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Proposal and Comment Information

Title: Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, R-1873

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Submitter Information

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Please see attached comment letter submitted on behalf of the Institute of International Bankers.

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By Electronic Mail

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

Re: **Notice of Proposed Rulemaking, Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, Federal Reserve Docket No. R-1873, RIN 7100-AH05**

The Institute of International Bankers ("IIB") appreciates the opportunity to comment on the notice of proposed rulemaking regarding modifications to the models and applicability of add-on components used to conduct the Board of Governors of the Federal Reserve System's ("Federal Reserve Board's") supervisory stress test.[1] The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB's members consist principally of international banks that operate branches, agencies, bank subsidiaries and broker-dealer subsidiaries in the United States.

We anticipate that our recommendations below may require collaboration between the industry and the Federal Reserve Board staff in order to create appropriately nuanced and sensitive models for the supervisory stress test. We are willing to meet to discuss these recommendations and others made by the industry in response to the Proposal, and to work with Federal Reserve Board staff on calibration of the models.

The following seven points summarize our recommendations to the Federal Reserve Board with respect to the Proposal:

- Incorporate transfer pricing arrangements in Pre-Provision Net Revenue ("PPNR") models to calculate non-interest revenues more accurately.
- Make the treatment of firms' exposures to borrowers that do not have FICO scores at origination less punitive and more representative of true risk, particularly with respect to

[1] Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, 90 Fed. Reg. 51,856 (proposed Nov. 18, 2025) (the "Proposal").

international borrowers, by allowing firms to update FICO scores when they become available and use other well-founded characteristics to approximate borrowers' risk in the interim.

- Eliminate offsetting valuation allowances for a firm's deferred tax assets ("DTAs") through the four-quarter look-ahead and instead allow DTAs from timing throughout the stress horizon by applying the capital rules' deduction and risk-weighting of such DTAs.

- Adjust the parameters and applicability of the global market shock ("GMS") and make the largest counterparty default ("LCD") more risk sensitive.

- Recalibrate the operational risk component of the stress test to (i) allocate such losses more realistically beyond the narrow nine-quarter stress horizon and (ii) adopt alternatives to modeling operational risk that do not solely rely on total asset size.

- Allow additional risk-mitigating hedges beyond accounting hedges to have a beneficial effect on PPNR.

- Make the intermediate holding companies ("IHCs") of Foreign Banking Organizations ("FBOs") not subject to the dividend add-on component of the stress capital buffer ("SCB").

We address each of these points in more detail below.

A. The Federal Reserve Board should incorporate transfer pricing arrangements in PPNR in order to more accurately calculate non-interest revenues.

The Federal Reserve Board has proposed replacing the current supervisory models for non-interest revenue and non-interest expense, which are based on firm-specific historical results, with modified models, which are not. The modified models would include a generalized, firm-agnostic model for non-interest revenue in which "aggregate bank projections from the FR Y-14A schedules are used to produce a path of noninterest income over the projection horizon" for all firms, and an efficiency ratio path model for non-interest expense that "is estimated via an industry model of firm projections from previous stress testing exercises" and then applied to an individual firm based on the firm's revenue mix, among other things.[2]

These generalized non-interest revenue models will be overly punitive to FBOs with material transfer pricing revenues because they do not sufficiently incorporate the impact of transfer pricing arrangements, which are significant and material when stress testing is applied at a sub-consolidated holding company level, such as at the IHC level. Moreover, given their aggregate nature, the proposed models would be heavily skewed by U.S. Global Systemically Important Banks ("GSIBs"), whose non-interest revenue is far more sensitive in stress than that of the IHCs. In large part, this is because IHCs typically have cost reimbursement and/or revenue-sharing arrangements (often called "Transfer Pricing" or "TP") with their foreign parent. In a TP arrangement, transactions booked outside the IHC, but

[2] Federal Reserve Board, *Supervisory Stress Test Model Documentation: Pre-Provision Net Revenue (PPNR) Model* 170-171 (Oct. 2025, updated Dec. 2025) (the "PPNR Model documentation"), https://www.federalreserve.gov/supervisionreg/files/pre-provision-net-revenue-models.pdf.

assisted by and participated in by the IHC, result in a transfer of revenue or reimbursement of cost to the IHC for such participation. Because of the contractual cost reimbursement feature of these arrangements, TP revenues are relatively stable in stress and would be grossly underestimated by the proposed net interest revenue models.

For IHCs of FBOs, TP arrangements can have a significant effect on revenue and expense line items; in contrast, while U.S. domestic firms may have TP arrangements, their effect is eliminated in consolidation because the stress test is applied at the top-tier holding company level. TP arrangements are negotiated at arms-length (as per international tax requirements), are legally enforceable and cannot be renegotiated without the agreement of both parties.

In the proposed industry-level models, TP revenue is modelled mainly as part of three non-interest revenue categories: (i) sales and trading, (ii) investment banking and private equity, and (iii) miscellaneous income. All three categories use discount factor models and thus subject TP revenue to the same shock sizes as other more volatile revenue components. This would result in applying a significantly more severe discount factor to TP revenue than would be supported by performance during actual stress periods. Based on analyses by our members, a review of 2025 Dodd-Frank Act Stress Test disclosures by U.S. GSIBs indicates that the range of average implied discount factors for non-interest revenue is 60-70%, whereas certain FBOs' average implied discount factors are only in the range of 85%—a much less severe reduction during stress. Therefore, using an industry aggregate or industry-wide projection would be disproportionately punitive for IHCs versus comparable U.S. domestic firms. Additionally, we recommend that the Federal Reserve Board disaggregate the "miscellaneous income" category into more granular and distinct categories that can better reflect revenue heterogeneity across the industry, and that can be used to reflect TP more accurately within that category so that appropriate discount paths can be developed for TP.

We believe that addressing this issue requires both short- and long-term solutions to create better and more equitable results that can capture the differences among firms, and particularly the differences between U.S. domestic organizations and the IHCs of FBOs.

In the short term, and on a temporary basis, the Federal Reserve Board could use the proposed aggregate projection models with certain modifications. First, in order to better tailor the models to differences across firms, and to preserve some of the firm-specific elements of the current regression models, the proposed model should not aggregate across the entire industry, but should have categories of projections for U.S. GSIBs, other U.S. non-GSIB regional banks and FBOs. Second, a single discount factor model for the miscellaneous income category does not sufficiently address the components of that category. We recommend that the miscellaneous category projection remain constant over the stress horizon until models and data collection for more granular analysis of that category are developed. This would be similar to how the supervisory stress test evaluates non-interest income: it is modeled as an eight-quarter median.[3] We also agree with the modifications suggested by other commenters such as the Bank Policy Institute for changes in the short term to the proposed models.

