			
Bank of America	Aa1	A+	AA
Citigroup	Aa3	A+	A+
JPMorgan Chase	Aa2	A+	AA
Wells Fargo	Aa2	A+	AA-
Goldman Sachs	A1	A+	A+

[65] BCBS, "Basel III: Finalising post-crisis reforms" at n 18 (Dec. 2017), https://www.bis.org/bcbs/publ/d424.pdf.

Morgan Stanley	Aa3	A+	AA-
Foreign GSIBs			
Barclays	A1	A+	A+
BNP Paribas	Aa3	A+	AA-
Deutsche Bank	A1	A-	A-
HSBC	A1	A+	AA-
Royal Bank of Canada	Aa1	AA-	AA-
Société Générale	A1	A	A
UBS	Aa3	A+	A+

(b) *Short-Term Bank Exposures*

With limited exceptions and unlike the Basel Framework, the Proposal does not distinguish between long-term and short-term exposures. Our analysis suggests that this would drive an increase in RWA of $65.5 billion and in required capital of $7.5 billion.[66] As the BCBS consultations on credit risk explain, the purpose of the lower risk weights for short-term bank exposures "is to avoid interference with monetary policy channels and to prevent any negative impact on market liquidity in interbank markets."[67] The Proposal does not address this rationale.

Interbank lending has an established and well-documented role in monetary policy transmission.[68] Jurisdictions that effect monetary policy by targeting overnight interbank rates (unsecured, like federal funds, or secured, like SOFR) often rely on banks to expand or contract their lending in response to central bank open market operations, the evidence for which is similarly well documented.[69] Higher risk weights on interbank exposures, however, could disrupt the functioning of this avenue of monetary policy transmission by imposing additional, unwarranted costs on such deposits. These concerns are particularly acute in the case of expansionary monetary policy: A high risk weight on interbank loans increases the cost of carrying those loans during an economic climate in which banks are likely to be more carefully managing their balance sheets. This in turn could put a floor on interbank

[66] Compared to implementing the Basel Framework's treatment of short-term exposures.

[67] BCBS, "Revisions to the Standardized Approach for Credit Risk," Second Consultative Document at 6 (Dec. 2015), https://www.bis.org/bcbs/publ/d347.pdf.

[68] *See, e.g.*, Xavier Freixas et al., "Bank Liquidity, Interbank Markets, and Monetary Policy," Federal Reserve Bank of New York Staff Report no. 371 (May 2009, *revised* Sept. 2009), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr371.pdf.

[69] Anil Kashyap et. al, "Monetary Policy and Credit Conditions: Evidence from the Composition of External Finance," American Economic Review 82, pp. 78-98 (Mar. 1993), https://scholar.harvard.edu/files/stein/files/aer-1993.pdf.

rates, indirectly increasing the rates at which banks are willing to lend to the economy, frustrating central bank attempts to loosen credit.

Increased risk weights on short-term bank exposures also could indirectly impact the availability and pricing of services that rely on interbank markets. For example, many of the Forum's member institutions maintain correspondent accounts with local banks (particularly where foreign banks are not allowed to have accounts with the local central bank) in other jurisdictions to facilitate foreign exchange transactions for their customers. Increasing the risk weights for this class of short-term exposures even compared to the Basel Framework would significantly impact our member institutions' ability to maintain global banking networks, increasing the cost to consumers and other end users of foreign currency exchange and remittance services.

2. Recommendations

We recommend that the Agencies assign a 20% risk weight to exposures to banks that pose low credit risk, including, at least, Grade A banks with CET1 ratios at or above 14% and leverage ratios at or above 5% consistent with the Basel Framework. We also recommend that the Agencies assign more granular risk weights to exposures based on maturity, including, at least, a risk weight of no more than 20% or 50% for Grade A or B banks, respectively, for short-term bank exposures with a maturity of three months or less. Such risk weights should be determined by a quantitative analysis of the risks posed by exposures of different maturity.

D. The final rule should adopt a risk-sensitive approach to regulated financial institutions subject to Basel-compliant bank capital requirements

1. Challenges and Concerns

Under the Basel Framework, exposures to securities firms and other financial institutions are treated as exposures to banks provided that these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks, including capital and liquidity requirements. This approach is particularly relevant in jurisdictions outside of the United States in which there is no bright line between commercial and investment banking and in which it is more common for securities firms and non-bank financial institutions to be subject to bank-style regulation.

For example, the EU requires certain large investment firms engaged in securities dealing and underwriting to be subject to the EU implementation of Basel III risk-based capital, leverage, disclosure, liquidity and large exposure standards (CRR[70]/CRD[71]), even though they do not engage in deposit-taking or similar activity.

[70] Council Regulation 575/2013, 2013 O.J. (L 176/1), as amended.

[71] Council Directive 2013/36/EU, 2013 O.J. (L 176/338), as amended.

Some of these firms are also required to register as a "credit institution" and are subject to the supervision by the European Central Bank as part of the Single Supervisory Mechanism alongside other large banks.[72]

Similarly, the UK applies Basel-equivalent capital, liquidity and other prudential requirements to certain non-credit institution (nonbank) investment firms designated for prudential supervision by the PRA under PS27/21 "Designating investment firms" based on size and complexity considerations. Even certain non-bank firms in the United States are subject to bank capital requirements, including U.S. swap dealers subject to most aspects of the Agencies' capital rules pursuant to 17 CFR part 23, subpart E.

In each case, such firms would not qualify as "banks" under the Proposal, because they may not be authorized to take deposits but would be subject to bank-style supervision and regulation by banking regulators including the PRA and (in many cases) the ECB. Exposures to such entities would be regarded as general corporate, rather than bank exposures. The EU and UK each have also applied the provision in the Basel Framework to allow non-banks in other jurisdictions that are subject to equivalent requirements to be treated as banks for the purpose of applying the CRR/CRD.[73]

In connection with the initial implementation of Basel Framework, the Agencies only provided a short statement to explain the rationale for categorizing exposures to securities firms as general corporate exposures,[74] and, importantly, they did not distinguish between U.S. and foreign securities firms, each of which may be subject to vastly different regulatory regimes. In carrying forward this narrow definition under the Proposal, the Agencies fail to elaborate or to state any rationale. In

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72 The Investment Firm Regulation (Regulation (EU) 2019/2033) and the Investment Firm Directive (Directive (EU) 2019/2034), in conjunction with the CRR/CRD, amend the definition of "credit institution" to include these types of entities, which are required to reclassify as such, and also apply the CRR/CRD to certain other investment firms that meet certain size and complexity criteria. *See* Council Regulation 2019/2033, 2019 O.J. (L 314/1) (See Recital (42), Article (1)(2) & Article 62(3)); Council Directive 2019/2034, 2019 O.J. (L 314/64); and CRR Article 4(1)(1).

73 Commission Implementing Decision (EU) 2021/1753 sets out the equivalence assessment in the EU. Commission Implementing Decision 2021/1753, 2021 O.J.(L 349/31). The UK's "The Capital Requirements Regulation Equivalence Directions 2020" provides the UK equivalence assessment of the EU. HM Treasury, "The Capital Requirements Regulation Equivalence Directions 2020" (Nov. 9, 2020), https://www.legislation.gov.uk/uksi/2019/541/pdfs/uksiod_20190541_en_015.pdf.

74 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62018, 62086 (Jan. 1, 2014) ("although the Basel capital framework permits exposures to securities firms that meet certain requirements to be assigned the same risk weight as exposures to depository institutions, the agencies do not believe that the risk profile of securities firms is sufficiently similar to depository institutions to justify assigning the same risk weight to both exposure types.").

contrast, the persistence of the approach under the Basel Framework that focuses on the regulatory framework to which an entity is subject (rather than on projecting U.S. statutory and regulatory distinctions onto the rest of the world) suggests an enduring international consensus around the feasibility and desirability of extending risk weights for banks to other highly regulated and supervised financial institutions.

The Proposal also provides specific rules for determining whether a foreign bank would qualify as Grade A, B or C. A foreign bank cannot be Grade A or B if "the capital standards imposed by the home country supervisor on the foreign bank are not consistent with the Capital Accord of the Basel Committee on Banking Supervision."[75] However, the Proposal does not elaborate on what qualifies as "consistent," potentially laying out a standard that even the Proposal would not meet due to its divergences from the Basel Framework.

2. <u>Recommendations</u>

We recommend that the definition of an exposure to a "bank" under the final rule be expanded to include regulated financial institutions that report information sufficient to make a "Grade" determination, and explicitly including (i) EU "class 1" investment firms and UK PRA-designated investment firms (ii) non-bank swap dealers that have elected to be subject to the prudential capital framework (iii) broker-dealers that are subsidiaries of bank holding companies or savings and loan holding companies, and (iv) bank holding companies, provided each entity is subject to bank or bank-equivalent supervision and prudential requirements (or subject to heightened requirements).

We also recommend that the requirement to qualify as a Grade A or B bank for foreign banks be amended to require the home country supervisor to have capital standards "broadly consistent" with the Basel Framework to allow for some divergences that are inevitable in any jurisdiction.

E. <u>The separate risk weight category for subordinated debt instruments should be eliminated</u>

1. <u>Challenges and Concerns</u>

ERBA would introduce the concept of a "subordinated debt instrument," which would be subject to a 150% risk weight. Significantly, the term explicitly includes preferred stock that is not an equity exposure. As we explain below, the explicit inclusion of preferred stock has the effect of mandating a 150% risk weight for instruments that may be effectively the most senior instrument in an entity's capital structure.

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[75] Proposal at 64041.

To provide a concrete illustration of this concern, consider municipal bond closed-ended funds ("CEF"), which are registered investment companies ("RIC") that primarily invest in tax-exempt municipal bonds.[76] For tax and other reasons, issuing preferred stock can represent the most efficient form of leverage for such a fund.[77] In that case, preferred stock effectively serves as the most senior instrument in a tax-exempt municipal CEF's capital structure due to contractual provisions limiting a fund's ability to issue debt senior to the preferred.[78] Both bonds and preferred stock issued by a CEF are considered senior securities under the Investment Company Act of 1940.[79]

In general, mandatorily redeemable preferred stock is classified as a debt security[80] under U.S. Generally Accepted Accounting Principles ("GAAP"). Under the current standardized approach, these investments would receive a risk weight of 100% as corporate exposures, higher than an equity exposure to an investment fund that held the same investments. As mentioned above, such preferred stock would be subject to a 150% risk weight under ERBA, despite being effectively the most senior instrument in the capital structure.

This result is particularly incongruous when compared to a common equity investment in the same fund. Under ERBA's modified look-through approach, assuming that the average risk weight of the underlying investments of the municipal CEF is 40% (representing a mix of general and revenue obligations) and the leverage ratio (preferred stock / total assets) is 40%, the adjusted risk weight would be 67%. In other words, a banking organization's investment in the preferred stock of the CEF would be assigned a risk weight more than two times higher than the risk weight that would apply to an investment in a more subordinated instrument.

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[76] While this discussion focuses primarily on tax-exempt CEFs, the recommendation would apply as well to non- municipal bond funds.

[77] Municipal CEFs may also issue tender option bonds ("TOBs") as a form of leverage, but TOB leverage is frequently not a permanent source of leverage, but instead represents adjustable or marginal leverage, with preferred equity serving as a more permanent part of the CEF's capital structure.

[78] In general, senior leverage can only be issued to a limited extent and for limited purposes, (e.g., temporary cash flow needs; debt issued to refinance preferred stock; Tender Option Bonds (TOBs), etc.), with the consent of the preferred holder.

[79] 15 U.S.C. § 80a–18(g) ("Unless otherwise provided: 'Senior security' means any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends; and 'senior security representing indebtedness' means any senior security other than stock.").

[80] *See* Financial Accounting Standards Board, ASC 320-10-20, Accounting Standards Codification, https://asc.fasb.org/1943274/2147481761 ("The term debt security also includes all of the following…Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.").

As the Agencies acknowledge in the Proposal, equity presents more risk than subordinated debt, because it "entitles a banking organization to no more than the pro-rata residual value of a company after all other creditors, including subordinated debt holders, are repaid."[81] Likewise, subordinated debt presents more risk than senior debt.

2. Recommendations

We recommend that the separate risk weight category for subordinated debt exposures be eliminated. If it is retained, we recommend the definition of "subordinated debt instrument" be revised to avoid including the reference to "preferred stock that is not an equity exposure."

More generally, we recommend that the risk weight for structurally senior instruments be capped at the risk weight that would apply for a structurally junior exposure to the same issuer.

F. We recommend that the Agencies redevelop risk weights for residential mortgage exposures based on a risk-based, empirical analysis, at the very least aligning with the Basel Framework for residential mortgage exposures[82]

The Proposal would adopt standardized risk weights for residential mortgage loans based on the LTV ratio of the loan, consistent with the Basel Framework's "whole loan" approach, but proposes to increase the calibration of those risk weights by 20% across LTV ratios.[83] Other than by citing concerns about "marginal funding costs" relative to smaller banking organizations, which we address further below, the Proposal does not provide an evidence-based economic justification for this approach or its calibration. Although we recognize that the proposed approach would be more risk sensitive than the current standardized approach, the over-calibration of risk weights, even without considering new standardized operational risk requirements, would disproportionately disadvantage LMI borrowers and communities and accelerate the shift in mortgage originations to less-regulated, systemically riskier, non-bank mortgage lenders.

1. Challenges and Concerns

(a) *Significant Over-Calibration*

Even marginal changes in the mortgage risk weights would have an outsized impact on the economy due to the immense size of the mortgage market. The Proposal

[81] Proposal at 64074.

[82] This section is responsive to Question 30.

[83] Proposal at 64048 (see table 2 and 3).

would affect balances for first-lien mortgages totaling nearly $1.4 trillion in the first quarter of 2023, which represent over 2.5 million loans.[84] Based on our analysis, the risk weights for residential mortgages would result in significant increases in RWA relative to the Basel Framework. More specifically, our analysis finds that adopting the more stringent standards proposed by the Agencies would increase ERBA RWA by over $176 billion, while increasing required capital by over an additional $18 billion.

The evidence does not support the proposed calibration. An analysis by the Urban Institute (the "Urban Institute Study") that compared the proposed capital requirements for a portfolio of bank loans against hypothetical loss rates for that portfolio using 2005-2008 loss experience revealed that proposed capital requirements "exceed what would be needed even to protect banks from a repeat of the Great Recession" across all LTV bands, with differences ranging from 12% to 1200%.[85] They estimate an average portfolio loss rate of 2.7%. These estimates likely even underestimate the potential over-calibration, given that bank lending has become more prudent over time with more stringent income verification, decreasing appraisal fraud and the introduction of the qualified mortgage rule, which has "largely ended the proliferation of nontraditional products, … [which] were more apt to default."[86] A similar quantitative study by the Bank Policy Institute estimated the portfolio loss at 2.9%, supporting the findings in the Urban Institute Study.

The Agencies support the Proposal's calibration by citing differences in marginal funding costs between large banking organizations and smaller organizations not subject to the Proposal and claiming that the proposed higher risk weights were necessary to maintain competitiveness between large and small banks. Risk, not competitiveness, should be the driving factor for capital requirements; but even accepting competitiveness as a consideration, as we discuss in Section I.A.3 above, this concern is unfounded. Specifically, the Agencies' analysis looks at residential loans under ERBA in isolation from the rest of the Agencies' capital framework and does not take into account the other requirements, current and proposed, that subject large banking organizations to higher capital costs for maintaining residential loans.

