ISLA AMERICAS, FRAN GARRITT

Proposal and Comment Information

Title: Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, R-1866

Comment ID: FR-2025-0026-01-C17

Subject

Docket R-1866; RIN 7100-AG92

Submitter Information

Organization Name: ISLA Americas

Organization Type: Company

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On behalf of ISLA Americas, please find attached comments to the proposal entitled Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement.

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June 23, 2025

VIA ELECTRONIC SUBMISSION

Ann Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement (Docket R-1866 and RIN 7100-AG92)

Dear Ms. Misback:

ISLA Americas[1] appreciates this opportunity to submit this letter to the Federal Reserve Board (the "FRB") on its proposed rule (the "Proposal") to amend the calculation and annual effective date of the stress capital buffer ("SCB") requirement.[2]

The Proposal states that the FRB "is also considering broad modifications to its regulatory capital and capital planning requirements for large firms to ensure they remain cohesive and effective, maintain the resilience of the banking sector, and minimize any unnecessary burden," and invites comments on "on all aspects of the proposal and [the FRB's] intended approach to seek comment on other significant changes to its supervisory stress test."[3] We write to offer a recommendation with respect to regulatory capital intended to minimize unnecessary burdens and on revisions to the stress testing framework.

In particular, we recommend that the FRB allow banking organizations to use the revised collateral haircut approach ("CHA") to calculate counterparty credit risk

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1 ISLA Americas is a non-profit industry association, presently representing the common interests of securities lending firms in the Americas region, namely institutional investors, asset managers, and custodial banks.

2 Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, 90 Fed. Reg. 16843 (Apr. 22, 2025).

3 *Id*. at 16844.

for repo-style transactions under the standardized approach and for purposes of the FRB's Comprehensive Capital and Analysis Review ("CCAR") process.

I. **Background**.

The current standardized CHA overstates credit risk associated with fully-collateralized repo-style transactions and disincentivizes sound credit risk management by negating the impact of netting arrangements and large diverse portfolios that reduce credit risk. Both foreign and domestic central banks and supervisors have recognized and sought to address this issue for over a decade now. For example, following the U.S. federal banking agencies' adoption of Basel III in 2013, which included a CHA, ISLA Americas (then the RMA Committee on Securities Lending) proposed modifications to the Basel Committee on Banking Supervision's ("BCBS") "comprehensive approach" in 2015. The BCBS adopted revisions to the "comprehensive approach" reflecting industry suggestions in 2017.[4] Most recently, the federal banking agencies' 2023 Basel III "Endgame" proposal would have revised the CHA consistent with the BCBS's "revised comprehensive approach." As the proposal explained, the revisions would "increase the risk-sensitivity of the collateral haircut approach."[5]

II. **Drawbacks of the Current Approach.**

The ongoing delays in the U.S.'s Basel III implementation with respect to the revised CHA inhibits the international competitiveness of U.S. industry participants, constrains market liquidity, and promotes regulatory arbitrage. Each of these outcomes can be avoided by the adopting of the revised CHA.

A. International Competitiveness.

The persistence of the current CHA exacerbates differences between the U.S. and major jurisdictions that have adopted the 2017 BCBS revisions, including the United Kingdom, the European Union and Japan. Capital requirements in these jurisdictions are, in most cases, model-based and subject to a lower 72.5% standardized floor, resulting in significantly lower capital requirements for the same activities.

Moreover, these differences extend to the U.S. operations of foreign banks. In particular, foreign banking organizations can offer indemnified agency securities lending services from their U.S. branches and agencies without being subject to U.S. regulatory capital

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4 Basel III: Finalising post-crisis reforms at 39 (Dec. 2017), available *here*.

5 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 64028, 64060 (Sept. 18, 2023). Although this proposal would have incorporated the revised CHA into the proposal's "expanded risk-based approach," we recommended that the banking agencies allow all banking organizations to opt in to the revised CHA approach for purposes of the standardized approach, consistent with the Agencies' approach to SA-CCR implementation. RMA Securities Lending Council Letter to Ann E. Misback, et al. (Jan. 16, 2024), available *here*.

requirements. This provides foreign firms with a significant competitive advantage and allows them to offer these services to prospective clients at a lower price relative to domestic banking organizations.

B. Market Liquidity.

U.S. banking organizations have increasingly limited risk-weighted asset capacity with which to supply U.S. capital markets with market liquidity and to facilitate collateral transformation. These regulatory capital constraints interact multiplicatively with other regulatory constraints (which effects the FRB should address in its revisions to the capital framework).

For example, the CCAR global market shock (on the dealer side) and large counterparty default (on the agent lender side) scenarios place the heaviest burdens on the largest suppliers of market liquidity. Similarly, the single-counterparty credit limits can serve as a supply bottleneck that limits downstream flow from the largest sources of supply (agent lenders) to the largest sources of demand (U.S. dealers).

C. Regulatory Arbitrage.

The current CHA also exacerbates differences between synthetic markets, which generally use the standardized approach for counterparty credit risk ("SA-CCR"), and cash markets (that rely on the CHA). As ISLA Americas (then RMA Committee on Securities Lending) has previously noted, this disparate treatment of cash securities lending and synthetic derivatives incentivizes market participants to engage in derivatives transactions that are economically equivalent to securities financing transactions.[6]

For example, equity total return swaps on main index equities are subject to SA-CCR charges far lower than fully cash-collateralized securities loans on the same securities. This disparity is even greater for larger, more diverse netting sets, as the illustrative example in the table below shows:

[6] RMA Committee on Securities Lending Letter to Robert deV. Frierson at 9 (June 3, 2016), available *here*.

Treatment of a Loan of $200 Ford Stock, $400 GE Stock and $150 cash vs. $606 cash collateral and $162 GM	
Methodology	**Exposure**
VaR-Based Measure	≈ $2.6
Current CHA	≈ $62.8
SA-CCR	≈ $39.0
Revised CHA	≈ $44.1

The lower capital requirement and over-the-counter nature of synthetic derivatives transactions allows market participants to take highly-leveraged, non-transparent positions.

III. Recommendation.

The FRB's capital plan rule provides that a bank holding company's stress capital buffer requirement is calculated based on "[t]he ratio of a bank holding company's common equity tier 1 capital to risk-weighted assets, as calculated under 12 CFR part 217, subpart D, as of the final quarter of the previous capital plan cycle, **unless otherwise determined by the Board**; minus the lowest projected ratio of the bank holding company's common equity tier 1 capital to risk-weighted assets, as calculated under 12 CFR part 217, subpart D, in any quarter of the planning horizon under a supervisory stress test; plus …[an adjustment for common stock dividends].(emphasis added)"[7]

The FRB could, for example, clarify that the calculation of the "lowest projected ratio" may also be "otherwise determined by the Board" and subsequently make the determination that risk-weighted assets for repo-style transactions should be calculated

[7] 12 CFR 225.8(f)(2)(i).

using the revised CHA. This would provide the FRB the flexibility to make a temporary adjustment to the SCB until the Basel III revisions are finalized.

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We would appreciate the opportunity to provide additional input for the FRB's consideration and would welcome the opportunity to meet to discuss our recommendations further.

Respectfully submitted,

Fran Garritt
CEO and President
ISLA Americas