In the longer term, the Federal Reserve Board should re-develop the models for analyzing non-interest revenue and expenses to address firm-specific attributes and better

[3] *Id.* at 34, 161-162.

capture differences across business mix, business size, footprint and risk profiles of business lines. In particular, we suggest that specific effort be made to collect data and to create a model for IHCs and their TP revenue and expenses. This could be done through (as non-exclusive examples) (i) forecasting TP revenue through a model that is separate from other non-interest revenue and applying a TP-specific discount factor or (ii) relying on firm-specific overlays to account for TP revenues, with any such overlays being made public. To do so, we encourage the Federal Reserve Board to amend the FR Y-14 to begin collecting TP revenue separate from other non-interest revenue and to collect more firm-specific information. These new FR Y-14 line items should be optional for reporting firms, to reduce burden on smaller organizations, or there could be a threshold for providing additional break-out of more granular information or additional fields of information.

B. The Federal Reserve Board's approach to exposures to borrowers that do not have FICO scores is overly punitive and not representative of true risk, particularly with respect to international borrowers.

Currently, the Federal Reserve Board adopts a conservative approach to missing data in a stress test: "given a lack of information about the true risk of a portfolio, the Federal Reserve will compensate for the lack of data by using a high percentile loss rate."[4] With respect to loans to borrowers without FICO ratings at the time of origination, the Federal Reserve Board imputes such missing values as the industry average lowest decile score, thereby assuming the borrowers are the worst credit risk and resulting in disproportionate loss under the stress test model as compared to the true risk of the loan book.[5] This is particularly burdensome for firms with a higher proportion of international borrowers (that are more likely not to have FICO scores at origination), including some FBOs, and the stress test on the loan books of such firms results in significant losses from the Expected Credit Losses ("ECL") variable.

The current approach assumes missing data indicate a "lack of information *sufficient* to produce a risk-sensitive estimate of losses or revenue components using information on the true characteristics of certain positions."[6] However, in the context of loans to international borrowers, there is not a "lack of information *sufficient* to produce a risk-sensitive estimate of losses;" rather, firms just do not have the *precise* information—namely FICO scores—the Federal Reserve Board requests in the stress test. Alternative data may sufficiently produce the requisite estimate of losses. Therefore, the stress test should allow participants to submit such alternative data for international borrowers to better reflect the true risk of the loan book.

To mitigate the excessively punitive effect of missing FICO scores of international borrowers at origination on firms' ECL results in the stress test:

- A firm should be able to provide an updated FICO score as soon as available, even if not available at origination, and the Federal Reserve Board should be able to approximate

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4 12 C.F.R. pt. 252, app. B, § 1.6.

5 *See* Federal Reserve Board, *Credit Risk Models* 44 (Jan. 2026), https://www.federalreserve.gov/supervisionreg/files/credit-risk-models.pdf ("For loans with missing model inputs, each missing input is generally set to the 90th percentile value calculated across all loans of the equivalent type.").

6 12 C.F.R. pt. 252, app. B, § 2.9(b) (emphasis added).

the origination score with the first-reported "current credit score" (FR Y-14M field 48). The ability to leverage updated data is a simple way to ensure the Federal Reserve Board has the most timely, accurate and risk-sensitive data.

- In the interim, until a FICO score is available:
    - The firm should include a special code in one or more of the three origination credit bureau score FR Y-14M fields (e.g., fields 13, 134, and 135 in the first-lien schedule) to indicate this fact pattern and enable the Federal Reserve Board to impute a score for international borrowers that is not the most punitive decile.
    - This imputed origination FICO score could be approximated by:
        - Assuming the dispersion of FICO scores across international borrowers is generally consistent with U.S. borrowers and, for example, by using an average or a median; or
        - Taking into consideration the characteristics of the particular borrower and loan, such as loan-to-value ratios, the origination spread or whether the interest rate is fixed or variable.

C. The Federal Reserve Board should apply the capital rules' deduction and risk-weighting to DTAs from timing.

In its "Aggregation Models" documentation, in Question C4, the Federal Reserve Board asks, "Should the Board consider modifying the valuation allowance four-quarter look-[ahead] assumption? If the Board were to change the valuation allowance look-ahead assumption, how should the Board address information collection burdens, avoid the creation of a more complex methodology, and potential inaccuracies? What would be the advantages and disadvantages of that change?" [7]

In our view, the four-quarter look-ahead used to determine whether DTAs from timing are realizable in the valuation allowance calculation is highly punitive, particularly for banks with considerable starting DTAs. The valuation allowance is used to reduce DTAs from timing that may otherwise be usable against future taxes. The Federal Reserve Board's four-quarter look-ahead serves to severely reduce, early in the nine-quarter stress horizon, the DTAs that may be used to otherwise reduce expenses in later quarters. The Federal Reserve Board appears to desire elimination of the DTAs from timing as early as possible, by positing a close to "gone concern" model and pre-determining "deferred tax assets to be unusable in a stress scenario when a firm is not profitable and does not generate a positive tax bill that a deferred tax asset could be used to offset."[8] Using the four-quarter look-ahead virtually ensures a large valuation allowance to offset any stress test start-date DTAs from timing by estimating "the gap between a firm's stock of DTAs from Timing and the next four quarters of future taxes owed."[9]

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7 Federal Reserve Board, *Supervisory Stress Test Model Documentation: Aggregation Models* 43 (Oct. 2025), https://www.federalreserve.gov/supervisionreg/files/aggregation-models.pdf ("Aggregation Models").

8 *Id.* at 35.

9 *Id.*

This look-ahead methodology severely impairs expense reduction over the stress period, and disproportionately impacts firms with large DTAs from timing at inception of the stress test. In addition, early reduction or elimination of DTAs from timing in the stress test is contrary to the philosophy of the stress test itself, which is to encourage capital preservation before stress so that a firm may be viable and support the economy during stress. Viable companies are able to maintain DTAs and use them over time, and the stress test is fundamentally an exercise in proving viability and going-concern strength. Thus, the close to "gone concern" bias (the concept that there would be no positive tax bill that a deferred tax asset could be used to offset) is inconsistent with the idea of maintaining a going concern that will both support the economy during stress and emerge from stress in a profitable way.

Furthermore, the Federal Reserve Board's approach is a bright-line four-quarter look-ahead that lacks the sensitivity to judgment that would be made under Generally Accepted Accounting Principles ("GAAP") as applied to a going-concern. The Federal Reserve Board's scenarios create a path to recovery in the latter quarters of the stress scenario, and therefore choosing to look only to the initial four quarters is not appropriate. Presenting a predominantly "gone concern" approach adversely impacts the results of the stress tests in manner disconnected from analyses and judgments that would occur during stress. FASB Statement No. 109 (now codified in ASC 740) establishes that a "valuation allowance is recognized if, based on the weight of available evidence, it is *more likely than not* that some portion or all of the deferred tax asset will not be realized."[10] Valuation allowance analyses are therefore based on more nuanced judgment[11] that includes both "the weight of available evidence" as well as historical information such as a "strong earnings history exclusive of the loss that created the future deductible amount."[12] In that context, a "going concern" forecast of the expected recovery is a "more likely than not" scenario. Moreover, DTAs from timing can be different depending upon the underlying timing issue, and certain types of DTAs generally have longer expected usage timelines than others.