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84 *See* Federal Reserve Bank of Philadelphia, "FR Y-14M First-Lien Mortgage Balance Charts" (2023), https://www.philadelphiafed.org/-/media/frbp/assets/surveys-and-data/y14/2023/q2/23q2-first-lienbalances-charts.pdf?la=en&hash=E249CF593C2A08CD93F99853D529632C [hereinafter, the "FR Y-14M Charts"].

85 Laurie Goodman and Jun Zhu, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios," Urban Institute Housing Finance Policy Center at 1, https://www.urban.org/sites/default/files/2023-09/Bank%20Capital%20Notice%20of%20Proposed%20Rulemaking.pdf [hereinafter, the "Urban Institute Study"].

86 *Id.* at 6.

First, large banking organizations subject to the Proposal would be required to compute their capital requirements under both ERBA and the current U.S. standardized approach, with their minimum capital requirements being based on the more binding of the two calculations. This floor would limit the benefits large banking organizations might see from implementing risk weights derived from a risk-based, empirical analysis.

Second, unlike smaller banking organizations, large banking organizations would be required to capitalize for operational risk that is directly tied to their mortgage lending. This is especially true for residential real estate loans sold to government sponsored enterprises ("GSE"), which receive a high effective risk weight from operational risk because of fee income.[87]

Lastly, our member institutions are also subject to additional capital requirements, such as the GSIB surcharge, the SCB and a long-term debt requirement and a number of liquidity requirements, like the liquidity buffer, the liquidity coverage ratio and the net stable funding ratio.[88] These additional capital and liquidity requirements result in higher marginal funding costs for these large banking organizations relative to smaller banks.

The Agencies' analysis also does not distinguish between real estate loans, such as those held for sale versus those held for investment, even though such characteristics could increase or decrease the risk of a mortgage.

(b) *Disparate Impact on LMI, Black and Hispanic Borrowers*

The Agencies state that they "are supportive of home ownership and do not intend the proposal to diminish home affordability or homeownership opportunities, including for low- and moderate-income (LMI) home buyers or other historically underserved markets."[89] We agree that the Proposal must be analyzed to avoid unintended impacts to home ownership. In that regard, the proposed calibration would increase funding costs to covered banking organizations in both the primary and secondary markets for residential mortgage loans, with disproportionate impacts for LMI borrowers, contrary to the objectives of the Community Reinvestment Act.

Relative to the current standardized approach, the ERBA risk weights for residential mortgages would have the greatest impact on high-LTV mortgages; approximately a

[87] Paul Calem and Francisco Covas, "The Basel Proposal: What it Means for Mortgage Lending," Bank Policy Institute (Sept. 30, 2023) ("[T]he risk weight for loans sold to the GSEs could increase to over twice their present values, largely due to the handling of fee income within the operational risk framework").

[88] The SCB is particularly punitive because it is not applicable in many other jurisdictions, so it would compound upon the 20% difference in the Proposal versus Basel.

[89] Proposal at 64048.

quarter of the impacted loans have LTVs over 80% and 10% have LTV ratios over 90%.[90] Analyzing 2021 Home Mortgage Disclosure Act data and the 2021 Federal Financial Institutions Examination Council CRA file, the Urban Institute Study found that 19% of high-LTV bank loans (45,000 loans per year) were made in LMI neighborhoods, compared with 13% of all bank loans in those neighborhoods.[91] Similarly, 28% of high-LTV bank loans (67,000 loans per year) were to LMI borrowers, whereas only 18% of all bank loans are to LMI borrowers. These concerns are particularly acute for Black and Hispanic borrowers – 9% (21,000 loans per year) of high-LTV loans were made to Black borrowers compared to 5% of all bank loans, and 13% of high-LTV loans (31,000 loans per year) were made to Hispanic borrowers compared to 9% of all bank loans.

As the Urban Institute Study observes, the "high-LTV market facilitates the type of lending banks are encouraged to do under the CRA, enabling them to make a disproportionate number of loans to LMI borrowers and borrowers in LMI communities."[92] Moreover, these loans tend to be conforming purchase loans, which help to facilitate first-time home ownership: 21% of high-LTV purchase loans were made in LMI communities, versus 15% of all bank loans made in those communities, with similar differences in purchase loans to LMI borrowers (31% in high-LTV markets versus 21% overall). With respect to Black and Hispanic borrowers, 27% of all purchase loans and 26% of conforming loans made to Black and Hispanic borrowers had high LTV ratios, compared with 19% of all bank loans.[93] As FDIC Director McKernan notes, "[t]he increased capital requirements could lead to an increase in interest rates for low- and moderate-income and other historically underserved borrowers who cannot always afford a 20% down payment, making it that much harder for these families to achieve homeownership."[94] Other organizations have echoed similar concerns, particularly as to Black home ownership.[95]

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90 *See* FR Y-14M Charts at 7.

91 Urban Institute Study at 8.

92 *Id.* at 9.

93 *Id.* at 8.

94 FDIC, "Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework" (July 27, 2023), https://www.fdic.gov/news/speeches/2023/spjul2723c.html.

95 *See, e.g.*, National Housing Conference, Mortgage Bankers Association, NAACP, National Association of REALTORS®, National Urban League, "Letter to Jerome Powell, Michael Hsu and Martin Gruenberg" at 1(July 24, 2023), https://nhc.org/wp-content/uploads/2023/07/Housing-Groups-Letter-re-Bank-Capital-7.25.23.pdf ("If these standards are adopted, they will have a devastating impact on our efforts to increase Black homeownership and disadvantage all first-time, and, in particular, first-generation homebuyers who do not have the benefit of multi-generational wealth or higher than average incomes."); Angela Lang, Comment Letter on Proposed Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Oct. 10, 2023), https://www.fdic.gov/resources/regulations/federal-register-

Higher capital costs to issue these loans reduces their potential return, resulting in higher loan fees or reduced availability and could make many loan opportunities uneconomical. Thus, the Proposal would appear to disproportionately disadvantage LMI borrowers and communities as well as Black and Hispanic borrowers.

(c) *Acceleration of Disintermediation*

The increased funding costs for covered organizations that would result from the proposed 20% risk weight add-on could also accelerate the share of mortgages originated outside the banking system, as it would become less economical for covered organizations to originate mortgages. As policymakers have noted, banks have lost ground to nonbanks in mortgage lending and servicing, and most activity is now conducted outside the regulated banking system.[96] Nonbank mortgage originations account for almost two-thirds of mortgage originations, representing a 27% increase since 2017. Increased capital requirements are likely to accelerate that trend.

The 2023 FSOC Annual Report voices concern over the growth of nonbank mortgage companies' market share and the risk this presents to financial stability particularly because "most nonbank mortgage originators rely on short-term wholesale funding, the majority of which is uncommitted lines that can be quickly pulled in times of stress."[97] Academic analysis concludes that these concerns arise because "nonbank mortgage companies are vulnerable to liquidity pressures in both their loan origination and servicing activities," and that the "sector in the aggregate appears to have minimal resources to bring to bear in an adverse scenario," noting further that "the same liquidity issues unfolded during the financial crisis, leading to the failure of many nonbank companies, requests for government assistance and harm to consumers."[98] At least one academic study also observes that the failure of nonbank lenders would have a disproportionate effect on minority borrowers,

publications/2023/2023-regulatory-capital-rule-large-banking-organizations-3064-af29-c-024.pdf; Isaac Russell, Comment Letter on Proposed Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Oct. 13, 2023), https://www.federalreserve.gov/SECRS/2023/October/20231013/R-1813/R-1813_092723_154732_477238732838_1.pdf.

[96] *See, e.g.,* "Remarks by FDIC Chairman Martin J. Gruenberg at the Exchequer Club on the Financial Stability Risks of Nonbank Financial Institutions" (Sept. 20, 2023), https://www.fdic.gov/news/speeches/2023/spsept2023.html (citing the 2022 FSOC annual report and CFPB data).

[97] FSOC, "2023 Annual Report" at 25 (Dec. 14, 2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.

[98] You Suk Kim, et al., "Liquidity crises in the mortgage market," Brookings Papers on Economic Activity, Spring, 347-428, at 347 (Mar. 8, 2018), https://www.brookings.edu/wp-content/uploads/2018/03/KimEtAl_Text.pdf.

because "nonbanks are more likely to originate mortgages to borrowers who are members of minority groups."[99]

2. Recommendations

We recommend that residential mortgage risk weights be redeveloped using a risk-based, empirical analysis such as the advanced approaches to more accurately reflect the risk presented by mortgages and to avoid unnecessary and potentially harmful impacts on American homeownership as well as LMI and minority borrowers and communities. At a minimum, risk weights should be aligned to the Basel Framework.

G. Standalone junior-lien real estate exposures should be assigned a risk weight consistent with the Basel Framework

1. Challenges and Concerns

Under the Proposal, a junior home equity line of credit and other second mortgage exposures generally would be considered to be an "other real estate exposure" subject to a 100% risk weight, "given the elevated risk of these loans when compared to similar senior lien loans."[100] In contrast, the Basel Framework would require banking organizations to combine the loan amount of the junior liens with all other loans secured with liens of equal or higher ranking and apply a risk weight equal to 1.25 times the risk weight that would otherwise be applicable if the loan were a first-lien loan.[101]

The Agencies do not attempt to quantify the elevated risk to which they cite. While we recognize that junior-lien loans represent an elevated risk compared to senior liens, we respectfully submit that the increased risk would be adequately captured under the Basel Framework's 1.25 LTV multiplier methodology, which conservatively adjusts risk weights to account for this risk.

2. Recommendations

We recommend that the final rule apply the Basel Framework's approach for standalone junior-lien real estate exposures, rather than regarding such exposures as "other real estate exposures."

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[99] *Id.* at 351.

[100] Proposal at 64051.

[101] Basel Framework, CRE 20.75, note 32.

H. The risk weights for the retail exposures should be recalibrated to better align with the risk they present, at the very least aligning with the Basel Framework for retail exposures

Consistent with the Basel Framework, the Proposal adopts an approach to risk weighting residential retail exposures based on product, differentiating between "regulatory retail" exposures, transactors and other retail exposures, but proposes to increase the risk weights for each product relative to the BCBS calibration by 10%.

The Agencies do not provide economic justification for the proposed calibration, which would be out of step with the UK and EU,[102] making it more expensive for Americans to use credit cards, buy cars, make home improvements and start businesses. As for residential mortgages, the over-calibration of retail risk weights, even without considering new standardized operational risk requirements, would disproportionately disadvantage LMI borrowers. Moreover, all of the basic economic forces that drive mortgage lending to non-banks as capital requirements increase are operative in the case of retail credit exposures. Increasingly, non-banks are providing retail credit products; increased capital requirements that are not justified by any discernible risk-related rationale and that do not conform with international standards will only hasten this trend, while creating many of the same financial stability concerns that have accompanied the rise in non-bank residential mortgage lending.

1. Challenges and Concerns

(a) *Unjustified Calibration*

Based on our analysis, the risk weights for retail credit would result in increases in RWA relative to both the current standardized approach and the Basel Framework. As elsewhere, the Agencies do not present evidence that suggests that the current overall calibration for retail credit exposures is understated, why the proposed product class divisions are justified or the evidence suggesting that a 10% add-on above the Basel Framework risk weights would be appropriate.

Instead, as mentioned above, the Agencies point to a concern regarding relative funding costs, which we have explained is unfounded given that, unlike smaller banking organizations, large banking organizations subject to the Proposal are subject to a 100% standardized approach floor and are subject to additional capital requirements, such as the GSIB surcharge, the SCB requirement and a long-term debt

[102] Bank of England, CP16/22 – Implementation of the Basel 3.1 standards ("CP16/22"), ¶ 3.139 n. 3 (Nov. 30, 2022); Proposal for amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor, COM/2021/664 ¶ 123 (Oct. 27, 2021) (the "EU Proposal").

requirement. These additional capital requirements result in higher marginal funding costs for large banking organizations relative to smaller banks.

(b) *Impact on Availability of Credit to Consumers and Small Businesses*

The most immediate impact of increased risk weights for retail exposures would be increases in the cost of, and reduced access to, credit for both individuals and SMEs (that meet the definition of "regulatory retail"), particularly relative to large corporations with publicly listed securities.

An additional significant impact, which the Proposal does not explore in significant detail, is the risk that over-calibrated capital requirements for retail products could reverse the progress the banking industry has made in recent years to eliminate "credit invisibility." Research has shown that establishing a credit score is vital to consumer well-being and financial self-sufficiency. A 2015 Consumer Financial Protection Bureau ("CFPB") study found a "strong relationship between income and having a scored credit record."[103] Despite this, the CFPB found that in 2010, as many as 45 million American consumers were either credit invisible, or had unscored credit records, with as many as 45% of consumers in LMI neighborhoods being either "credit invisible," or having unscored credit records.[104] CFPB research has also shown that credit cards are the most common product used to overcome credit invisibility.[105] By increasing the cost of offering consumer credit products, such as credit cards, the Proposal could make it more difficult for banks to offer credit cards and in turn for consumers to open and maintain cards to remain "credit visible."

Impact on Small Business Lending

Research from the U.S. Small Business Administration shows that small businesses account for over 40% of U.S. economic activity.[106] Additionally, small businesses account for almost 60% of jobs in the U.S. and are the country's primary driver of

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[103] The CFPB Office of Research, "Data Point: Credit Invisibles" at 6 (May 2015), https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

[104] *Id.* at 15.

[105] The CFPB Office of Research, "CFPB Data Point: Becoming Credit Visible" at 5 (June 2017), https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf ("Across all age groups and income levels, credit cards trigger the creation of consumer credit records more frequently than any other product.").

[106] Kathryn Kobe and Richard Schwinn, "Small Business GDP: 1998–2014," U.S. Small Business Administration Office of Advocacy at 3 (Dec. 2018), https://advocacy.sba.gov/wp-content/uploads/2018/12/Small-Business-GDP-1998-2014.pdf.

job creation.[107] Forum member institutions hold $85 billion in small business loans and serve as a major source of lending to small businesses.[108]

After dropping to multi-year lows during the pandemic, applications for most common types of traditional financing, loans, lines of credit and cash advances rebounded above pre-pandemic levels, as small businesses sought to meet operating expenses and expand, replace capital assets or make repairs.[109] Despite this, the share of applicants that were fully approved declined significantly from pre-pandemic levels (down to 53% from 62% pre-pandemic), with the most marked decreases for black applicants (down to 20% from 34% pre-pandemic).[110] Increases in required capital could accelerate these trends, making it more difficult for small businesses to access working capital lines of credit (by far the most common form of financing requested).[111]

Consumer Protection Implications

Another potential impact of increased costs for retail credit would be to shift the provision of that credit outside of the regulated banking sector. Credit products, including credit cards, offered by banking organizations provide significantly more expansive consumer protections than those from outside of the regulated banking sector.[112]

In contrast, nonbank lenders, including so-called "buy now, pay later" ("BNPL") lenders, offer products that do not include many of these protections. Between 2019 and 2021, the number of BNPL loans issued to consumers increased by almost tenfold, with even more significant increases among Black, Hispanic, female and

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107 *Id.* at 37.

108 *See* Forum, "Essential to the U.S. Economy," https://fsforum.com/our-impact/essential-to-the-u-s-economy.

109 Federal Reserve Bank of Atlanta, et al., "2023 Report on Employer Firms: Findings From the 2022 Small Business Credit Survey" at 13 (Mar. 8, 2023), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2023/2023_sbcs-employer-firms.pdf?sc_lang=en&hash=7894978FBECA844D6213416460C8924E.

110 *Id.* at 17 and 18.

111 *Id.* at 14.