For these reasons, we view the look-ahead as negatively affecting the needed clarity of the stress tests, and believe a more widely used and clear approach would benefit the stress tests and create consistency with actual decision-making during stress. We recommend that the Federal Reserve Board eliminate the four-quarter look-ahead and eliminate the concept, in the stress test, of the valuation allowance that reduces existing (and generated)[13] DTAs from

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10 Financial Accounting Standards Board ("FASB"), Summary of Statement No. 109: Accounting for Income Taxes (effective date: Dec. 15, 1992), https://www.fasb.org/page/PageContent?pageId=/reference-library/superseded-standards/summary-of-statement-no-109.html&bcpath=tff (emphasis in original). *See also* FASB, *Accounting Standards Codification (ASC) Topic 740* ("ASC 740"), Section 740-10-30-5(e) ("Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.").

11 ASC 740, Sections 740-10-30-23 and 740-10-30-24 ("An entity shall use judgment in considering the relative impact of negative and positive evidence . . .[,] application of judgment based on a careful assessment of all available evidence is required to determine the portion of a deferred tax asset for which it is more likely than not a tax benefit will not be realized.").

12 ASC 740, Section 740-10-30-22(c).

13 Aggregation Models at 32 ("The Retained Earnings Model generates a deferred tax asset under stress when a firm records a gain or loss for financial reporting purposes earlier or later than when it records

timing. In its stead, the Federal Reserve Board should apply the requirements of the capital rule during the stress test:

- Deduct from CET1 those DTAs from timing, without any related valuation allowance to lower the DTA, that individually exceeds 25% of the firm's CET1;[14]
- DTAs from timing that are not deducted based on the 25% threshold receive a 250% risk weight;[15] and
- Allow utilization of the DTAs from timing over the stress horizon, if there would be positive taxes owed in a quarter.

In our view, this recommendation would apply uniformly across firms by treating all firms equally, regardless of initial pre-stress DTA composition. Additionally, it reduces complexity and administrative burden by applying a process already used in capital planning, and it increases transparency of how the DTAs will be affected, without compounding unknown projections. It would retain focus on the 9-quarter stress horizon, during which firms experience significant losses, as it would still require that firms deduct DTAs above 25% of CET1. This would also be consistent with how firms would apply the DTAs in the ordinary course of their own capital planning. This recommendation would also not require any additional data collection or modeling.

D. The Federal Reserve Board should address the degree and breadth of applicability of the GMS and LCD and make targeted changes to several of the stress testing market risk components to increase risk sensitivity.

1. *The Federal Reserve Board should revise the thresholds at which the GMS component of the supervisory stress test applies to firms.*[16]

In general, the applicability of the GMS is not appropriately calibrated to apply only to firms for which an add-on capital requirement for trading activity is justified due to the potential impact on financial stability resulting from the size and scale of a firm's trading activity. Among the firms currently subject to the GMS, there are meaningful differences in size and risk profile, calling into question whether inclusion of those firms with significantly lower size and risk profile is appropriate given the disproportionate cost placed on those firms. This is exacerbated by the fact that the thresholds at which the GMS applies have not been updated since 2017 to take into account economic growth and inflation. In addition, as further discussed below in Section D.2, the trading risks captured by the GMS are already captured in

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these same gains or losses for tax purposes. . . . Growth of these assets in turn increases a firm's tax benefits under stress").

14 *See* 12 C.F.R. § 217.22(d)(1)(i).

15 *Id.* at n.29.

16 The Proposal asks in Question 48 about the scoping of the GMS ("Question 48: The global market shock component currently applies to firms subject to Category I, II, and III standards that have aggregate trading assets and liabilities of $50 billion or more, or trading assets and liabilities equal to or greater than 10 percent of total consolidated assets. What are the advantages and disadvantages of applying the global market shock component to this group of firms? Should this component apply to a different set or subset of firms? If so, how should the Board determine which set or subset of firms should be subject to the global market shock component?"). Proposal at 51,927.

large part by the market risk capital rules, which inherently estimate potential trading portfolio losses under severe market conditions through the Stressed Value-at-Risk component, as well as other aspects of the stress test, including projections of risk weighted assets and trading revenue components, thereby applying duplicative stress that is not justified for firms without systemically important trading activities.

The GMS currently applies to six Category I U.S. GSIBs and two Category III IHCs. The IHCs are materially smaller than any U.S. GSIB, both in terms of total assets and with respect to their total trading assets and liabilities ("TAL").[17] In addition, there are important differences in the riskiness and systemic importance of the trading asset portfolios of such firms as compared to the U.S. GSIBs.[18] As currently constructed, the GMS places an outsized burden on the IHCs. Firms face a fixed cost in complying with the GMS. Given the relative size of the IHCs subject to the GMS as compared to the U.S. GSIBs, such cost disproportionately affects IHCs' risk management resources compared to those of U.S. GSIBs.

First, the TAL threshold should be increased. The current fixed-dollar TAL threshold at which the GMS applies was introduced in 2017 and has remained at $50 billion in aggregate TAL over the subsequent nine years.[19] In its proposal to set the TAL threshold at its current level of $50 billion, the Federal Reserve Board observed that "[a]s of December 31, 2016, the only firm that would be subject to the global market shock based solely on the proposed $50 billion asset [sic] threshold is a BHC [bank holding company] that currently is

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17 In Q3 2025, the average total assets of the two IHCs subject to the GMS was $172.4 billion, while the average total assets of the U.S. GSIBs subject to the GMS was $2.64 trillion. The average TAL of such IHCs was $48.4 billion, while the average TAL of such U.S. GSIBs was $701.5 billion. Averages based on data from Form FR Y-9C as of Q3 2025 available at Federal Financial Institutions Examinations Council, National Information Center, https://www.ffiec.gov/npw/ ("FFIEC Financial Data"). These are not just mere differences but depict a separation of orders of magnitude.

18 For example, the average projected trading and counterparty losses through Q1 2027 under the severely adverse scenario in the most recent stress test for the two IHCs was $1.35 billion, while for the U.S. GSIBs, such average projected losses was $4.96 billion (and $6.15 billion excluding the two custody banks). *See* Federal Reserve Board, *2025 Federal Reserve Stress Test Results* 19 tbl.8 (June 2025), https://www.federalreserve.gov/publications/files/2025-dfast-results-20250627.pdf ("2025 Stress Test Results"). When looking at an average of the prior five years of stress tests, the results are even more disparate, with average projected trading and counterparty losses under the severely adverse scenario for the two IHCs averaging $1.43 billion, while the average projected losses for the U.S. GSIBs was $10.62 billion (and $13.74 billion excluding the two custody banks). Averages based on data from Federal Reserve Board, *2024 Federal Reserve Stress Test Results* 18 tbl.8 (June 2024), https://www.federalreserve.gov/publications/files/2024-dfast-results-20240626.pdf ("2024 Stress Test Results"); Federal Reserve Board, *2023 Federal Reserve Stress Test Results* 16 tbl.7 (June 2023), https://www.federalreserve.gov/publications/files/2023-dfast-results-20230628.pdf ("2023 Stress Test Results"); Federal Reserve Board, *2022 Federal Reserve Stress Test Results* 18 tbl.6 (June 2022), https://www.federalreserve.gov/publications/files/2022-dfast-results-20220623.pdf ("2022 Stress Test Results"); Federal Reserve Board, *Dodd-Frank Act Stress Test 2021: Supervisory Stress Test Results* 31 tbl.6 (June 2021), https://www.federalreserve.gov/publications/files/2021-dfast-results-20210624.pdf; Federal Reserve Board, *Dodd-Frank Act Stress Test 2020: Supervisory Stress Test* Results 29 tbl.5 (June 2020), https://www.federalreserve.gov/publications/files/2020-dfast-results-20200625.pdf.

19 12 C.F.R. § 252.54(b)(2)(i)(A); *see* Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 82 Fed. Reg. 59,608, 59,611 (Dec.15, 2017) ("TAL Threshold Establishment").

subject to the global market shock under the current $500 billion total assets threshold."[20] Both of the IHCs subject to the GMS have total assets less than half of the $500 billion originally contemplated.[21] Furthermore, in setting this threshold, the Federal Reserve Board sought to quantify what constituted a "firm[] with significant trading activity."[22] However, the Federal Reserve Board did not sufficiently justify either why $50 billion in TAL was the appropriate threshold for such "significant trading activity" initially or why that value should remain constant over time.[23] In fact, in the 2009 stress test, the Federal Reserve Board applied the GMS to firms with over $100 billion of trading assets only.[24]

To better capture firms with truly systemic trading portfolios, the Federal Reserve Board should revert to the initial $100 billion threshold, increase such threshold to account for inflation and economic growth between when it was originally used in 2009 and today, add to it to include trading liabilities, and then automatically index the threshold for inflation and economic growth on a yearly basis going forward. If the threshold is not indexed to inflation and economic growth automatically, the Federal Reserve Board should commit to revisiting and adjusting the threshold as needed so that it does not again become inappropriately low over time due to inflation and economic growth.

Second, the threshold based on the ratio of a firm's TAL to total consolidated assets should be removed.[25] The 10 percent ratio threshold is also not appropriate because it would apply the GMS to firms with immaterial trading activity if such firms had a sufficiently small total asset base. For example, a Category III firm may have as low as $100 billion in total assets, which would then require the GMS at $10 billion of TAL. An amount of $10 billion in aggregate TAL is a small fraction of the average TAL for U.S. GSIBs subject to the GMS, which is over $700 billion,[26] highlighting the significant differences in levels of trading activity among firms that would be subject to the GMS and disproportionate compliance burdens imposed on smaller firms. Therefore, the TAL-to-total assets ratio captures firms that do not exhibit the types of risk that warrant application of the highest level of severity of the stress tests (supervisory severely adverse scenarios, plus GMS). Firms whose TAL do not exceed the revised fixed-dollar aggregate threshold should not be subject to the GMS.

Finally, U.S. Treasury securities should be excluded from the calculation of TAL for these purposes. Such securities do not pose the same risk as other trading assets,

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20 Proposed Agency Information Collection Activities, 82 Fed. Reg. 26,793, 26,796 (comment requested June 9, 2017).

21 The total assets data are from Form FR Y-9C as of Q3 2025 available at FFIEC Financial Data. The firms subject to the GMS are available at Federal Reserve Board, *2026 Stress Test Scenarios* 6 tbl.1 (Feb. 2026), https://www.federalreserve.gov/publications/files/2026-final-supervisory-stress-test-scenarios-20260204.pdf ("2026 Stress Test Scenarios").

22 TAL Threshold Establishment at 59,610-59,611.

23 *Id.*

24 Even if the fixed-dollar TAL threshold is raised to $200 billion, firms subject to the GMS would still account for 90% of all TAL in U.S. bank holding companies ("BHCs").

25 12 C.F.R. § 252.54(b)(2)(i)(A).

26 The averages are based on data from Form FR Y-9C as of Q3 2025 available at FFIEC Financial Data. The firms subject to the GMS are available at 2026 Stress Test Scenarios at 6 tbl.1.

which has been recognized by the Federal Reserve Board on numerous occasions.[27] The ownership of U.S. Treasuries, whether or not in trading accounts, does not indicate greater complexity, greater organizational instability or greater need for testing an organization against a market shock. Therefore, including such securities in the context of the trigger for a market risk shock is inappropriate. In addition, the Federal Reserve Board and other regulators have been focused on enhancing Treasury market liquidity, which would be served better by not penalizing firms with more stringent stress testing requirements for actively engaging in the U.S. Treasury market.[28]

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[27] For example, in the capital rules, U.S. Treasury securities and those obligations issued by U.S. government agencies are assigned a zero percent risk weight. 12 C.F.R. § 217.32(a)(1)(i). In addition, credit transactions between banks and their affiliates, if secured by U.S. Treasury securities, are exempt from the quantitative lending limits under Regulation W. 12 C.F.R. § 223.42(c). Lending limits also provide exemptions for exposures collateralized by U.S. Treasuries. *See*, *e.g.*, 12 C.F.R. § 32.3(c)(3) (exemption from national bank lending limits); 12 C.F.R. § 252.71(q) (U.S. government is "exempt counterparty" and therefore exposure shift to U.S. Treasury collateral under 12 C.F.R. § 252.74(b) exempts transaction). From a trading risk perspective (and therefore better correlated with calculations based on TAL), the general prohibition on proprietary trading under the Volcker Rule does not apply to the purchase or sale of U.S. Treasury securities. 12 C.F.R. § 248.6(a)(1). Also in relation to market risk of U.S. Treasuries, these securities are treated as Level 1 high-quality liquid assets ("HQLA") under rules related to the liquidity coverage ratio. 12 C.F.R. § 249.20(a)(3). Level 1 HQLA are not subject to haircut under the liquidity rules, and haircut levels are assigned relative to market price volatility of HQLA, indicating that the bank regulatory agencies have determined that U.S. Treasuries have little to no market volatility in periods of stress. In addition, the final rule implementing recent changes to the enhanced supplementary leverage ratio explicitly states that U.S. treasury market intermediation is a "lower-risk" activity. *See* Regulatory Capital Rule: Modifications to the Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Their Subsidiary Depository Institutions; Total Loss-Absorbing Capacity and Long-Term Debt Requirements for U.S. Global Systemically Important Bank Holding Companies, 90 Fed. Reg. 55,248, 55,251 (Dec. 1, 2025) ("eSLR Final Rule").