112 For example, the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (the "CARD Act") prevents banking organizations from issuing credit cards to consumers absent the card issuer's consideration of the consumer's ability to repay and also generally prevents issuance of credit cards to consumers under the age of 21, among other protections. *See* 15 U.S.C. § 1637(c); 15 U.S.C. § 1665e; 12 C.F.R. § 1026.51; *see also* Adam J. Levitin, "Consumer Finance: Markets and Regulation" at 526-527 (2nd ed. Sept. 14, 2022). The CARD Act's consumer protections also limit the ability of banking organizations to engage in certain activities, such as certain types of price or rate increases and changes in the terms of existing balances. *See* Levitin, "Consumer Finance: Markets and Regulation" at 529-34.

LMI borrowers.[113] Oftentimes, nonbank BNPL products lack disclosures of loan terms, have confusing dispute filing and resolution processes and may require all borrowers to use autopay for all loan payments.[114] Moreover, nonbank BNPL lenders may encourage overextension, may collect and share consumer data in a way that compromise consumer privacy and decline to report information about consumers to national consumer reporting companies, making it difficult for BNPL borrowers to build credit.[115]

2. Recommendations

We recommend that retail risk weights be redeveloped using a risk-based, empirical analysis such as the advanced approaches to more accurately reflect the risk presented by such exposures and to avoid unnecessary and potentially harmful impacts on American consumers, as well as LMI and minority borrowers and communities.[116] At a minimum, risk weights should be aligned to the Basel Framework.

I. The final rule should not restrict the availability of the lower, 65% risk weight for investment-grade corporate exposures to companies that have, or are controlled by a company that has, publicly traded securities outstanding

The Proposal would restrict the availability of the 65% risk weight for certain investment-grade corporate exposures to entities that have, or are controlled by a company that has, a publicly traded security outstanding. While we support the use of a reduced risk weight for investment-grade corporate exposures, the public listing requirement is unnecessary and artificially excludes creditworthy private companies of all sizes as well as certain regulated investment funds, such as mutual funds and pension funds (and their foreign equivalents) that do not list securities on an exchange, making the public listing requirement incompatible with their economic and legal structure.

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[113] The CFPB Office of Research, "Consumer Use of Buy Now, Pay Later: Insights from the CFPB Making Ends Meet Survey" at 2 (Mar. 2023), https://files.consumerfinance.gov/f/documents/cfpb_consumer-use-of-buy-now-pay-later_2023-03.pdf.

[114] CFPB, "Buy Now, Pay Later: Market trends and consumer impacts" (Sept. 2022) at 4, https://files.consumerfinance.gov/f/documents/cfpb_buy-now-pay-later-market-trends-consumer-impacts_report_2022-09.pdf.

[115] *Id.* at 4-5.

[116] This section is responsive to Question 30.

1. Challenges and Concerns

Based on the results of our quantitative analysis, the public listing requirement would be a significant driver for the increased credit risk RWA. Specifically, we estimate that the use of the public listing requirement results in an increase in ERBA RWA of over $269.1 billion, which would result in nearly $29.2 billion of additional required capital. The Agencies justify the public listing requirement by arguing that (i) the requirement is simple and objective, providing consistency between organizations, and (ii) publicly traded companies are subject to enhanced transparency and market discipline. We respectfully submit that the Agencies can achieve these objectives without relying solely on a public listing requirement, which would in fact significantly overstate credit risk for non-publicly traded firms and certain regulated investment funds.

(a) *The public listing requirement is excessively narrow. The Agencies' objectives of consistency, transparency and market discipline could be achieved through alternative criteria.*

While public listing provides some measure of consistency in the preparation and disclosure of financial information across firms, public listing requirements are not directly relevant to the assessment of credit risk and would exclude significant populations of creditworthy firms and investment funds from qualifying for the lower risk weight. Based on data from the U.S. Census Bureau, there were 6.1 million employer firms[117] in the United States in 2019 (the latest available data).[118] In contrast, during the same time period, there were only 4,266 listed companies in the United States.[119] Similarly, as of year-end 2022, there were 8,763 mutual funds (with $22.1 trillion in total net assets) registered with the SEC, but only 2,989 ETFs[120] (representing $6.5 trillion in net assets).[121]

A significant number of companies and investment funds in the United States do not (or cannot) seek to raise capital in public markets for reasons that have no bearing on creditworthiness. For example, many private commercial firms may not seek to raise

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[117] The data does not include non-employer firms, such as mutual funds and pension plans that play a critical role in helping Americans safeguard and grow their savings and to provide them with adequate financial security during retirement.

[118] United States Census Bureau, "2019 SUSB Annual Data Tables by Establishment Industry" (Feb. 2022), https://www.census.gov/data/tables/2019/econ/susb/2019-susb-annual.html (see cell F4 of the "U.S. & states, 6-digit NAICS" spreadsheet).

[119] The World Bank, "World Development Indicators," DataBank (last visited Dec. 26, 2023), https://databank.worldbank.org/source/world-development-indicators/Series/CM.MKT.LDOM.NO.

[120] Virtually all of these must be RICs.

[121] Investment Company Institute, "2023Investment Company Factbook" (May 2023), https://www.ici.org/system/files/2023-05/2023-factbook.pdf.

capital in public markets because their business models do not require rapid and regular (or any) infusions of capital. As another example, regulated investment funds typically[122] are structured to offer retail and institutional investors cost-effective access to pools of investment assets and do not issue debt or raise equity in public markets as a function of these objectives. Yet more companies simply may not meet applicable listing requirements, which can include criteria that do not have any bearing on either creditworthiness or the ability for the Agencies (or the public) to independently validate assessments of creditworthiness.

Despite not having publicly listed securities, many of these entities are subject to regulation or material external oversight as to the preparation and disclosure of their financial statements that would achieve the Agencies' objectives of consistency, transparency and market discipline in a similar manner as (or even more stringently than) would a public listing standard. The Agencies appear to acknowledge this oversight in asking whether to apply a lower risk weight to "exposures to companies that are not publicly traded but are companies that are 'highly regulated.'[123]

Regulated Investment Funds

RICs (and their foreign equivalents) provide a salient example of a class of entities for which the public listing requirement is incompatible with an entity's legal and economic structure and does not reflect an objective assessment of its transparency, structure, credit risk profile or credit loss history. By statute and regulation, RICs are subject to disclosure requirements in line with, or more extensive than, those of publicly listed companies, including: (1) a requirement to issue and update prospectuses (at least annually) containing key information about the fund and to make statements of additional information available to investors upon request and without charge; (2) a requirement to prepare and publish annual and semiannual shareholder reports (including audited annual financial statements); (3) requirements to submit Form N-Port (a complete list of the fund's portfolio securities), Form N-CEN (census-type information) and Form N-PX (voting record on specific proxy issues at portfolio companies); and (4) daily valuation requirements (subject to scrutiny from funds, their advisers, their boards of directors, regulators and independent auditors) to support redeemability on a daily basis at a price that reflects the current market value of the fund's portfolio investments.

RICs are also subject to internal and external oversight by boards of directors (subject to independence requirements), auditors and regulators, including potentially the U.S. Securities and Exchange Commission ("SEC") and FINRA or a bank regulator. Moreover, RICs are subject to prudential limitations that further enhance

[122] Exchange-traded funds seek listing primarily as a means of providing investors with access to pools of assets on an intra-day basis, rather than to raises capital.

[123] Proposal at 64054 (see Question 39).

their credit standing, including: (1) liquidity standards (e.g., limiting investments in illiquid assets to no more than 15% of net asset value); (2) limitations on leverage, including on the issuance of "senior securities" and borrowing, in most cases up to 33% of assets; (3) custody and customer asset segregation requirements; (4) affiliate transaction limitations; and (5) asset diversification requirements.[124] As an added layer of protection, RICs are generally managed by fund managers that are themselves subject to regulatory oversight, including an obligation to act in investors' best interest and to manage the fund in accordance with any applicable investment mandate. Foreign equivalents (such as UCITS) are subject in many cases to a similarly stringent regulatory regime as to disclosure, governance and prudential limitations.

Pension Funds

Pension funds (and their foreign equivalents) are another relevant example. Pension funds typically cannot issue securities, such that the public listing requirement would preclude many of them from receiving the lower, 65% risk weight. As with RICs, pension funds are subject to stringent statutory and regulatory disclosure requirements and extensive disclosure and supervision regimes, in line with or beyond those of public companies. As a result of daily net asset value calculation requirements and disclosure requirements under the local law, pension funds often disclose information comparable to or, in some cases, greater than publicly listed entities, including key performance metrics such as funded status, returns on investments, plan liabilities, risk management and plan governance. For many U.S. pension plans, financial statements are subject to standards set by the Governmental Accounting Standards Board and are subject to audit by the Legislative Audit Bureau. State pension plans generally are also subject to open meeting laws, requirements concerning access to public records and oversight by elected bodies (e.g., state legislatures) and appointed boards. Similar to RICs, pension funds are also subject to prudential regulation by national (or state and provincial) agencies that govern the administration of the pension plans.

Audited Financial Statements

Even in the absence of a formal regulatory regime, the Agencies' policy objectives could be satisfied by reference to any number of objective criteria. For example, audited financial statements are designed precisely with the objective of promoting consistent financial reporting as well as improving market discipline and transparency across reporting firms. Accounting standards, such as GAAP, exist to provide clear, consistent and comparable information on organizations' financial statements. Auditing standards work together with accounting standards to ensure

[124] *See generally* Investment Company Institute, "How US-Registered Investment Companies Operate and the Core Principles Underlying Their Regulation" (May 2022), https://www.ici.org/system/files/2023-06/us-reg-funds-principles.pdf.

that those financial statements that purport to be prepared in accordance with accounting standards can be independently verified. The Statements on Auditing Standards published by the American Institute of Certified Public Accountants (establishing minimum standards for certified public accountants when auditing entities that are not "issuers" as defined by the Sarbanes-Oxley Act),[125] or equivalent standards published by an international body with membership in the International Federation of Accountants, ensure that the audited financial statements are "presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in financial statements."[126]

Moreover, audited financial statements are designed to promote market discipline and transparency by reference to a set of standards by which financial results are reported that can be verified by an independent third party. In this regard, we note that auditing standards include extensive guidelines to ensure that audits of financial statements are independent in fact and in appearance, "impl[ying] an impartiality that recognizes an obligation to be fair not only to management and those charged with governance of an entity but also users of the financial statements who may rely upon the independent auditor's report."[127]

Private Diligence and Supervisory Review

The Agencies' objectives also could be met through existing credit due diligence standards and the Agencies' supervision and examination process. The Agencies' annual Shared National Credit ("SNC") process provides a salient example of this. The banking regulators regularly review the credit ratings assigned to loans and assess the validity of these credit assessments through the annual SNC reporting process.

The SNC has been conducted since 1977 and regularly examines bank lending facilities and assesses the quality of loan underwriting. The SNC demonstrates that regulators can and do regularly assess the credit evaluation processes of banks and that their reviews are conducted using data with sufficient transparency to ensure consistent and credible data is available.[128] Moreover, the SNC process more broadly points to the longstanding and important role that supervisory review and approval of clearly documented credit underwriting processes play in establishing the

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125 The Public Company Accounting Oversight Board has adopted similar standards for audits for public companies.

126 AU-C Section 200.04.

127 AU-C Section 200.A17.

128 *See* Agencies, "Shared National Credit Program 1st and 3rd Quarter 2022 Reviews" (Feb. 24, 2023), https://www.occ.treas.gov/publications-and-resources/publications/shared-national-credit-report/files/shared-national-credit-report-2022.pdf.

credibility, consistency and transparency of banking organizations' credit assessment practices.

(b) *The increase in credit risk RWA resulting from the public listing requirement does not reflect demonstrable differences in credit risk that would outweigh the potential negative impacts.*

The Proposal does not present an evidence-based economic analysis to justify the significant increases in capital requirements that would result from the public listing requirement. Implicit in the public listing requirement is the assumption that it would result in better credit outcomes (or that it would reduce variability in credit assessments). But the data and academic literature do not support this conclusion. Standard models of credit risk use a variety of variables to measure and assess credit risk, including existing leverage, age of firm, firm industry, firm profitability and seniority of the loan, but the academic literature and best-practice default loss modeling do not typically include the presence of publicly listed securities as an indicator of underlying credit risk.[129]

The public listing requirement therefore would create a significant funding advantage for a small number of the largest corporations by ensuring that only they can obtain the most favorable financing terms. The public listing requirement (considered together with other components of the framework, including the new standardized operational risk capital requirement and market risk and CVA frameworks) would also make it more difficult and expensive for end users to obtain *non-credit* financial products (e.g., derivatives for hedging) due to the implied increase in counterparty credit risk when facing these entities. These end users are incentivized to pass on the increased costs to their customers and, in the case of regulated investment funds, such as RICs, UCITS and pension funds, would result in decreasing returns to investors and beneficiaries, including employees, retirees and pensioners.

Relatedly, the public listing requirement would materially disadvantage precisely those firms that rely most intensively on bank borrowing. Large companies that issue public securities regularly raise funding from public markets. Companies and investment funds without public market access rely to a much greater extent on banks

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[129] *See, e.g.,* Frederic S. Mishkin, "Prudential Supervision: What Works and What Doesn't," University of Chicago Press 1-30 (Jan. 2001), https://www.nber.org/system/files/chapters/c10756/c10756.pdf; Darrell Duffie, et al., "Frailty Correlated Default," The Journal of Finance, Vol. LXIV, No. 5, 589–609 (Sept. 28, 2009), https://www.darrellduffie.com/uploads/pubs/duffieecknerhorelsaita2009.pdf; Edward I. Altman, "Financial Ratios, Discriminant Analysis and the Prediction of Corporate Bankruptcy," The Journal of Finance, Vol. XXIII, No. 4 (Sept. 1968), https://www.raggeduniversity.co.uk/wp-content/uploads/2016/08/FINANCIAL-RATIOS-DISCRIMINANT-ANALYSIS-AND.pdf.

as a source of funding. This includes, in the case of RICs, access to alternative sources of liquidity as encouraged by SEC regulation and guidance.[130]

In the case of regulated investment funds, such as RICs, UCITS and pension funds, the public listing requirement can also produce highly inconsistent outcomes. For instance, while an ETF that tracks the S&P 500 would be eligible for treatment as an investment-grade exposure and the 65% RWA due to its having publicly listed securities, an open-ended mutual fund (organized as a RIC or a UCITS) with the same mandate and same risk profile would not be eligible, resulting in higher funding and hedging costs. Such an outcome represents an example of legal form over economic substance that should not be mandated by regulation.

Finally, the public listing requirement would also create meaningful competitive concerns. As mentioned further above, the EU and UK propose to permit internal models for credit risk, subject to a standardized output floor, which can result in risk weights significantly lower than 65%. For unrated corporates, neither the EU nor the UK has proposed to adopt a public listing requirement.[131] Adopting a public listing requirement would reinforce already significant divergences in overall capital requirements between U.S. and European banking organizations and result in a significant competitive disadvantage for (i) U.S. banking organizations operating abroad and (ii) foreign banks operating in the United States through their U.S. branches and agencies (as well as any U.S. subsidiaries not required to be held under an intermediate holding company).

2. Recommendations

Consistency and transparency need not come at the cost of inappropriate and overly conservative risk weights. Accordingly, we recommend removing the public listing requirement.

If the Agencies retain the public listing requirement, banking organizations should be permitted to make use of alternative diligence options that accomplish the Agencies' objectives of increased consistency, transparency and market discipline as an alternative to such requirement. These alternative criteria could include a requirement that the entity be subject to disclosure regulation or material external oversight as to preparation and publication of financial statements. Such entities

[130] *See, e.g.*, Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, 87 Fed. Reg. 77172 (Feb. 14, 2023); Investment Company Liquidity Risk Management Programs, 81 Fed. Reg. 82142 (Nov. 18, 2016).

[131] The UK consultation would allow an approved model as one of the inputs to determine whether an unrated corporate entity should be deemed to be investment grade. CP16/22 at 3.105. The EU Council proposal would permit use of a 65% risk weight for output floor purposes if the probability of default is less than 0.005, subject to transition until December 31, 2032. EU Proposal at Article 465.

would explicitly include: (1) any entity registered with the SEC under the Investment Company Act of 1940 or foreign equivalents thereof; (2) any employee benefit plan as defined in paragraphs (3) and (32) of section 3 of ERISA, a "governmental plan" (as defined in 29 U.S.C. § 1002(32)), or any similar employee benefit plan established under the laws of a foreign jurisdiction; (3) a private fund that is required to provide a prospectus to investors and the lending entity; (4) highly-regulated entities (e.g., investment advisors, insurance companies, broker-dealers, swap dealers, security-based swap dealers and foreign equivalents); (5) any company that has published unqualified audited financial statements or provides such financials to the banking organization along with (i) interim financial statements (audited or unaudited) and (ii) a fund prospectus, if relevant; or (6) a company with publicly listed securities outstanding (or that is controlled by a company with publicly listed securities outstanding).

We also recommend removing the public listing requirement from the criteria to qualify as financial collateral for all the reasons described above.[132]

J. The risk weight for exposures to corporate SMEs should be set at 85% to align with the Basel Framework[133]

1. Challenges and Concerns

Under the Proposal, exposures to SMEs that do not meet the definition of "regulatory retail" would not be regarded as retail exposures.[134] These exposures typically would be subject to a 100% risk weight, given that such companies are unlikely to have publicly listed securities outstanding. In contrast, the Basel Framework includes an 85% risk weight for such exposures.[135]

The Proposal's omission of a separate category of corporate SMEs with a lower risk weighting will negatively impact corporate SMEs' ability to access both credit and non-credit financial products and services (such as hedging via derivatives) and could stifle the growth and development of SMEs that are critical to fueling the innovation that drives the engine of the American economy. In this regard, we note that many of the concerns that we raise above with respect to SME regulatory retail exposures regarding the cost of credit would apply in this case as well.

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132 We note the Agencies justify restricting the types of debt securities recognized for risk mitigation because they assert that debt securities issued by companies with a publicly traded security outstanding are more stable and liquid. As in other areas of the Proposal, the Agencies do not justify this claim or expand on why a public listing requirement is the ideal way to achieve the necessary stability and liquidity for risk mitigating recognition.

133 This section is responsive to Question 40.

134 Proposal at 64051.

135 Basel Framework at CRE 20.47.

This approach would be inconsistent with proposals in other major jurisdictions (including the EU and UK).[136] The effect of this omission in combination with the public listing requirement would be to favor lending to large, publicly listed corporations (assuming the public listing requirement is retained), which may negatively impact lending to these corporate SMEs.

2. Recommendations

We recommend that a lower risk weight of 85% be applied to corporate SMEs that do not qualify as retail exposures.

K. The final rule should assign an 80% risk weight to any high-quality project finance exposure in the operational phase

1. Challenges and Concerns

The Proposal appropriately distinguishes between the risks of pre-operational and operational project finance exposures but does not appropriately distinguish between high-quality and non-high quality project exposures. A project finance operational phase exposure would be defined as "as a project finance exposure where the project has a positive net cash flow that is sufficient to support the debt service and expenses of the project and any other remaining contractual obligation…and where the outstanding long-term debt of the project is declining."[137] Any period prior to this would be "pre-operational." The Basel Framework includes these two categories but also includes a category of "high-quality" project finance exposures subject to an 80% risk weight.

A high-quality project finance exposure generally refers to "an exposure to a project finance entity that is able to meet its financial commitments in a timely manner and its ability to do so is assessed to be robust against adverse changes in the economic cycle and business conditions."[138] High-quality projects should be eligible for the 80% risk weight because in addition to producing sufficient income to pay off their costs, high-quality projects must be prepared to do so even in adverse conditions. These qualities reduce the likelihood of default and are appropriately distinguished under the Basel Framework and under the proposed implementation of the Basel Framework in other jurisdictions, including the EU, the UK and Canada.[139] This distinction is supported by default studies, which show that investment grade project finance exposures have lower default rates than investment grade corporate

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[136] CP16/22 at 3.127; EU Proposal at Article 501.

[137] Proposal at 64055.

[138] BCBS, "Basel III: Finalising post-crisis reforms" at 14-15.

[139] *See* EU Proposal at Article 122a(3)(c); CP16/22 at 3.112; Office of the Superintendent of Financial Institutions, "2024 Capital Adequacy Requirements" at Chapter 4, Item 69 (Nov. 2023/Jan. 2024).

infrastructure exposures, excluding utilities.[140] In this context, the 80% risk weight would even be a conservative approach, when compared to 65% risk weight that is applicable to investment grade corporate issuers.

2. Recommendations

We therefore recommend that the Agencies include an 80% risk weight category for high-quality project finance exposures during their operational phase. For this purpose, we recommend adopting the definition of "high-quality project finance exposure" under the Basel Framework.

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140 *See* S&P, "Default, Transition, and Recovery: 2022 Annual Infrastructure Default and Rating Transition Study," Table 3 (Nov. 15, 2023), https://www.spglobal.com/ratings/en/research/articles/231115-default-transition-and-recovery-2022-annual-infrastructure-default-and-rating-transition-study-12852228#:~:text=Infrastructure%20as%20an%20asset%20class,to%200.2%25%20from%200.1%25.

IV. Credit Risk Mitigation

Credit risk mitigation is critical for prudent risk management. Proper mitigation and offsetting of risks allows banking organizations to have additional balance sheet capacity to better serve clients and facilitate economic growth. In that regard, we recommend certain modifications to the credit risk mitigation framework to recognize bona fide transfers of credit risk and ensure that banking organizations can serve their intended functions in a frictionless way.

- The final rule should remove the SFT haircut floor framework in line with other jurisdictions and to eliminate conflict with pre-existing broker-dealer regulations;
- The final rule should retain the ability to recognize the risk-mitigating effects of:
  - Investment grade corporate debt securities regardless of whether the corporate issuer (or its parent) has a publicly traded security outstanding;
  - Non-investment grade corporate debt securities for term repo-style transactions that have been included in the market risk measure; and
  - Reducing market price volatility haircuts for U.S. Agency debt to be better aligned with underlying price risk.
- The final rule should clarify the interaction between the credit risk mitigation framework and synthetic securitization frameworks and in particular should confirm that direct-issued credit-linked notes ("CLN") qualify as synthetic securitizations (including the operational criteria).
- The operational criteria for traditional securitizations should be amended to recognize the benefit of bona fide transfers of credit risk where the underlying exposures are legally isolated from the bankruptcy estate of the originator, even if they are not de-recognized by the originator under GAAP.

A. The final rule should remove the requirement that "eligible guarantees" be provided by "eligible guarantors," except with regard to securitizations

1. Challenges and Concerns

Under the Proposal, the Agencies would revise the definition of "eligible guarantee" to require that such guarantees always be provided by an "eligible guarantor,"

consistent with the current standardized approach.[141] As the Agencies have previously acknowledged, the requirement disqualifies many guarantees of middle-market and commercial real estate loans that often involve guarantors that would not meet the eligible guarantor definition, even though they provide "valuable credit risk mitigation that should be recognized." [142]

The Agencies included an "eligible guarantor" requirement under the advanced approaches in 2013 but removed it in 2014, instead only applying the requirement to certain securitization exposures.[143] The Agencies explained that it was retaining the "eligible guarantor" requirement for purposes of the standardized approach, because "the standardized approach generally assigns a single risk weight to exposures to most corporate borrowers and guarantors and does not incorporate the definition of eligible guarantee into a risk-sensitive methodology like the advanced approaches."[144]

Whereas the current standardized approach only includes a 100% risk weight for most types of corporate exposures, ERBA includes a variety of risk weights ranging across a variety of corporate, retail and real estate exposures for which "valuable credit risk mitigation" should be recognized. The previously implied rationale (that removing the "eligible guarantor" requirement would be less relevant under a framework that assigns the same risk weight to most corporate borrowers and guarantors) thus would not apply to a meaningful extent. In addition, the eligible guarantor requirement would also unnecessarily restrict banks' ability to recognize guarantees and credit derivatives fully collateralized by financial collateral if provided by an eligible guarantor. In these cases, the identity of the guarantor is irrelevant so long as the collateral is sufficient to cover the guarantee or credit derivative. The applicable risk weight should be the risk weight applicable under the simple approach (modified as we suggest in this letter) or, in the case of a guarantee funded by cash, 0%.

2. Recommendations

Given that the originally stated rationale for retaining the eligible guarantor requirement would not apply to ERBA, we recommend removing the "eligible guarantor" requirement.

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141 *See* Proposal at n. 116 ("Under subpart E in the current capital rule, an eligible guarantee need not be issued by an eligible guarantor unless the exposure is a securitization exposure. The proposal would require all eligible guarantees to be issued by an eligible guarantor.").

142 Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule, Revisions to the Definition of Eligible Guarantee, 79 Fed. Reg. 44120, 44121 (July 30, 2014).

143 *Id.* at 44120.

144 *Id.* at 44121.

B. We recommend that the final rule permit recognition of credit risk mitigation benefits of an eligible credit derivative where the hedged exposure references a parent entity that controls the obligor on a underlying exposure, as long as a default on the underlying exposure triggers payment by the parent entity under the instrument

1. Challenges and Concerns

Under the Proposal's credit risk mitigation rules, a banking organization "may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if…the reference exposure and the hedged exposure are to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to assure payments under the credit derivative are triggered when the obligor fails to pay under the terms of the hedged exposure."[145]

Many corporate groups structure their operations with a holding company (that may issue publicly traded debt or equity securities and with respect to which financial institutions may sell credit protection) and operating subsidiaries (to which loans may be made and where collateral may reside). Moreover, the holding company often guarantees obligations of its operating subsidiaries.

To the extent that there is a legally enforceable cross-default or cross-acceleration in place that ensures that payments under credit protection purchased on the parent holding company are triggered when the obligor fails to pay under the terms of the hedged exposure, then banking organizations should be able to recognize credit protection purchased on an obligor's parent company. In such a case, the creditworthiness of a parent company is directly to that of its operating subsidiaries, such that credit protection purchased on the parent company (typically the only entity with respect to which standardized credit protection is available) provides the same credit protection as credit protection purchased on the obligor directly.

2. Recommendations

We therefore recommend that the final rule permit recognition of credit risk mitigation benefits of an eligible credit derivative where the hedged exposure references a parent entity that controls the relevant obligor as long as there is a legally enforceable cross-default or cross-acceleration in place that ensures that payments under credit protection purchased on the parent holding company are triggered when the obligor fails to pay under the terms of the hedged exposure.

[145] Proposal § __.120(b)(2).

C. Clarification is needed for an eligible guarantee covering a netting set of counterparty credit risk transactions in the context of maturity mismatch determination

1. Challenges and Concerns

Under both the current standardized approach and the Proposal, if a single eligible guarantee or eligible credit derivative covers multiple hedged exposures, a banking organization must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and must calculate a separate RWA amount for each exposure.[146]

Although decomposing protected exposures may simplify the determination of credit protection on portfolios of long cash positions, decomposition may not make sense for netting sets of derivatives and SFT transactions meeting qualified master netting agreement ("QMNA") criteria that may include offsetting payables/deliverables and receivables. In such a case, the capital rule provides that the exposure amount be determined at the netting set level using either the standardized approach for counterparty credit risk ("SA-CCR") or collateral haircut approach, as opposed to at the trade level. However, the credit risk mitigation framework does not further specify how the maturity should be determined for the purposes of applying the maturity mismatch.

2. Recommendations

We recommend that for a netting set of derivatives, repo-style transactions or eligible margin loans that meet QMNA criteria, at least for purpose of determining the applicability of any maturity mismatch haircut applicable to the credit protection, a banking organization should be able to compare the maturity of the purchased protection against the notional weighted average maturity for the netting set.

D. The Agencies should confirm that a banking organization may recognize the credit risk mitigation benefits of fixed notional credit derivatives that cover a derivative exposure

1. Challenges and Concerns

Under the Proposal and under the current standardized approach, a banking organization may only recognize the credit risk-mitigating benefits of an eligible credit derivative via the wholesale credit risk mitigation framework if credit risk is fully covered by the eligible credit derivative or is covered on a pro rata basis.[147] In this context, it might be helpful to clarify how this requirement should apply in

[146] Proposal at § __.120(a)(5).

[147] Proposal § __.120(a)(2); 12 CFR 217.36(a)(2).

instances where the hedged exposure amount changes over time and could be below or above the fixed protection amount provided by a credit derivative.

We believe that a fixed notional credit default swap (a common form of credit protection, which may only be sold in fixed dollar amounts independent of any underlying obligation) that hedges an interest rate swap whose exposure would fluctuate over time and as such could at times exceed or fall below the protection amount would meet that requirement, and could be considered a risk mitigant under the wholesale credit risk mitigation framework as opposed to the synthetic securitization framework where this requirement must not be met.[148] Given that the credit derivative could cover all of the exposure at some point in time, the wholesale credit risk mitigation framework would be most appropriate because in such instances there would be no credit tranching requiring treatment as a securitization. Of course, when a bank reflects the credit risk mitigation benefits, it would take into account how much of the hedged exposure is covered by the credit derivative.

2. Recommendation

The Agencies should confirm that a banking organization may recognize the credit risk mitigation benefits of fixed notional credit derivatives that cover a derivative exposure.

E. The final rule should modify the conditions for use of the "simple approach" for collateralized transactions in the Credit Risk Mitigation framework

1. Challenges and Concerns

The Proposal would continue to allow banking organizations to recognize the risk-mitigating effects of financial collateral using the simple approach for collateralized transactions where financial collateral secures exposures that are not derivative contracts or netting sets of derivative contracts.[149] Under the Proposal, a banking organization may use the simple approach if the financial collateral meets three requirements: (1) the collateral must be subject to a collateral agreement for at least the life of the exposure; (2) the collateral must be revalued at least every six months; and (3) the collateral (other than gold) and the exposure must be denominated in the same currency.[150]

Most notably, the collateral agreement requirement appears to inadvertently exclude the recognition of financial collateral for exposures where the banking organization's exercise of rights under the agreement may be stayed or avoided under applicable

148 *See* 12 CFR 217.41(b)(1)(ii).

149 Proposal §__.121(a)(1)(i).

150 Proposal §__.121(b)(1)(ii).

law. The limitation regarding stays was initially included under the U.S. implementation of Basel II solely with respect to qualified financial contracts ("QFC"), including securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements, because these exposures are exempt from automatic stays under relevant insolvency laws.[151]

In expanding the availability of the simple approach to "all exposures," it is unclear whether the Agencies intended the approach to apply beyond QFCs. The result is that, because non-QFC exposures such as commercial loans and letters of credit typically are not exempt from the automatic stay (even though banking organizations are often able to foreclose on the collateral in a timely manner), the simple approach would realistically (and apparently unintentionally) only provide meaningful relief for a narrow range of QFCs that do not qualify as repo-style transactions and eligible margin loans. The scope of the simple approach, when considered in conjunction with removal of modelled approaches to credit risk, would appear to disincentivize banks from engaging in prudent credit risk management, particularly where there is no prospect of structuring the collateral arrangement in a way that would be exempt from the automatic stay.