[28] Most recently, the federal banking agencies finalized the eSLR Final Rule with the express goal of reducing disincentives to engage in low-risk activities or important market functions, including intermediation in the U.S. Treasury market. *See* eSLR Final Rule at 55,250 ("The proposal discussed, as an example, concerns that a regularly binding leverage capital requirement could disincentivize large banking organizations from intermediating in the U.S. Treasury market. Market participants have suggested that such disincentives could, under certain circumstances, impede the orderly functioning of the U.S. Treasury market and of U.S. and global financial markets more broadly. As discussed further below, some commenters on the proposal echoed this concern. The U.S. Treasury market is one of the deepest and most liquid markets in the world and serves as a source of safe and liquid assets that are used for a variety of purposes in the financial markets. Confidence in the efficient functioning of the U.S. Treasury market, including during times of stress, is critical to the stability of the domestic and global banking and financial systems.") (internal citations omitted).

Since 2021, the Inter-Agency Working Group ("IAWG"), composed of staff from the U.S. Treasury, Federal Reserve Board, Federal Reserve Bank of New York, Securities and Exchange Commission and Commodity Futures Trading Commission, has been spearheading initiatives to enhance Treasury market resilience. Treasury Borrowing Advisory Committee, *Inter-Agency Working Group's efforts on Treasury Market Resilience* 2, 6 (Oct. 29, 2024), https://home.treasury.gov/system/files/221/TBACCharge1Q42024.pdf. Notable efforts include requiring the central clearing of certain repurchase and cash transactions in Treasury securities, increasing public disclosure on Treasury securities transactions and on hedge funds, collecting new data on the bilateral uncleared repo market, launching a Treasury buyback program and establishing a standing facility to finance Treasury repo with pre-authorized dealers and banks. *Id.* at 8; Nellie Liang, Brookings, *What's going on in the US Treasury market, and why does it matter?* (Apr. 14, 2025), https://www.brookings.edu/articles/whats-going-on-in-the-us-treasury-market-and-why-does-it-matter/.

In summary, the Federal Reserve Board should:

- Raise the fixed-dollar TAL threshold;
- Eliminate the ratio of TAL to total assets threshold; and
- Exclude U.S. Treasury securities from the calculation of TAL.

2. The Federal Reserve Board should publish for comment the thresholds at which the LCD component of the supervisory stress test applies to firms.

The specific criteria, including thresholds, the Federal Reserve Board applies when selecting the firms subject to the LCD are unknown.[29] While 12 C.F.R. § 252.54(b)(2)(i) mentions the possibility of a "counterparty component" in addition to a trading shock when setting out the TAL thresholds for triggering the GMS, (i) the Federal Reserve Board itself indicates that the LCD component arises from the more discretionary Regulation YY provision wherein the Federal Reserve Board "may require a company to include one or more additional components in its severely adverse scenario in the annual stress test based on the company's financial condition, size, complexity, risk profile, scope of operations or activities, or based on risks to the U.S. financial system",[30] and (ii) the cohort of LCD component participants includes two global custody banks (but not other banks known to be large global custody banks). Therefore, in the continued interest of objectivity and transparency, the Federal Reserve Board should publish the pre-defined, objective criteria and supporting rationale it uses to determine which firms are subject to the LCD.

In addition, the Volcker exemption discussed in Footnote 27 above, also supports this rationale, as a significant reason for the exemption was to not hinder Treasury market liquidity.

[29] We are not aware of any published criteria for triggering the LCD, and the LCD applies to "firms with substantial trading or custodial operations, as identified by the [Federal Reserve] Board." Federal Reserve Board, *Supervisory Stress Test Model Documentation: Market Risk Models* 268 (Jan. 2026), https://www.federalreserve.gov/supervisionreg/files/market-risk-models.pdf (the "2026 Market Risk Models Documentation"). Currently, we understand that the Federal Reserve Board notifies firms via a confidential letter that it has determined the LCD is appropriate for the firm based on its size, complexity, risk profile, scope of operations, activities, and risks presented to the U.S. economy. Those letters include no further details. No firm knows precisely why it is being required to hold an additional "add-on" to capital under the LCD.

[30] *See* 2026 Market Risk Models Documentation at 268 n.288.

3. *The Federal Reserve Board should remove double-counting based on both GMS losses and regular stressed market risk losses under the market risk capital rules and stress test.*[31]

The GMS component of the stress test, as currently calibrated, has reduced banks' holdings of debt securities and ability to act as market-makers, and should be revisited in connection with this Proposal and the forthcoming revisions to the market risk capital rules.[32]

All GMS participants also apply the market risk capital rules. Under the standardized measure for market risk, a firm must sum its Value at Risk ("VaR")-based capital requirement for trading positions[33] and its stressed VaR-based capital requirement,[34] in addition to other addons.[35] First, the VaR-based measure already includes any stress or volatility that have occurred over at least the last year, and perhaps longer.[36] In addition, for VaR, the "institution must update data sets at least monthly or more frequently as changes in market conditions or portfolio composition warrant."[37] Second, the stressed VaR-based measure also already includes "model inputs calibrated to historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the Board-regulated institution's

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31 The Proposal asks in Question 46 and 47 whether the GMS and LCD components should continue to apply to the severely adverse scenario. ("Question 46: The global market shock component and the largest counterparty default component of the severely adverse scenario are both based on the global market shock. Should the Board consider removing one or both of these components from the severely adverse scenario? If so, what alternative approaches should the Board consider to account for trading and counterparty losses in the supervisory stress test? For example, should trading and counterparty losses be considered as part of the macroeconomic scenario as opposed to the global market shock? What would be the advantages and disadvantages of retaining these components or replacing them with alternative approaches?

Question 47: Should the Board continue to include a global market shock component in the severely adverse scenario? What would be the advantages and disadvantages of including a market shock component in the severely adverse scenario? If the Board determines to remove the market shock component, are there additional changes that the Board should implement that would mitigate any disadvantages from this change?") Proposal at 51,927.