Further, the simple approach may only be used where collateral (other than gold) is denominated in the same currency, which does not allow for any partial currency mismatch, consistent with Basel Framework (CRE22.15). This approach is not necessary to appropriately account for risk and is inconsistent with the approach taken in other jurisdictions. In particular, this requirement is more stringent than the Basel standard, which hurts U.S. economic competitiveness and unjustifiably penalizes U.S. banking institutions. The Basel standard specifies that "currency mismatches are allowed under all approaches" and explains that "under the simple approach there is no specific treatment for currency mismatches."[152]

2. Recommendations

We therefore recommend that the Agencies remove the prerequisite to the simple approach that requires that financial collateral be "subject to a collateral agreement for at least the life of the exposure," or remove the requirement that a banking

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[151] *See* Risk-Based Capital Standards: Advanced Capital Adequacy Framework - Basel II, 72 Fed. Reg. 69288 (Dec. 7, 2007). *See also* Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 42882 (Sept. 12, 2017), Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 50228 (Oct. 30, 2017) and Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 82 Fed. Reg. 56630 (Nov. 29, 2017).

[152] Basel Framework at CRE 22.15.

organization's exercise of rights under a collateral agreement must not be stayed or avoided under applicable law.

Finally, we recommend that the condition for using the simple approach only if the exposure is denominated in the same currency be changed to allow for at least a partial currency mismatch. Recognition of a partial currency mismatch could include recognition of the matched portion, subject to a standard haircut (e.g., 8%, adjusted for any timing mismatch based on the number of days between revaluation) or recognition of the currency mismatch only for certain products, such as contingent facilities.

F. The final rule should clarify the interaction between the credit risk mitigation framework and synthetic securitization frameworks

As discussed further below, our member institutions are members of the Structured Finance Association, share the concerns raised in the SFA's letter and support its recommendations, including with respect to directly issued CLNs. Below, we highlight a subset of those concerns related to the credit risk mitigation framework.

1. Challenges and Concerns

Under the current rule and the Proposal, a synthetic securitization is a transaction in which "[a]ll or a portion of the credit risk of one or more underlying exposures is retained or transferred to one or more third parties *through the use of one or more credit derivatives or guarantees* (other than a guarantee that transfers only the credit risk of an individual retail exposure)."[153] Moreover, a banking organization may only recognize for risk-based capital purposes the use of a credit risk mitigant for a synthetic securitization if the credit risk mitigant is either:

- Financial collateral;
- A guarantee that meets all criteria in the definition of "eligible guarantee" other than the requirement that the guarantee cover all or a pro rata portion of the underlying exposure; or
- A credit derivative that meets all the criteria as set forth in the definition of "eligible credit derivative" other than the requirement that the guarantee cover all or a pro rata portion of the underlying exposure.

The definitional and operational criteria exclude certain types of bona fide risk transfers from qualifying as synthetic securitizations, including CLNs.

(a) *Brief Background on CLNs*

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[153] 12 CFR 217.2 (emphasis added).

CLNs are transactions in which banking organizations issue notes to investors based on a tranched reference pool of financial exposures for cash. The principal amount due on the notes is reduced if there are losses on the underlying reference assets. As such, through issuing CLNs, banking organizations effectively purchase credit protection from the investors purchasing the notes, typically in the form of a "hypothetical credit default swap" or "hypothetical guarantee" in which the bank issuer acts as the buyer of credit protection/beneficiary and a hypothetical seller/guarantor acts as the seller of credit protection. If credit losses on the reference exposures exceed a certain threshold, the bank retains cash equal to the credit-related losses, which reduces the principal balance of the CLNs. In this way, cash proceeds serve as collateral for the underlying reference assets.

Although we respectfully submit that CLNs meet the definition of "synthetic securitization" and satisfy the operational criteria for synthetic securitizations, an FRB FAQ[154] recently cast doubt as to whether: (1) cash proceeds raised in a CLN issuance qualify as "financial collateral" for purposes of satisfying the operational criteria for synthetic securitizations and (2) a hypothetical credit derivative meets the definition of "credit derivative" for purposes of the definition of "synthetic securitization."

(b) *Financial Collateral*

The credit risk mitigation component of the operational criteria for a synthetic securitization may be satisfied if the credit risk mitigant is "financial collateral." The FRB's FAQ suggests that cash proceeds raised in a CLN issuance may not satisfy this definition, noting that "[t]he cash purchase consideration for [CLNs] is property owned by the note issuer, not property in which the note issuer has a collateral interest."[155] Not only do cash proceeds represent a property right superior to a security interest in a deposit account, the FRB FAQ conflates the asset and liability characteristics of cash.

Among all of the forms of collateral listed in the definition of "financial collateral," cash on deposit is the only form of collateral that can be both an asset and liability for the banking organization. On the asset side, cash on deposit corresponds to some fungible pool of cash entrusted by a depositor to the bank. On the liability side, cash on deposit reflects a deposit liability to the depositor in the same amount. Due in part to the fungibility of the asset side, a security interest in cash on deposit in favor of the depository bank is not typically a property right in the asset, but rather, an interest in

[154] FRB, "Frequently Asked Questions about Regulation Q" (Sept. 28, 2023), https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm [hereinafter, the "FRB FAQ"].

[155] *Id.*

the deposit account (which is a liability of the depository bank).[156] Upon foreclosure of a depository bank's security interest in a deposit account, the bank typically does not take possession and ownership of the associated asset (because the cash associated with the deposit is already owned by the bank and typically not readily identifiable among the bank's other cash). Instead, the foreclosure will be effected following a credit event by reducing the depository bank's liability to the customer in respect of the deposit account liability. As described herein, the CLNs function in the same way. The cash proceeds of the CLN issuance will be held by the issuing bank on deposit for its own account (but not subject to withdrawal by any third party depositor), while the liability to the CLN holders (the principal and interest payments) is subject to reduction upon the occurrence of a credit event.

The FRB FAQ's position also would diverge from the Basel Framework, which explicitly provides, "[c]ash-funded credit-linked notes issued by the bank against exposures in the banking book that fulfil the criteria for credit derivatives are treated as cash-collateralised transactions."[157]

The FRB seems to acknowledge the tenuous nature of its position and concedes that through directly-issued CLNs, banking organizations can transfer credit risk "at least as effectively as the synthetic securitizations," and invites banking organizations to request a reservation of authority from the appropriate Federal Reserve Bank.[158] However, public reporting suggests that the various Federal Reserve Banks have taken different approaches to determining whether CLNs meet the capital rule's definition of synthetic securitization.[159] As such, whether a banking organization may treat cash-collateralized CLNs as synthetic exposures depends on the organization's geography. This inconsistent approach undermines the Proposal's objective of "enhanc[ing] the consistency of requirements across large banking organizations."[160]

(c) *Credit Derivative Definition*

The definition of "synthetic securitization" requires that credit risk be transferred "through the use of one or more credit derivatives or guarantees." The FRB FAQ questions whether hypothetical credit derivatives often found in CLN structures

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156 *See, e.g.*, UCC § 9-102(a)(29) (definition of "deposit account"); UCC § 9-312(b)(1) (perfection of security interests in deposit accounts).

157 Basel Framework at CRE 22.34 n. 3.

158 FRB FAQ (see Question 3).

159 Philip Alexander, "Plumb job: can Basel III unblock US credit risk transfer?," Risk.net (July 5, 2023), https://www.risk.net/regulation/7957090/plumb-job-can-basel-iii-unblock-us-credit-risk-transfer.

160 Proposal at 64030.

satisfy the definition of "credit derivative," which refers to financial contracts executed under "standard industry credit derivative documentation."[161]

The phrase "executed under" is a legal term of art that refers to the substance, not the form, of a contract. A credit derivative need not be executed on any particular form in order for it to incorporate or reflect the relevant principles of standard industry credit derivative documentation. Moreover, a hypothetical credit derivative has a better credit risk profile than a credit derivative entered into with another entity due to the lack of counterparty credit risk.

Thus, there is no economic basis on which to exclude a hypothetical credit derivative from qualifying as a "credit derivative" for purposes of satisfying the definition of "synthetic securitization."

2. Recommendations

We recommend the Agencies to make clear in the final rule that the cash proceeds of directly issued CLNs constitute cash on deposit, regardless of whether the issuing bank holds or deposits those cash proceeds with its own bank or with another bank.

We also respectfully request that the Agencies confirm this in the rule text by stating that a hypothetical credit derivative satisfies the definition of "credit derivative" if it references standard industry credit derivative documentation or incorporates their relevant terms. Finally, we recommend that the Agencies confirm that a hypothetical financial guarantee meets the definition of "guarantee" under the capital rule.[162]

G. Minimum Haircuts for SFTs

The Proposal would impose minimum haircut requirements on certain SFTs with unregulated financial institutions on non-government securities. These minimum haircuts drive an increase in RWA under ERBA of $123.8 billion, corresponding to $14.7 billion in required capital.

SFTs, including repurchase and reverse repurchase (repo) transactions, securities lending and borrowing transactions and margin lending, play a pivotal role in financial markets by: (1) providing sources of secured, short-term funding and investment; (2) facilitating central bank operations; (3) facilitating settlement and preventing failures; (4) hedging primary securities issuances; (5) ensuring liquidity in the secondary markets; (6) fostering price discovery; and (7) ultimately allowing for

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[161] 12 CFR 217.2.

[162] The FRB FAQ does not specifically raise this question, but the statements made about credit derivatives introduce ambiguity as to how the Agencies would interpret the definition.

more efficient deployment of capital.[163] The Proposal's minimum haircut floors inappropriately push the boundaries of what capital standards are meant to address, may lead to disintermediation in the securities financing markets and would make the United States an outlier among BCBS jurisdictions. In this regard, as far as we are aware, no major jurisdiction has implemented or proposed minimum SFT haircuts as part of their Basel III implementations.

By contrast, jurisdictions such as the European Union and the United Kingdom have recommended continued deliberation on the need and design of minimum SFT haircuts. Specifically, the European Union proposes to require European regulatory bodies "to report . . . on the appropriateness of implementing in the [European] Union the minimum haircut floors framework applicable to SFTs."[164] Similarly, the PRA "will consider whether implementation in the capital framework is appropriate in due course, taking into account data available under SFT reporting."[165]

Our member institutions are members of the International Swaps and Derivatives Association ("ISDA") and Securities Industry and Financial Markets Association ("SIFMA"), share the concerns raised in the joint ISDA and SIFMA comment letter (the "ISDA/SIFMA Letter") and support its recommendations regarding the proposed minimum haircuts, including by removing the SFT haircut floor framework in line with other jurisdictions and to eliminate conflict with pre-existing broker-dealer regulations. Moreover, we would strongly oppose expanding the scope of minimum haircuts to SFTs with underlying sovereign collateral, including, U.S. sovereign collateral, regardless of technical defaults.[166]

Additional detail regarding these concerns and recommendations can be found in that letter.

H. Counterparty Credit Risk

Our member institutions are central to the functioning of the securities financing and derivatives markets. As mentioned above, SFTs play a pivotal role in financial markets. Similarly, derivatives are commonly used to manage various financial risk exposures, including price, foreign exchange, interest rate and credit risks and allow investors and end users to unbundle and transfer these risks, contributing to a more

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[163] *See, e.g.*, Viktoria Baklanova et. al., "Reference Guide to U.S. Repo and Securities Lending Markets," Federal Reserve Bank of New York Staff Report No. 740 (Sept. 2015, *revised* Dec. 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr740.pdf.

[164] EU Proposal at 27.

[165] CP16/22 at 1.5 n. 3 (Nov. 30, 2022).

[166] Prior to proposing to implement minimum SFT haircuts on such securities, we would expect the Agencies to undertake an analysis of the impacts on U.S. Treasury market liquidity as U.S. banking organizations scale back and as the Federal Reserve System relies more heavily on non-bank dealers and foreign banks to effectuate monetary and fiscal policy.

efficient allocation of capital, facilitating cross-border capital flows and creating opportunities for portfolio diversification.[167]

It is critical that the Proposal's methodology for quantifying exposure for such transactions accurately reflects their risks and appropriately incentivizes risk management. Over-calibration of capital requirements for counterparty credit risk negatively affects end users' ability to access critical capital markets services, including particular derivatives that commercial entities, asset managers, insurance companies and investment funds may use to hedge their risks, as well as SFTs that end users such as mutual funds, pension funds and other regulated investment vehicles use to supplement returns for investors and beneficiaries, including employees and retirees.

Our member institutions are members of ISDA and SIFMA, share the concerns raised in the ISDA/SIFMA Letter and support its recommendations regarding counterparty credit risk, including the following.

- Retain the ability to recognize the risk-mitigating effects of:
    - Investment grade corporate debt securities regardless of whether the corporate issuer (or its parent) has a publicly traded security outstanding; and
    - Non-investment grade corporate debt securities for term repo-style transactions by not requiring to include them in the market risk measure;
- Clarify that the netting set formula applies to eligible margin loan transactions booked as a single unit account for GAAP and also permit it for single repo-style transactions with multiple securities as collateral; and
- Reduce market price volatility haircuts for U.S. Agency debt to be better aligned with underlying price risk.

Additional detail regarding these concerns and recommendations can be found in the ISDA/SIFMA Letter.

[167] Ramana Ramaswamy et. al., "Emerging Local Securities and Derivatives Markets," International Monetary Fund, World Economic and Financial Surveys No. 2004/018 (Apr. 20, 2004), https://www.imf.org/-/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wefs/2004/_derivmkts.ashx.

I. Reporting of PD. LGD, ELGD, and EAD on FR Y-14Q and FR Y-14M

1. Challenges and Concerns

The Proposal's replacement of the IRB approach for credit risk with ERBA obviates the need for banking organizations to calculate and report certain parameters used in those calculations, including probability of default ("PD"), LGD and exposure at default ("EAD").

The Proposal, however, suggested that banking organizations should continue to report PD, LGD, ELGD (expected LGD) and EAD on forms FR Y-14Q and FR Y-14M:

> "…the Board proposes to revise FR Y–14Q, Schedules A and H, as well as FR Y–14M, Schedules A, B, and D, to specify that banking organizations subject to expanded risk-based standards should report PD, LGD, ELGD, and EAD items as specified in the Board's capital rule, calculated as proposed (emphasis added). The Board is also proposing to remove references to the IRB approach in Schedule H, and to instead require banking organizations subject to expanded risk-based standards to calculate PD, LGD, and EAD as described in the Board's capital rule."[168]

The reference to the continued reporting of PD, LGD, ELGD and EAD appears to be a drafting error that we respectfully request be corrected. The Proposal clearly decommissioned the usage of PD, LGD, and EAD parameters by eliminating the IRB approach to credit risk, and did not propose any such parameters in the context of ERBA. Instead, the risk weights under ERBA would be entirely based on static values provided in the Proposal.

2. Recommendations

We respectfully request the Agencies to update the reporting instructions to provide that reporting of PD, LGD, ELGD and EAD would no longer be required.

[168] Proposal at 64180.

V. Securitization Framework

The Agencies have long recognized the role that securitization markets play in providing a secondary market that supports primary lending channels and ultimately improves consumer access to credit cards, automobiles and a range of other credit products.[169] Borrowers benefit from the "increasing availability of credit on terms that lenders may not have provided had they kept the loans on their balance sheets,"[170] reduced loan origination fees,[171] and lower lending rates.[172] For investors, securitization "offer[s] a combination of attractive yields (compared with other instruments of similar quality), increasing secondary market liquidity and generally more protection by way of collateral overages and/or guarantees by entities with high and stable credit ratings."[173]

Currently, covered banking organizations calculate the risk weights for their securitization exposures using either the Supervisory Formula Approach or the Simplified Supervisory Formula Approach. The Proposal would replace these approaches with a new approach, the SEC-SA.[174] This new approach would result in significantly higher capital requirements for securitization exposures, primarily driven by an increased supervisory p factor. We estimate a 35.5% increase in RWA for securitization exposures in the banking book relative to the current SA.

The Proposal does not present evidence of an increase in the credit risk of securitization exposures that would merit such a significant increase in RWA. In particular, the framework appears to disregard the significant regulation and guidance that has been put into place in the United States over the past decade that significantly increased transparency and decreased risk in the securitization markets, including Regulation ABII, credit risk retention requirements and stricter underwriting standards.

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169 U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities" at 4-5 (Oct. 2017), https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

170 OCC, "Asset Securitization," Comptroller's Handbook, 4–5 (Nov. 1997), https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/asset-securitization/pub-ch-asset-securitization.pdf.

171 Claire A. Hill, Securitization: A Low-Cost Sweetener for Lemons, 74 WASH. UNIV. L. REV. 1061, 1112 (1996), https://openscholarship.wustl.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1630&context=law_lawreview.

172 Xudong An, et al., "Value Creation through Securitization: Evidence from the CMBS Market," The Journal of Real Estate Finance and Economics at 24 (Feb. 2008), https://www.anderson.ucla.edu/documents/areas/fac/finance/jrefe_cmbs_market.pdf.

173 OCC, Asset Securitization Comptroller's Handbook at 4.

174 Proposal at 64068.

A significant portion of the over-calibration would be driven by the increase in p-factor under the SEC-SA from 0.5 to 1.0, which would drive a $71.1 billion increase in RWA, corresponding to $7.9 billion in required capital. The Agencies attempt to justify the increased p-factor by suggesting that the increase "would help to ensure that the framework produces appropriately conservative risk-based capital requirements when combined with the reduced risk weights applicable to certain underlying assets..."[175] The data does not support this explanation. Based on our analysis, the lower floor would only drive a 9% reduction in RWA, while the increased p-factor would drive 44% of the increase. Reverting the p-factor to 0.5 and implementing just a subset of our recommendations would mitigate the significant increases in RWA by $104.4 billion, corresponding to $11.6 billion in required capital.

Our member institutions are members of Structured Finance Association, share the concerns raised in the SFA's letter and support its recommendations regarding the securitization framework, including:

- The FRB should undertake a quantitative analysis of securitization calibration across both CCAR stress tests and risk weights under the simplified supervisory formula approach ("SSFA");
- The p-factor under SEC-SA should be reduced from 1.0 to 0.5; the p-factor for qualifying securitization transactions should be set at 0.25;
- The Agencies should clarify the treatment of directly issued CLNs, including by:
    - Establishing transparent guidelines for recognizing the risk mitigating benefits of directly issued CLNs;
    - Making clear that directly issued CLNs meet the definition of synthetic securitization and, as discussed in Section IV.F above, that (1) an embedded credit derivative can satisfy the definition of "credit derivative," and (2) an embedded guarantee can satisfy the definition of "guarantee"; and
    - Clarifying that the proceeds of directly issued CLNs constitute "financial collateral" for purposes of the operational criteria for synthetic securitizations (as discussed in Section IV.F above);

[175] *Id.* at 64070.

- The accounting derecognition requirement under the operational criteria for traditional securitizations should be replaced with a legal isolation requirement;

- Synthetic excess spread should not prohibit a bank from recognizing the risk-mitigating benefits of synthetic securitizations;

- Credit conversion factors should apply to the unused portion of loan commitments to securitization special purpose entities ("SPE");

- The calculation of various parameter values should be revised, including:

  - The definitions of K_G and K_A, which as proposed, would produce anomalous and arbitrary results;

  - K_G and K_A should not include defaulted underlying exposures that serve as excess collateral;

  - To avoid interpretive confusion between the definition of parameter W and the definitions of "defaulted exposure" and "defaulted real estate exposure," and to ensure comparability in the calculation of securitization risk weights across banking organizations, the Agencies should explicitly state that Parameter W does not include delinquent underlying exposures that are modified and become reperforming;

  - The positive current exposures from interest rate and exchange rate derivatives should not be included in the calculation of K_G; and

  - The 1.5 multiplier for currency mismatches should not apply to the calculation of K_G;

- The risk weight floor for resecuritizations should not apply to certain resecuritizations involving senior securitization exposures;

  - The 100% risk weight floor for resecuritizations should not apply if both the resecuritization exposure and the underlying exposures are senior securitization exposures;

- Other provisions of the Proposal should be removed or adjusted as follows:

  - For the purposes of determining the risk weights applicable to securitization exposures backed by regulatory retail exposures, the aggregate limit and granularity limit criteria should be measured at the pool level;

    - Where there is no pari passu exposure, the Proposal should permit the use of a derivative contract's exposure at default as an alternative method for determining tranche size;

    - The look-through approach should not be subject to the 15% risk weight floor; and

    - Where the delinquency status of all underlying exposures is unknown, a subpool approach is reasonable; and

- The recommendations to SEC-SA should also be made to SSFA.

Additional detail regarding our concerns and these recommendations can be found in the SFA's letter.

VI. Equity Risk

As a normal part of their credit intermediation activities, banking organizations may acquire and hold limited amounts of equity exposures. Equity investing allows banking organizations to, among other things, provide credit to the real economy more flexibly and efficiently than would be possible solely with debt. These investments may include investments in: (1) projects designed to promote community welfare, including low-income housing tax credit financing, or to advance national legislative objectives, such as renewable tax credit equity financing; (2) small business investment companies ("SBIC"); (3) investment funds to generate fee income, including seed investments; (4) financial technology providers; (5) venture capital funds that promote capital formation and innovation; (6) FMI, including central counterparties, exchanges and trading venues that allow financial markets to function efficiently; and (7) public and privately held equity as hedges of risk arising from other activities.

We respectfully submit that the proposed approach to calculate RWA for equity exposures would upend decades of regulatory policy without sufficient rationale or evidence-based economic analysis. To address these concerns, we recommend that the final rule:

- provide a 100% risk weight to equity exposures pursuant to a nationally legislated program;
- retain the 100% risk weight for non-significant equity exposures;
- restore the 100% effective hedge pair equity risk weight treatment for unlisted equity instruments or allow such instruments to receive a market risk weight treatment;
- retain the 600% risk weight for investment firms with greater than immaterial leverage;
- simplify its look-through approaches for exposures to investment funds held in the banking book; and
- remove the "no material liabilities" prong of the definition of "investment fund."

A. The final rule should provide a 100% risk weight to equity exposures pursuant to a nationally legislated program

1. Challenges and Concerns

The Basel Framework provides for a 100% risk weight for "national legislated programmes that provide significant subsidies for the investment to the bank and

involve government oversight and restrictions on the equity investments."[176] In other words, the Basel Framework recognizes the need to harmonize bank capital rules with legislative objectives to ensure that bank regulators do not inadvertently discourage investments that a legislative body has determined to be a social good.

Consistent with this principle, the Proposal would allow banking organizations to assign a 100% risk weight to community development investments, including low-income housing tax credit equity investments[177] and new market tax credits,[178] in part because these investments "generally receive favorable tax treatment and/or investment subsidies that make their risk and return characteristics different than equity investments in general."[179]

The Agencies' and the Basel Framework's rationale extends equally to other forms of tax credit equity investments, including renewable electricity production tax credits and renewable energy investment tax credits. Just like low-income housing tax credit and new market tax credit investments, these exposures "receive favorable tax treatment . . . that make their risk and return characteristics different than equity investments in general."[180] Moreover, as part of statutorily established programs, such investments "involve government oversight and restrictions on the equity investments."[181] For example, the allocation of tax credits associated with these tax credit equity investments is subject to Internal Revenue Service interpretation.[182] In this manner, the Proposal's approach to nationally legislated programs is inconsistent.

We believe that equity exposures that support public policy goals, particularly those relating to supporting local communities and entrepreneurs, should also continue to receive a 100% risk weight along with community development investments and SBICs. This would include Community Development Financial Institutions ("CDFI") and Minority Depository institutions ("MDI"),[183] which play a significant role in supporting local communities. We also note that CDFIs and MDIs receive the same treatment as community development investments and SBICs under the current capital rules as they relate to the definition of a financial institution, and yet under the

176 Basel Framework, CRE 20.59.

177 12 CFR 24.6(a)(4).

178 12 CFR 24.6(c)(3).

179 Proposal at 64077.

180 *Id.*

181 Basel Framework at CRE 20.59.

182 Internal Revenue Service, Rev. Proc. 2007-65; Mark P. Keightley et al, "Tax Equity Financing: An Introduction and Policy Considerations," Congressional Research Service at 8 (Apr. 17, 2019).

183 CDFI Fund, "CDFI Certification" (last visited Jan. 15, 2024), https://www.cdfifund.gov/programs-training/certification/cdfi; FDIC, "Minority Depository Institutions List" (last visited Jan. 15, 2024), https://www.fdic.gov/regulations/resources/minority/mdi.html.

proposal they would be excluded from the types of equity exposures that would continue to receive a 100% risk weight.

Neither the current capital rule nor the Proposal extends the explicit 100% risk weight to such investments. Whereas today, such investments could be held in the 100% bucket, under the Proposal such investments would be subject to a 400% risk weight, significantly increasing the cost of such investing. Our analysis indicates that this would drive increases in RWA under ERBA by $123.2 billion, corresponding to required capital of $12.5 billion. Consistency demands consistent treatment for all such federally mandated tax credit investments and other exposures that support public policy goals, such as investments in MDIs and CDFIs.

2. Recommendations

For these reasons, we recommend the final rule allow banking organizations to assign a 100% risk weight to the full scope of nationally legislated tax credit equity investment exposures (i.e., any entity that engages predominantly in activity that would allow the investor to claim a business-related credit under 26 U.S.C. subpart D), including, but not limited to, tax equity investments in renewable energy projects.

B. The final rule should retain the 100% risk weight for non-significant equity exposures

The Proposal would adopt a version of the simple risk weight approach for equity exposures that would not include the 100% bucket for non-significant equity exposures. Our member institutions' experience over the last decade in using the 100% bucket has demonstrated that it appropriately captures the risk of non-significant equity exposures and that any increase in the capital charge associated with these exposures would be unwarranted.

1. Challenges and Concerns

The results from our analysis demonstrate that, in the aggregate, removing the non-significant equity bucket would drive an increase in RWA of $186.7 billion, corresponding to an increase in required capital of $18.7 billion. This increase would raise the capital requirements on certain tax credit equity investments, investments in essential FMI, venture capital investments, investments in fee-generating funds and strategic investments that promote innovation. This outcome would harm both banking organizations and the real economy.

(a) *The Proposal inappropriately penalizes strategic investments, including in core FMI and disincentivizes innovation in the banking sector*

Banking organizations also use the 100% bucket for strategic investments in FMI, qualifying central counterparties, exchanges, and trading venues. These entities are highly regulated, are used to support core payment and settlement activities in the

financial markets and pose little risk to banking organizations. For example, certain FMI (including qualifying central counterparties ("QCCP")) are designated as systemically important by FSOC and are subject to a stringent set of prudential and risk management standards. Exchanges and trading venues are similarly regulated by markets regulators around the world and allow for smooth operation of financial markets.

Equity exposures to these entities arise out of a need to conduct activities that are essential to the business of banking and, in the case of FMI and QCCPs, are a prerequisite to membership. For example, membership in the Depository Trust & Clearing Corporation requires banks to become shareholders of the entity, with the size of the stake generally determined by relative usage. These exposures represent long-term, strategic investments that are not intended to be inherently risky, speculative investments. They are made to improve the efficiency, transparency, and stability of financial markets – a goal that regulators across jurisdictions share. Infrastructure investments in particular increase competition, reduce risk and operational inefficiencies, lower transaction costs and increase market liquidity. As such, the Agencies should promote, rather than penalize, such investments.

In addition, banking organizations make strategic investments in FinTech providers that are principally engaged in activities that are financial in nature or incidental to such activities, as that phrase is defined in section 4(k) of the Bank Holding Company Act. These exposures to FinTechs allow banking organizations to develop and access innovative solutions and enable them to more effectively and efficiently serve their customers. As the pace of technological innovation intensifies, these types of investments are likely to become more important. Therefore, it is not appropriate to subject such strategic investments to inappropriate risk weights that could undermine efforts to invest in and develop new market infrastructure and technology.

(b) *The Proposal's effective increase in the capital charge for venture capital funds is inappropriate*

Banking organizations also currently use the 100% bucket for certain investments in venture capital funds. Much like investments in SBICs, investments in venture capital funds support innovation and thereby promote economic growth and job creation. In this regard, the Proposal's treatment of equity exposures to venture capital funds is neither internally consistent, nor consistent with the Basel Framework.

In particular, the statutory framework establishing SBICs provides that:

> [i]t is declared to be the policy of the Congress and the purpose of this chapter to improve and stimulate the national economy in general and the small-business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which

> small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply.[184]

The Agencies relied on a similar rationale to exclude venture capital funds from the definition of a covered fund (and the attendant investment restrictions), pointing to the fact that banking organizations' investment in venture capital funds would "support capital formation, job creation, and economic growth, particularly with respect to small businesses and start-up companies." [185]

Further, allowing a 100% risk weight for qualifying venture capital funds would be consistent with the goals of federal programs, such as the Equity/Venture Capital Programs of the State Small Business Credit Initiative,[186] which "provide capital in the form of equity investments to underserved startups and investors,"[187] including to venture capital funds in which banking organizations have also invested, and the Capital Challenge program of the U.S. EDA, which "seeks to increase access to capital where there is a limited supply of equity-based funding" and provides operational support for "the formation, launch, or scale of investment funds that seek to invest their capital in scalable startups."[188]

Yet while the Proposal would assign a 100% risk weight to SBIC exposures, it would effectively disallow the same treatment for venture capital funds. Based on underlying policy considerations, both asset classes should be eligible for similar treatment.

(c) *The Proposal would penalize banking organizations' efforts to make fund investments, including seed investments, contradicting the Volcker Rule and Congress's and the Agencies' long-standing policy to promote diversification*

In addition, banking organizations use the 100% bucket for investments in funds, including seed investments that generate fee income as part of their asset management businesses in an effort to diversify their revenue streams and build resilience. The Proposal's approach to equity risk (and, for that matter, operational

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[184] 15 U.S.C. § 661.

[185] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 46422, 46444 (July 31, 2020).

[186] U.S. Department of the Treasury," State Small Business Credit Initiative (SSBCI)" (last visited Jan. 15, 2024), https://home.treasury.gov/policy-issues/small-business-programs/state-small-business-credit-initiative-ssbci.

[187] U.S. Department of the Treasury, "State Small Business Credit Initiative - Fact Sheet" (June 2023), https://home.treasury.gov/system/files/256/State-Small-Business-Credit-Initiative-SSBCI-Fact-Sheet.pdf.

[188] U.S. Economic Development Administration, "Capital Challenge" (last visited Jan. 15, 2024) https://www.eda.gov/funding/programs/build-to-scale/capital-challenge.

risk) would raise capital costs associated with fund investments to a prohibitively high level. This would be aggravated, in the case of non-dealer banking organizations, by the requirement in the Proposal to measure most investment fund exposures using trading book rules. This approach would be both contrary to the Volcker Rule's stated objectives and long-standing congressional and Agency policy regarding diversification. For example, seed investments in registered funds that are not market risk covered positions would be subject to a 250% risk weight, and "skin in the game" investments made in private funds that are not market risk covered positions would be subject to a 400% risk weight. Not only would this undermine decades of financial regulatory policy, but also it would reduce the resiliency of these banking organizations by discouraging diversification into fee-related activities, undermining the Agencies' rationale for proposing these changes.