32 *See* Dr. Guowei Zhang, SIFMA, *Assessing the Empirical Validity of the Federal Reserve's 2026 Global Market Shock Scenarios* (Nov. 18, 2025), https://www.sifma.org/news/blog/assessing-the-empirical-validity-of-the-federal-reserves-2026-global-market-shock-scenarios; Tara Payne, Bank Policy Institute, *Proposed 2026 Stress Test Scenarios Improve Transparency, But Leave Key Questions on Fed Discretion* (Dec. 1, 2025), https://bpi.com/proposed-2026-stress-test-scenarios-improve-transparency-but-leave-key-questions-on-fed-discretion/; Greg Hopper, Bank Policy Institute, *How to Make the Global Market Shock Coherent* (May 5, 2025), https://bpi.com/how-to-make-the-global-market-shock-coherent/; Dr. Guowei Zhang and Dr. Peter Ryan, SIFMA, *US Stress Test Capital Requirements Are Excessively Volatile and Overestimate Losses* (Oct. 6, 2022), https://www.sifma.org/news/blog/u-s-stress-test-capital-requirements-are-excessively-volatile-and-over-estimate-losses-identifying-the-problem-and-how-to-solve-it; Adam Freedman and Francisco Covas, Bank Policy Institute, *The Global Market Shock and Bond Market Liquidity* (May 23, 2019), https://bpi.com/the-global-market-shock-and-bond-market-liquidity/.

33 *See* 12 C.F.R. § 217.205.

34 *See* 12 C.F.R. § 217.206.

35 *See* 12 C.F.R. § 217.204(a).

36 *See* 12 C.F.R. § 217.205(b)(2).

37 *Id.*

current portfolio."[38] The firm must have a "process for selecting, reviewing, and updating the period of significant financial stress used to calculate the stressed VaR-based measure and for monitoring the appropriateness of the period." While we understand that there is some variability in the market shock applied by the Federal Reserve Board under the GMS, in our experience the scenarios generally overlap significantly with other stressed measures (i.e., the scenarios that firms select for a 12-month stressed VaR period of significant financial stress). For example, in the experience of our members, firms generally choose a range of months within the 2007-09 crisis for stressed VaR, while the severely adverse scenario for the Federal Reserve Board's stress test often includes parameters that produce 2007-09 crisis-like results.

Furthermore, there is additional overlap in the stress test itself. Those participants subject to the GMS are to recognize the GMS in the first quarter of the stress test and carry the shocked losses through the remainder of the stress test horizon. The GMS is characterized, at least in 2026, as falling equity prices, expectations for increasing inflation, widening credit spreads and dollar appreciation, brought on by "a set of hypothetical shocks to a large set of risk factors reflecting general market distress and heightened uncertainty."[39] Yet, the macroeconomic severely adverse scenario in 2026 is also characterized by unemployment increase, a decline in demand, increased credit spreads, falling equity and real estate prices, and dollar appreciation.[40] By carrying the lower shocked value through the stressed period, it compounds the losses on the trading assets, based on the same macroeconomic effects applied twice. Furthermore, the LCD component of the supervisory stress test utilizes the stressed market prices under the GMS (and not just the severely adverse scenarios) for collateral and transaction pricing which may, directionally, yield greater in-the-money and uncollateralized values at the time of the counterparty default, thus compounding the overlap.

Even if there are some differences (i.e., we understand that a shock and a 9-quarter recession horizon may paint different pictures), in our members' experience and based on our members' review of data, the overlap is significant (worsening the troughs of Common Equity Tier 1 ("CET1") losses in an unrealistic way) and therefore requires considered and significant recalibration. The compounded effect of the following overlapping metrics/scenarios should be rethought and corrected:

- VaR-based measurement requirement to iterate models for market conditions, including stress and volatility;
- Stressed VaR-based measurement requirements for choosing a period of significant financial stress;
- The GMS hypothetical shock that includes many of the same factors as both the period chosen by firms for a period of VaR significant financial stress *and* the 9-quarter severely adverse scenario;
- The severely adverse scenario which continues the overlapping of stress on already stressed elements; and

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38 12 C.F.R. § 217.206(b)(1).

39 *See* 2026 Stress Test Scenarios at 19-21.

40 *Id.* at 7-9.

- The LCD which first increases losses through applying the stress scenario and the GMS to asset, liability and collateral amounts, and then assumes that a large counterparty defaults when those stressed values are in play.

We note that this issue will be exacerbated if the Fundamental Review of the Trading Book ("FRTB") is finalized by the federal banking agencies. The FRTB is designed to include additional market stress elements as compared to the current market risk requirement, effectively rendering the GMS, which we understand was in part introduced to address what were viewed as weaknesses in the market risk framework, redundant. Therefore, the Federal Reserve Board should not both introduce the FRTB and maintain the GMS, particularly not as currently calibrated.

4. The LCD should take into account probability of default.

The LCD assumes a 100% probability of default of the stress test participant's largest counterparty. However, through risk management and monitoring, as well as customer and transactional onboarding and approval advances over the last two decades, the likelihood that a participant's largest counterparty is also the counterparty that is most likely to fail is completely unrealistic. It is, in fact, the inverse of expected risk management practices. Firms provide additional credit lines and permit increased exposure to those counterparties that they believe run a much lower risk of default. Therefore, the Federal Reserve Board should modify its approach to more accurately reflect the true risk posed by a firm's largest counterparties. As examples of possible alternatives, the European Banking Authority and the Bank of England have developed methods of scoping large counterparties that are more risk-sensitive and realistic.[41] The LCD framework should be more sophisticated, nuanced and risk-sensitive, leveraging criteria regarding size, concentration of exposures and probabilities of default rather than a simplistic choice of the largest counterparty.

In addition, whether or not the Federal Reserve Board adopts the approach to LCD scoping suggested above, the set of excluded counterparties from the LCD should be expanded. The Federal Reserve Board has moved in this direction under the Proposal. Currently, certain sovereign entities, multilateral development banks, supranational entities and qualifying central counterparties are excluded from consideration in identifying a firm's largest counterparty.[42] The Proposal proposes to additionally exclude sovereign entities with a credit

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[41] Under the E.U. approach, firms must identify their 10 largest counterparties and of those counterparties, firms must identify the 3 most vulnerable ones based on the highest external probability of default. *See generally* European Banking Authority, *2025 EU-Wide Stress Test, Methodological Note* (Jan. 20, 2025), https://www.eba.europa.eu/sites/default/files/2025-01/0246e2f3-fa57-47d1-99f2-7a5b80cae509/2025%20EU-wide%20stress%20test%20-%20Methodological%20Note.pdf. Under the U.K. approach, firms are required to identify counterparties that are particularly vulnerable to the stress scenario and model their defaults accordingly. They are expected to exercise judgment in identifying vulnerable counterparties under the stress scenario. The number of counterparties to be defaulted is determined based on the firm's top exposures with minimum numbers specified for different categories. If the stress scenario indicates that more counterparties would be at risk of default, firms are expected to default additional counterparties beyond the minimum requirement. *See generally* Bank of England, *Stress testing the UK banking system: Guidance on the 2025 stress test for participants* (Mar. 24, 2025), https://www.bankofengland.co.uk/stress-testing/2025/guidance-for-participants.