The significant, multi-year rulemakings implementing the Dodd-Frank Act's provisions related to the Volcker Rule have resulted in a considered approach to regulating banking organizations' interactions with funds. Specifically, the Volcker Rule permits banking entities to seed, manage and sponsor registered funds. In addition, the rule allows customer-facing activity for private funds managed and sponsored by banking entities and makes deliberate policy choices about the extent to which a banking entity is permitted to make principal investments in such funds. By doing so, the Volcker Rule effectuates Congress's purpose of "eliminat[ing] excessive risk-taking activities . . . *while at the same time preserving safe, sound investment activities that serve the public interest*."[189] This approach demonstrates that both Congress and the Agencies believe that banking organizations should be permitted to engage in asset management activities that allow banking organizations to diversify and develop new revenue streams.

More generally, for decades, Congress and the Agencies have promoted diversification of banking organizations' activities. For example, in 1999, then-Comptroller John Hawke testified before Congress on GLBA that "[p]roviding banks . . . the opportunity to maintain strong and diversified earnings through a range of prudently conducted financial activities is [a] . . . critical component of safety and soundness."[190] Comptroller Hawke went on to explain that banks' historical dependence on net interest margins generated from traditional lending made them vulnerable to changes in economic conditions.[191] Similarly, during congressional debates on the GLBA, members of Congress highlighted the benefits of diversification, including "increas[ing] competition, promot[ing] innovation,

189 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (emphasis added).

190 John D. Hawke, Jr., "Prepared Statement of John D. Hawke, Jr.," Hearings Before the Committee on Banking, Housing, and Urban Affairs, 116th Cong. at 5 (Feb. 24, 1999).

191 *Id.*at 5-6.

lower[ing] consumer costs, and allow[ing] the United States to maintain its world leadership in the financial services industry."[192]

Agency principals continue to echo these views. For example, FRB Governor Bowman, in discussing the Proposal, noted that "[d]iversification in revenue streams can enhance the stability and resilience of a bank, and excessive capital charges for these revenue-generating activities could create incentives for banks to roll back the progress they have made to diversify revenues."[193] Moreover, recent research has shown that "asset diversification by banks leads to a higher and more stable credit supply, and […] this provides positive spillovers to the economy" including through increased lending.[194] The Proposal's approach to investment funds must be consistent with these objectives.

Another example is employee related programs, including bank-owned life insurance ("BOLI") and company-owned life insurance ("COLI") products, which are life insurance policy contracts that protect banks against the loss of certain employees. If managed as separate accounts, the capital rules require investments held in such separate accounts to be treated as investments in investment funds, which would hinder banking organizations' ability to obtain such products. Similarly, defined benefit pension fund net assets held by a depository institution that are not deducted would also be similarly impacted.[195] In each case, a banking organization's investment in the underlying investment may be subject to a 100% risk weight as a non-significant equity investment. Under ERBA, the risk weight for such investments that are not market risk covered positions likely would increase to 250%, given that the equities are generally publicly traded. Such an increase is unwarranted given the prudent investment style associated with pension fund and other employee-related assets in general.

2. Recommendations

As demonstrated above, the Proposal's removal of the non-significant equity bucket results in an inappropriately punitive treatment of non-significant equity exposures, including investments in FMI, venture capital funds and investment funds more generally. Accordingly, we recommend that the Agencies retain the 100% risk weight "bucket" for non-significant equity exposures.

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[192] 145 Cong. Rec. H11544 (daily ed. Nov. 4, 1999).

[193] FRB, "Statement by Governor Michelle W. Bowman" (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20230727.htm.

[194] Gelman et al, "Bank Diversification and Lending Resiliency," at 6 (Apr. 17, 2023), https://deliverypdf.ssrn.com/delivery.php?ID=941086029119009012127091104009102030040035068060068038011067127081004085098004007121027055021115000042004095074116087001114119062049001061039125084120103006116066121021022063070002122104003092104123066127002027082123123090112079110002026120067078013117&EXT=pdf&INDEX=TRUE.

[195] 12 CFR 217.22(a)(5).

C. The final rule should restore the 100% risk weight for effective hedge pairs

1. Challenges and Concerns

Under the Proposal, the current 100% risk weight treatment for effective hedge pairs would be removed in its entirety. Our analysis shows that this would drive an increase in RWA of $235.4 billion, corresponding to required capital of $24.8 billion. The Proposal states that these risk weights are no longer relevant because "[t]he hedge pair treatment under the current capital rule is only available if each of the equity exposures is publicly traded or has a return that is primarily based on a publicly traded equity exposure. … [S]uch positions would generally be subject to the proposed market risk capital framework under the proposal."[196]

While it is true that hedge-pair positions would *generally* be subject to the Proposal's market risk capital framework, it would not be true in all cases. For example, under the Proposal, unlisted equity instruments would no longer receive the equity risk weights for hedge pairs but also would be ineligible for market risk treatment. The impact would be particularly significant, and result in substantially higher capital requirements not commensurate with actual risk, in the case of unlisted instruments that are convertible or exchangeable into listed equities and are fully hedged and insulated from any meaningful equity risk.

Visa Class B shares are a concrete example of an unlisted instrument held by a number of banking organizations today.[197] Such shares are not publicly traded and generally not considered to be market risk covered positions; however, they are often hedged with publicly traded Visa A shares, which generally eliminates the market risk of the position.[198] Even though the position is flat from a market risk perspective, the Proposal would increase the associated capital requirements by at least 5.5 times.[199] Another example would be employee deferred compensation programs, which often are hedged by publicly-traded equity exposures.

2. Recommendations

Removing the hedge-pair treatment in its entirety results in significant overstatements of equity risk for unlisted equity instruments when they are hedged.

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[196] Proposal at 64077.

[197] Visa Class B stock was created to deal with certain litigation initiated prior to Visa's initial public offering in 2008.

[198] Visa B shares are fully convertible into Visa A shares at the published ratio. The equity market risk of the Visa B position is eliminated by the combination of the stock hedge and Conversion Ratio Swap protection for future changes to the ratio.

[199] The increased risk weights and loss of hedge-pair treatment would translate into a 400% risk weight for the Visa B shares and 250% risk weight for the Visa A hedge.

To ensure the regulatory capital framework appropriately reflects risk, properly incentivizes risk management and avoids materially increasing the costs of hedging activities, we recommend that the hedge-pair treatment for such instruments be retained. Alternatively, the qualifications for market risk treatment should be expanded so these instruments may be eligible for market risk treatment at the election of a banking organization. At a minimum, we urge the Agencies to retain the hedge-pair treatment for banking organizations' Visa B positions.

D. The 400% risk weight for banking book equity exposures should be limited to truly early-stage venture capital investments

1. Challenges and Concerns

The Proposal would retain the current capital rule's 400% risk weight for banking book equity exposures that are not publicly traded. Our analysis shows that this would drive an increase in RWA of $26 billion, corresponding to required capital of $3.1 billion. We believe this treatment is overbroad and disincentivizes banking organizations from engaging in long-term, relationship-based equity investments, further shifting this activity to less-regulated non-bank financial institutions.

Moreover, as the Basel Framework points out, this bucket is not intended to capture "unlisted equities of corporate clients with which the bank has or intends to establish a long-term business relationship."[200] Instead, this risk weight is meant for investments in "unlisted companies that are invested for short-term resale purposes or are considered venture capital or similar investments which are subject to price volatility and are acquired in anticipation of significant future capital gains."[201] Relationship-driven equity investments are not held for short-term resale or in anticipation of significant future capital gains and, as such, should not be subject to an excessively high risk weight.

2. Recommendations

Because the 400% risk weight is overbroad, we recommend that it be limited to truly early-stage venture capital investments as the term is defined in the regulatory reporting context. Specifically, we recommend that the 400% risk weight be limited to equity exposures "to start-up or high-risk companies specializing in new technologies, ideas, products, or processes" where "[t]he primary objective of [the] investment[] is capital growth."[202]

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200 Basel Framework at CRE 20.58 n. 25.

201 Basel Framework at CRE 20.58.

202 FRB, "Instructions for Preparation of Consolidated Financial Statements for Holding Companies," Reporting Form FR Y-9C, HI-12 (Dec. 2023),

In addition, we recommend that other banking book unlisted equity investments be assigned a 250% risk- weight similar to publicly traded equity exposures with tradability restrictions. Though these exposures are unlisted, because they are long-term investments in which the banking organization is not seeking short-term profit, we believe they exhibit similar risk characteristics as publicly traded exposures with tradability restrictions.

E. The final rule should retain the 600% risk weight for investment firms with greater than immaterial leverage[203]

1. Challenges and Concerns

The Proposal would remove the 600% risk weight for equity exposures to investment firms with greater than immaterial leverage. Our analysis shows that the removal would drive an increase in RWA of $7 billion, corresponding to required capital of $0.9 billion.

In proposing the current capital rule, the Agencies observed that these exposures warranted a 600% risk weight "due to their particularly high risk."[204] The Agencies now claim, without any justification, that the risk posed by these exposures warrants a 1250% risk weight.[205] Based on our member institutions' experience, this would be inconsistent with observed loss history and outputs of GMS exercises.

2. Recommendations

Because the Agencies have not justified increasing the risk weights applicable to investment firms in the banking book with greater than immaterial leverage, and because our member institutions' experience suggests that 600% is an adequate risk weight for this asset class, we recommend the final rule retain the current capital rule's treatment for these exposures.

https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=81d24d2b-870d-4e43-98c2-3ca4983678f1.

[203] This section is responsive to Questions 68 and 69.

[204] Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52888, 52924 (Aug. 30, 2012).

[205] Proposal at 64077–78.

F. The final rule should simplify its look-through approaches for exposures to investment funds held in the banking book

1. Challenges and Concerns

The Proposal would require our member institutions, as organizations subject to the Proposal's market risk rule, to apply the alternative modified look-through approach to banking book exposures to investment funds.

We believe the treatment of investment fund derivative exposures is particularly punitive. Specifically, the Proposal would require calculating the exposure amount for each netting set as:

$$\text{Exposure Amount} = C * \alpha \text{ (Replacement Cost + Potential Future Exposure)}$$

C would be set at 1 for derivatives that are not CVA risk covered positions and 1.5 for derivatives that are CVA risk covered positions or if the banking organization cannot determine whether it is a CVA risk covered position. Moreover, α would be set at 1 if the counterparty is a commercial end user but 1.4 if the counterparty is not a commercial end user or the banking organization is not able to determine whether the counterparty is a commercial end user.

We believe the higher calibration of C and α when a banking organization cannot determine whether the derivative is a CVA risk covered position or determine the counterparty is improperly calibrated. The Agencies have not released any evidence to support these calibrations, except to note that the treatment "intended to provide a conservative approach" to banking book exposures to investment funds.

Equity investments in investment funds do not present CVA risk from the perspective of the investing bank, so the RWA amount should not capture CVA risk. There is no reason to have a capital charge for CVA with respect to investments or exposures that do not present CVA risk, such as equity exposures in an investment fund. The agencies should therefore eliminate this upward adjustment based on CVA risk.

Further, the Proposal would require that, if the banking organization cannot determine replacement cost under SA-CCR or is using the alternative modified look-through approach, then replacement cost ("RC") = notional amount, potential future exposure ("PFE") = 15% * notional amount and $\alpha = 1.4$ for non-commercial end user counterparties. We are concerned that the treatment of derivative exposures would not be sufficiently risk sensitive given that, unlike the current capital rule, the Proposal would not exclude derivative contracts used for hedging (rather than speculative purposes), and do not constitute a material portion of the investment fund's exposures.

The proxies the Agencies propose could result in excessively high PFE amounts, particularly for interest rate foreign exchange and investment grade credit derivatives. The table below shows the standalone add-on amounts under SA-CCR for unmargined derivative transactions and derivative transactions with a margin period of risk ("MPOR") of 10 business days:

	30Y IR	FX	7year IG SN	7year Seculative SN	7year sub speculative SN	Equity SN	Energy	Other Commodity
Margined	2.3%	1.2%	0.8%	2.3%	10.6%	9.6%	12.0%	5.4%
Unmargined	7.8%	4.0%	2.7%	7.7%	35.4%	32.0%	40.0%	18.0%

As the table shows, only unmargined equity, commodity and sub speculative credit derivatives would result in higher standalone add-ons than proposed. Based on this, and the considerable variation, the add-on calibration appears to be insufficiently granular and overly conservative. The add-ons should be set as follows:

- 2% for the portion where the bank knows that the fund has margined interest rate, foreign exchange and credit derivatives;
- 10% for the portion where the bank knows that the fund has margined equity and commodity derivatives;
- 7% for the portion where the bank knows that the fund has unmargined interest rate, foreign exchange and credit derivatives; and
- 15% if the bank has no information around margining / asset class composition.

In relation to the RC, we would propose that if the bank knows that the derivatives of the fund are daily margined the RC should be zero. Otherwise, the RC should be recalibrated. In this context, it is helpful to review the derivative statistics provided by BCBS. The table below shows the average ratio of gross market value and notional between the second half of 2021 and the first half of 2023:

Asset Class	2021-S2	2022-S1	2022-S2	2023-S1	Average
FX	2.4%	4.3%	4.5%	3.6%	3.7%
IR	1.8%	2.3%	3.0%	2.5%	2.4%
Equity	9.0%	8.5%	7.3%	7.3%	8.0%
Comm	17.6%	31.1%	22.3%	13.4%	21.1%
Credit	2.3%	2.6%	1.9%	2.0%	2.2%

For foreign exchange, interest rate and credit, RC should be set at 5% of notional, while for equity 10% and for commodity 30%. If the banking organization does not know the composition, the RC should be set at 30%.

Finally, with respect to investment funds which themselves have equity exposures to other investment funds, the Proposal would require banking organizations to use the alternative modified look-through approach for the first and second layer of investment funds. Each subsequent layer of investment funds would receive a 1250% risk weight. We do not believe this approach is appropriately calibrated for the risk posed by each subsequent layer of investment funds. As a simple matter, a banking organization's exposure to loss decreases significantly at each layer of investment. Thus, it is unlikely that a banking organization could experience losses due to a performance of a third- or fourth-layer investment firm exposure. Moreover, gathering the required information so that a banking organization can even determine a third-layer investment fund has invested in a fourth-layer investment fund is operationally challenging and does not materially inform the banking organization's risk level.

2. Recommendations

As the discussion above demonstrates, the Agencies should revise the alternative modified look-through approach. Specifically, we recommend that:

- Banking organizations should not be required to apply the look-through treatment for derivatives if the investment fund has a *de minimis* exposure to derivatives.
- In line with the current capital rule, the Agencies should exclude derivative contracts that are used for hedging rather than speculative purposes and do not constitute a material portion of the investment fund's exposures.
- RC and PFE should be recalibrated as outlined above.
- CVA component should be excluded.
- The alternative modified-look through approach should only apply to investment fund exposures of the fund in which the banking organization directly invests.

G. The "no material liabilities" prong of the definition of "investment fund" should be removed

1. Challenges and Concerns

An "investment fund" is defined, and would continue to be defined under ERBA, as a company (1) where all or substantially all of its assets are financial assets and (2) that has no material liabilities. This definition may have been appropriate when it was introduced in 2007; however, given that the capital framework has been updated to take into account the leverage of investment funds, the second clause of the definition is no longer necessary.