[42] A complete list of excluded counterparties is available in the 2026 Stress Test Scenarios: "In identifying its largest counterparty, a firm subject to the counterparty default component will not consider the United States and sovereign entities with a rating equivalent to 'AA-' or higher based on the firm's internal credit rating system, certain multilateral development banks and supranational entities

rating equivalent to AA- and above based on firms' internal ratings.[43] In addition to the current exclusions and the proposed expanded exclusion for sovereign entities, the Federal Reserve Board should exclude other counterparties that have low risks of default from consideration as a defaulting counterparty. We propose the following additional exclusions:

- Pension plans; and
- Counterparties with 0% risk weight under the capital rules.[44]

These entities pose sufficiently small probabilities of default that their inclusion in the LCD scoping is unnecessary, even if they are a large counterparty, and distorts the true risk of a large counterparty default.

We would also welcome the opportunity to collaborate with the Federal Reserve Board to determine additional counterparties appropriate to exclude from the LCD. For example, counterparties with firm-modeled probabilities of default that are sufficiently low or below a materiality threshold, even if their exposures are large, may merit exclusion.

5. *The Federal Reserve Board should not extend the GMS window.*[45]

Under the Proposal, the Federal Reserve Board would revise "the date range for the GMS as-of date to occur between (inclusive of) October 1 of the calendar year two years prior to the year in which the stress test is performed to (exclusive of) October 1 of the calendar year one year prior to the year in which the stress test is performed."[46] This extends the current

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(International Bank for Reconstruction and Development, International Monetary Fund, Bank for International Settlements, European Commission, and European Central Bank), or qualifying central counterparties ("QCCPs"). See the definition of a QCCP at 12 CFR 217.2. Please note that although the International Bank for Reconstruction and Development is excluded, the other subsidiaries of World Bank Group (including the International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, and International Centre for Settlement of Investment Disputes) must be considered when selecting the firm's largest counterparty. U.S. IHCs are not required to include any affiliate as a counterparty. An affiliate of a company includes a parent of the company, as well as any other firm that is consolidated with the company under applicable accounting standards, including U.S. generally accepted accounting principles or International Financial Reporting Standards. See 12 CFR 252.171(b) & (f)." 2026 Stress Test Scenarios at 22 n.30.

43 *See* 2026 Market Risk Models Documentation at 269 (description of the Largest Counterparty Default Model, including sovereigns with a credit rating equivalent to AA- and above based on firms' internal ratings.).

44 *See* 12 C.F.R. § 217.32.

45 The Proposal asks about the advantages and disadvantages of modifying the window for the GMS as-of date in Question 27 ("Question 27: What are the advantages and disadvantages of modifying the window for the GMS as-of date in the stress test from October 1 of the calendar year one year prior to the year in which the stress test is performed through March 1 of the year in which the stress test is performed, to a date that is no earlier than October 1 of calendar year two years prior to the year in which the stress test is performed and that precedes October 1 of the calendar year one year prior to the year in which the stress test is performed? What alternative GMS as-of date ranges, if any, should the Board consider, and why? In addition to changing the GMS as-of date window, what other changes, if any, should the Board consider making to the stress test timeline? What effects, if any, would changing the window for the GMS as-of date have on any other aspects of the stress test or the stress test timeline?"). Proposal at 51,873.

46 *Id.*

range (from October 1 of the previous year to March 1 of the year of the stress test cycle) of 5 months to 12 months and means that the selected date may be almost two years prior to the given stress test. This range is both too long and too far in the past, resulting in stale data and greater operational challenges for firms. With a date that is materially before the start of the stress testing exercise, internal models may change and portfolios may not represent those that will actually be carried into the 9-quarter stress horizon. We recognize the utility of a window that is further before the stress test is performed; in the current window, the Federal Reserve Board essentially always chooses a date in October.[47] However, instead of the proposed solution, the Federal Reserve Board should shift the GMS window to be from May to October of the previous year, which would allow for greater flexibility for the selected date than the current window without the same operational challenges of the proposed window extension. Once the GMS as-of date is chosen, we encourage the Federal Reserve Board to disclose it publicly rather than just privately to firms subject to the GMS. Some firms voluntarily run the GMS scenario and would benefit from earlier knowledge of the as-of date.

E. The Federal Reserve Board should recalibrate the operational risk component of the stress test to (1) lessen the unrealistic amounts of operational risk losses across the narrow nine-quarter stress horizon and (2) create a more nuanced approach than reliance on total asset size.

1. The Federal Reserve Board should not force excessive operational risk losses into the narrow nine-quarter horizon.

The operational risk models in the stress tests are not appropriately calibrated. In particular, too much operational risk loss is allocated to the nine-quarter stress horizon. Operational risks play out with some short material impacts, but also longer and larger impacts that extend over years, such as legal issues. We note the following points, indicating a need for recalibration:

- In its "Operational Risk Model" documentation, the Federal Reserve Board notes that "firms subject to the [Federal Reserve] Board's stress test experienced nearly $450 billion in realized operational losses [over a 23-year period] between 2000 and 2023."[48] However, in the 2025 stress test results, the Federal Reserve Board estimated $179 billion of operational losses,[49] under the severely adverse scenario, for the 22 banks over the nine-quarter stress horizon, with aggregate losses across those banks totaling nearly $550 billion.[50] And, in the 2024 stress test results, the Federal Reserve Board estimated $193 billion of operational losses,[51] under the severely adverse scenario, for the 31 banks over the nine-quarter stress horizon, with aggregate losses across those banks

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47 *E.g.*, 2026 Stress Test Scenarios at 19; 2025 Stress Test Results at 23, 26 n.4; 2024 Stress Test Results at 20; 2023 Stress Test Results at 18; 2022 Stress Test Results at 12.

48 Federal Reserve Board, *Supervisory Stress Test Model Documentation: Operational Risk Model* 5 (Oct. 2025), https://www.federalreserve.gov/supervisionreg/files/operational-risk-model.pdf ("Operational Risk Model documentation").

49 2025 Stress Test Results at 24.

50 *Id.* at 1.