When the Agencies adopted the current definition of "investment fund" in connection with the implementation of Basel II, they noted that "[i]nvestment vehicles with material liabilities provide a leveraged exposure to the underlying financial assets and have a risk profile that may not be appropriately captured by a look-through approach."[206] The Agencies provided this explanation in the context of discussing comments on the proposed definition that "objected to the exclusion of investment funds with material liabilities from…[the look-through] treatment, observing that it would exclude equity exposures to hedge funds," as well as others that "suggested that investment funds with material liabilities should be eligible for the look-through approaches."[207]

Though the look-through approach introduced in 2007 did not capture all of the risk of leveraged investment funds, the Proposal and the current full look-through approach would. Under the Proposal, banking organizations would be required to multiply the average risk weight for equity exposure to an investment fund by the ratio of the total assets of the investment fund to the total equity of the investment fund. This adjustment would capture the risk from an investment fund's leverage by proportionately increasing the average risk weight of a banking organization's equity exposure to the investment fund.

The Proposal does not discuss to what extent a company could have leverage (and therefore liabilities) while remaining an investment fund – that is, the Proposal does not address the extent to which leverage would not constitute "material liabilities" for purposes of the definition of investment fund. The Agencies have not otherwise provided formal commentary, such as interagency FAQs or preamble discussions in rulemakings, on the definition of "investment fund."

2. Recommendations

In light of the fact that the current full look-through approach and the proposed look-through approaches are designed to capture a fund's leverage, as well as the fact that it is unclear to what extent a company could have leverage and still remain an investment fund, the Agencies should revise the definition of investment fund so that a fund with material liabilities may be considered an investment fund.

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[206] 72 Fed. Reg. at 69381.

[207] *Id.*

VII. Operational Risk

The Proposal would replace the advanced measurement approach for operational risk with a new standardized measurement approach, and would also incorporate the new approach into the capital stack to which the SCB is applied, a buffer requirement which already includes a capital charge for operational risk losses. We respectfully submit that the proposed operational risk RWA framework is conceptually flawed and significantly overstates operational risk, particularly with respect to fee-based businesses, which is further compounded by the overlap with the stress testing framework. We share the concerns raised in the joint letter by the Bank Policy Institute and American Bankers Association (the "BPI/ABA Letter") and support its recommendations to address the over-calibration of operational risk.

Unlike other aspects of the Proposal that are targeted to the risks of specific products and services, the operational risk capital requirements apply on a firm-wide basis, thereby impacting the cost and availability of all financial products and services provided by our member institutions and therefore would contribute significantly to the Proposal's over-calibration. Indeed, operational risk charges are the single largest source of capital increases under the Proposal. Based on our analysis, operational risk RWA would account for approximately 64% of the total increase in Forum member institution RWA.[208] Despite the significant potential quantitative impact on required capital, the Proposal draws conclusions without presenting evidence-based economic analysis to justify the necessity, design or calibration of the proposed methodology.

These conceptual flaws lead to operational risk capital requirements that far exceed actual historical loss experience. A 2023 study by the Operational Riskdata eXchange Association (ORX) (the "ORX Study") found that comparing approximate capital requirements under the proposed approach to annual loss values reveals firms' operational losses are typically 6-7% of required capital and rarely exceed 15% of required capital.[209] Even allowing for a significant margin of error, the data imply significant over-calibration.

The significant overstatement of operational risk capital is driven by a number of factors:

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[208] We note that 64% of the increase reflects the estimated RWA amounts in Table 3 which differ from the RWA amounts presented in the Proposal. According to the Proposal, increased RWA from operational risk accounts for 78% of the total RWA increase for Category I and II banking organizations and 89% of the increase for all covered banking organizations. The Agencies' analysis implies the 78% estimate is due to significant underestimation of increases in credit risk RWA, which in turn underestimate overall RWA increases. *See* Proposal at 64168.

[209] ORX, "Basel III and standardised approaches to capital: Analysis of ORX global banking data in response to regulatory reforms" at 9 (Oct. 2023), https://orx.org/resource/basel-iii-and-standardised-approaches-to-capital-2023 [hereinafter, the "ORX Study"] (click "Download the report" and input the prompted information to access the report).

- The Proposal imposes a standalone standardized operational risk capital requirement, but makes unjustified assumptions regarding the relationship between operational risk losses, on the one hand, and credit, market and CVA losses, on the other hand.

- The Proposal overlaps with the FRB's supervisory stress testing framework, which is calibrated based on the current standardized approach, and already include projections of operational risk losses.

- The Proposal appears to have been designed based on a population of 89 banks, the vast majority of which are based outside of the United States and that have vastly different loss experience across business lines.[210]

- The Proposal significantly over-capitalizes risk arising from fee-related business, therefore disincentivizing banking organizations from diversifying their income streams away from net interest income, primarily as a result of (1) measuring revenue and expense on a gross, rather than net, basis and (2) unlike the interest component, not capping the services component.

- The over-calibrated Business Indicator is subject to an "internal loss multiplier" floored at one, which is a conceptually flawed approach because: (1) it incorrectly assumes that unfavorable loss experience is relevant and should increase operational risk capital requirements, but favorable loss experience is irrelevant and should not lower such requirements and (2) past operational losses do not reliably predict future operational risk losses.

In the Modified RWA analysis that is presented in this letter, we assume that operational risk RWA is reduced by 35% relative to the Proposal. This reduction in the over-calibration of operational risk RWA would reduce required capital by $56.4 billion. This reduction is broadly consistent with the range of options for addressing operational risk that are presented in the BPI/ABA letter. Additional detail regarding these and other concerns, as well as our recommendations regarding operational risk that FSF member institution's support, may be found in the BPI/ABA Letter.

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[210] The ORX Study analyzed loss ratios across 17 business lines and 45 firms confirms that there are significant differences in loss experience across business lines, between Western European firms and U.S. firms in the same business line and between individual banking organizations. Overall, the data reveal over 10-fold differences between the median loss ratios between Western Europe and the United States, over 20-fold differences between median loss ratios across business lines and over 100-fold differences between median and 90th percentile loss ratios in the same business line and same region. *Id.*

VIII. Market Risk Capital, Credit Valuation Adjustment Capital and Trading Book Boundary Issues

American companies rely more heavily on capital markets funding than traditional bank lending, in contrast to every other major jurisdiction. Capital markets play a critical role in economic growth, providing 71.9% of equity and debt financing for non-financial corporate issuers.[211] Collectively, as of the third quarter of 2023, Forum member institutions account for 66% of bank capital markets activities (by revenue), which support the needs of companies to invest and grow. Our member institutions also play a critical role in providing liquidity to a wide array of financial markets, ranging from the U.S. Treasury market to the IPO market for innovative start-up companies.

The Proposal would revise the market risk capital rule by introducing a set of standardized approaches and significantly limit the use of internal models for market risk. We estimate that the Proposal would increase market risk capital requirements for our member institutions by 72.6%, corresponding to an increase in RWA of $277.9 billion. The Proposal would also introduce a new CVA capital requirement, which would result in an additional $216.7 billion of RWA. The Agencies do not present evidence of an increase in market risk or counterparty credit risk among our member institutions that would justify such large increases in capital.

Our member institutions are members of ISDA and SIFMA, share the concerns raised in the ISDA/SIFMA Letter and support its recommendations regarding the proposed market risk and CVA frameworks, including the following:

- The Proposal should avoid adverse effects to the liquidity and vibrancy of capital markets, including by improving recognition of diversification:
  - Across asset classes in the standardized approach;
  - Across asset classes in the modelled approach;
  - Between modelled and non-modelled in the modelled approach; and
  - Between trading desks using modelled and non-modelled approaches.
- The Proposal should avoid increasing capital requirements for markets where that outcome would not be aligned with underlying risks, including by:

[211] SIFMA, “2023 Capital Markets Fact Book” at 6 (July 2023), https://www.sifma.org/wp-content/uploads/2022/07/2023-SIFMA-Capital-Markets-Factbook.pdf.

    - Clarifying that to-be-announced and deliverable pools that are Uniform Mortgage-Backed Securities-eligible are treated as the same obligor for both the sensitivities-based method ("SBM") and the default risk charge ("DRC");

    - Exempting certain sovereign exposures from credit spread risk and DRC charges;

    - Recognizing the tax-exempt status of public sector entities ("PSE") in the calibration of risk weights under SBM and lower LGD under DRC to reflect historical recovery rates;

    - Improving the calibration of the SEC-SA approach, including inclusion of a "Simple, Transparent and Comparable" securitization framework similar to that set out in the Basel Framework, appropriately adjusted for the operation of the U.S. market, as discussed in Section V above; and

    - Revising available approaches for equity investments in funds under the standardized approach for market risk so that they are implementable and appropriately aligned with inherent risk.

- The Proposal should avoid adverse impacts to commercial end users, corporates, banking organizations and other derivatives end users, as well as resulting negative effects on investors, including by:

    - Exempting the client-facing leg of a cleared derivative transactions from CVA capital requirements because these exposures do not pose any CVA risk (i.e., banking organizations do not suffer CVA losses on client-cleared activity);

    - Distinguishing between regulated (i.e., pension funds, insurance companies, RICs) and unregulated financials to reflect more appropriately the differences in risk profiles;

    - Improving recognition of single name and index hedges under both the basic CVA and standardized CVA approach frameworks;

    - Revising the MPOR for CVA purposes to be no greater than 5 business days for derivative transactions subject to regulatory margin requirements in alignment with CVA calculations recognizing the significant improvements in OTC derivatives markets, including the introduction of margin rules for uncleared swaps requiring initial margin and daily variation margin; and

    - Enhancing the risk sensitivity of equity hedge recognition in DRC for derivatives, and given the inability to use models for calculating DRC, extending the maturity scaling allowed for physical equities to derivatives, as well as "Optional Early Termination" clauses in equity derivative contracts.

- Certain aspects of the Proposal that 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 modelled approaches should be modified, including by:

    - Converting the profit and loss attribution test for modelled desks to an entirely qualitative requirement used for supervisory monitoring as this test would otherwise introduce volatility in capital levels that would disincentivize banking organizations from using modelled approaches; and

    - Capping the total modelled capital at the standardized approach amount in order to provide appropriate incentives for banking organizations to build models and to recognize the conservatism of the standardized approach.

- The proposed decomposition treatment of correlation trading positions under the DRC should be clarified and certain provisions revised to increase risk sensitivity and more accurately reflect the economics of hedging activities.

- The Agencies should allow for appropriate time to implement these significant changes to the framework.

Implementing the recommendations suggested in the ISDA/SIFMA letter would mitigate the impact on market risk capital by $186.2 billion in RWA, corresponding to $22.8 billion in required capital and the impact on CVA capital by $50.1 billion, corresponding to $5.7 billion in required capital.

Additional detail regarding these concerns and recommendations can be found in the ISDA/SIFMA Letter.

Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com) with any questions.

Respectfully Submitted,

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President and CEO
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cc: Mark Van Der Weide
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Appendix A

Changes Lacking Economic Impact Analysis

In this Appendix, we identify significant categories of proposed changes to the risk-weighting methodologies that the Agencies do not attempt to justify with economic analysis.

- Total capital requirement calibration;
- Effective date for final rule and SCB requirement;
- SCB and GSIB surcharge transition calibration;
- Definition of "defaulted exposure" and "defaulted real estate exposure";
- Bank and non-bank financial institution exposures;
- Risk weight for subordinated debt;
- Risk weight for junior-lien real estate exposures;
- Public listing requirement for investment-grade corporates;
- Risk weights for corporate SMEs;
- High-quality project finance exposures;
- Treatment of "eligible guarantees";
- Recognition of eligible credit derivatives";
- Application of minimum SFT haircuts;
- Calibration of counterparty credit risk capital requirements;
- Securitization calibration across supervisory stress tests;
- Risk weights under the simplified supervisory formula approach;
- Value of the securitization p-factor;
- Treatment of credit-linked notes;
- Treatment of synthetic securitizations;
- Application of the credit conversion factor and calculations of other factors;

- The risk weight floor for resecuritizations;
- Risk weights applicable to securitization exposures backed by regulatory retail exposures;
- Determining tranche size for securitization exposures;
- Risk weight floor for securitization exposures;
- Approach to delinquency status for securitization exposures;
- Risk weights for equity exposures to nationally legislated programs;
- Removal of 100% non-significant bucket;
- Risk weights for effective hedge pairs;
- Risk weight for non-publicly traded equities;
- Risk weight for investment firms with material leverage;
- Look-through approaches for banking book fund exposures;
- Operational risk capital (in its entirety); and
- Calibration of the Trading book/CVA frameworks (in their entirety).

Appendix B

Table B1: Summary of Mitigants

In this Appendix, we list the impact on RWA and required capital impact of certain of our recommendations.

Table B1: Risk-weighted Asset and Capital Impacts of Proposed Mitigants ($BN)

Mitigant	RWA Impact	Capital Impact
Credit Risk		
Credit		
Treat Broker Dealers as Banks	7.9	0.8
Align bank short-term risk-weight with Basel framework	28.6	3.2
Treat highly regulated financials as investment grade corporates	31.0	3.1
No securities listing requirement for investment grade status	200.9	21.4
Align residential mortgage risk-weights with Basel Framework	176.1	18.3
Allow use of simple approach (CRM) without requiring collateral agreement where it is required that the transaction is removed from stay risk	15.6	1.9
Total	**460.1**	**48.5**
Securitizations		
Revert p-factor to 0.5 in securitization framework	71.1	7.9
Cap risk-weight at maximum potential loss	1.0	0.1
Revert to existing definition of W parameter	32.2	3.7
Total	**104.4**	**11.6**
Equity		
Align treatment of nationally legislated programs with Basel framework	123.2	12.5
Retain 100% risk-weight for all hedge pairs	235.4	24.8
Apply 400% risk-weight only for venture capital investments	26.0	3.1
Apply 600% risk-weight to investment funds with material leverage	7.0	0.9
Retain 100% for all non-significant equity	97.9	10.8
Total	**489.5**	**52.1**
Memo: Retain 100% for all non-significant equity (standalone impact)	186.7	18.7
Counterparty		
Derivatives		
Treat broker-dealers as banks	7.6	0.8
Treat highly regulated financials as investment grade corporates	31.9	3.4
No securities listing requirement for investment grade status	40.2	4.6
Align bank short-term risk-weight with Basel framework	30.0	3.6
All other mitigants	14.1	1.4
Total	**123.8**	**13.9**
Securities Financing Transactions (SFTs)		
Remove SFT haircut floors	123.8	14.7
Treat broker-dealers as banks	7.3	0.8
Treat highly regulated financials as investment grade corporates	16.2	1.7

No securities listing requirement for investment grade status	28.0	3.2
Align bank short-term risk-weight with Basel framework	6.9	0.7
All other mitigants	100.0	10.6
Total	**282.2**	**31.6**
Market		
All trading book mitigants	186.2	22.8
Total	**186.2**	**22.8**
CVA		
All CVA Mitigants	50.1	5.7
Total	**50.1**	**5.7**
Operational		
Set ILM = 1 Adjusted for BPI Letter	515.0	56.4
Total	**515.0**	**56.4**
Addenda: Combined Impacts		
Treat Broker Dealers as Banks	22.8	2.4
Align bank short-term risk-weight with Basel framework	65.5	7.5
Treat highly regulated financials as investment grade corporates	79.1	8.2
No securities listing requirement for investment grade status	269.1	29.2

Calculations based on Forum member institution data submissions as of Q2 2023. RWA impacts are calculated as the aggregate difference between the RWA that would result before and after the mitigant is applied. The capital impact is defined as the aggregate decline in required capital resulting from applying each mitigant. Totals do not add due to rounding.