51 2024 Stress Test Results at 22.

totaling nearly $683 billion.[52] Not only do the aggregate operational losses per stress test equate to 28-33% of total losses, but the 2024 nine-quarter horizon operational losses across the 31 banks *are almost 43% of the total operational losses that the Federal Reserve Board cites over a 23-year period.* This should, by itself, indicate that operational losses should be calibrated downward for the 2.25-year window. Indeed, just using simple math, one might start with a presumption that only one-tenth of the 23 years of operational losses (and not more than 4 times that amount) should occur in a 2.25-year window. If the stress test were to retain operational risk losses and generally adhere to the current method, the Federal Reserve Board should publish a comprehensive analysis about the severity calibration and alternatives they considered and rejected.

- To compound this issue, over the 22-year period from 2000-2022, the Federal Reserve Board notes that the "Clients, Products, and Business Practices" category comprises 72.5% of operational losses, and that "[f]irms often categorize legal events in this event type, particularly those related to improperly marketed products that were prevalent during the 2008 financial crisis."[53] *However*, the Federal Reserve Board also suggests, and our experience supports, that "large legal events" (those within the category comprising 72.5% of operational loss events) can take "several years for their financial impact to be fully realized."[54] The fact that large legal events take years for operational risk losses to add up, coupled with the weighting of the "Clients, Products and Business Practices" component as heavily legal loss-driven and greater than all other components, would dictate that the amount of operational risk losses that may typically occur in a nine-quarter stress horizon should not be as great as projected in the last two stress tests.

2. Based on the inflated operational risk loss calculations in recent stress tests, the Federal Reserve Board should consider more nuanced alternatives to modeling operational risk in the stress tests.

First, the Federal Reserve Board used "[t]otal assets . . . throughout the Operational Risk Model as a proxy measure for firms' exposure to operational risks . . . [and as] a proxy measure for firm complexity."[55] In our view, total assets is too blunt a tool for the stress tests, and more nuanced approaches should be considered. The more appropriate approach is to consider the business mix of a firm's operations, and to develop models for the operational risk losses over different business and risk types. Operational risk is not equal across business lines and different operational elements are present among all types of businesses, including credit cards vs. personal lending, retail vs. institutional, trading vs. lending, etc. As another alternative,

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52 *Id.* at 1.

53 Operational Risk Model documentation at 10.

54 *Id.* at 28. *See also id.* at 25 ("[S]ome operational losses, particularly large legal losses, take several years to unfold").

55 *Id.* at 35. We acknowledge that the Federal Reserve Board has also proposed that certain liquid assets be excluded from total assets. *Id.* at 36-38.

a revenue-based approach could be more sensitive to business mix, although we would recommend further study[56] on how revenues may be used as a proxy for business mix.[57]

One key issue with the use of total assets is that the stress tests assume that "a bank's assets generally remain unchanged."[58] In contrast, the Federal Reserve Board acknowledged that "firm revenue tends to decrease dramatically during recessions."[59] In our view, a reduction in revenues and a slow-down in business activity should present fewer "opportunities for operational risk to manifest."[60] The Federal Reserve Board's stress test is designed to calculate the revenues during the stress horizon, and therefore the difficulties suggested by the Federal Reserve Board regarding volatility of revenue[61] should not be an impediment and any reduction in revenue during the stress horizon could be used as a scalar on operational risk losses.

Furthermore, and importantly, the asset-based approach may not appropriately capture the risk profile of FBOs, as their U.S. IHCs are likely to be comprised of a few narrow business lines, suggesting a fundamentally different business model, set of risk exposures and operational structures compared to U.S. GSIBs.

- An FBO's asset base is not typically indicative of riskiness of activities. Indeed, often there is a greater proportion of lower-risk activities in FBO's U.S. operations than in the aggregate across domestic bank's operations.[62] Such lower-risk activities also are simpler and do not always translate to higher operational risk. Thus, using asset size is a blunt proxy, because it cannot account for the complexity of operations, the nature of business lines (e.g., transaction banking vs. investment banking), and the risk management frameworks in place.

- FBO's U.S. activities may be more narrowly focused, with asset size not indicating the operational risk of those business lines. FBOs tend to focus on fewer activities in their U.S. operations (than globally) and on specialized activities (e.g., trade finance, correspondent banking) with lower operational risk profiles than diversified GSIBs. The

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56 If revenues and/or expenses were used as a measure of business mix and complexity, similar to our comments in Section A above, we recommend that the Federal Reserve Board give due consideration to the effects of TP on revenues and expenses.

57 We note that the so-called Basel III Endgame proposed using revenue as the proxy for business volume, which may correlate more closely with the business activity that may cause operational risks. *See* Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64,028, 64,082-83 (proposed Sept. 18, 2023) (the "Basel III Endgame Proposal") ("Higher business volumes present more opportunities for operational risk to manifest.").

58 2025 Stress Test Results at 16 n.10.

59 Operational Risk Model documentation at 36.

60 *See* Basel III Endgame Proposal at 64,083.

61 *See* Operational Risk Model documentation at 36 ("[T]otal income exhibits much higher volatility over time than do asset-based measures and would introduce greater volatility to operational loss projections").

62 *See* William Goulding & Daniel E. Nolle, *Foreign Banks in the U.S.: A Primer* 8-10, 11, fig.3a, tbl.4 (Federal Reserve Board: International Finance Discussion Papers, Nov. 2012, rev. Dec. 2012), https://www.federalreserve.gov/pubs/ifdp/2012/1064/revision/ifdp1064r.pdf.

same asset size can represent very different operational risk exposures depending on the business mix.

- FBOs' U.S. entities may have operational risk managed at the group level, in addition to being managed in the U.S. operations. But losses may be absorbed or mitigated by the parent, distorting the relevance of U.S. asset size as a risk indicator.

- The proposed model's pooling of industry data will overweight U.S. GSIB experience, penalizing FBOs whose IHCs are generally Category III or IV with lower operational risk profiles.

Therefore, we recommend that the proxies used to scale operational risk be more nuanced, focusing on business lines, business mix and composition, typical asset risk weights for different businesses and business line operational risk loss history.

Second, to the extent that the Federal Reserve Board is contemplating the application of operational risk capital charges to a broader range of firms in connection with its work on the Basel III Endgame, we urge the Federal Reserve Board to eliminate any compounding effects that may result from operational risk being used in everyday capital calculations and additional operational risk elements (beyond simply stressing the everyday calculations) being employed in the stress tests.

Third, drawing projected operational losses from the 93rd percentile of the aggregate loss distribution is too conservative given the historical frequency of severe recessions (four over a 60-year period). Allocating a constant tail percentile across nine quarters may create inconsistencies with scenario narratives.[63]

F. The Federal Reserve Board should permit risk-mitigating hedges that do not meet the requirements of accounting hedges to also have a beneficial effect on PPNR.

In the Proposal, the Federal Reserve Board noted that "Currently, the FR Y-14Q captures certain types of hedges, including hedges on accrual loans and loans held under the fair value option and certain designated accounting hedges on securities, but is not comprehensive, which limits the ability of the supervisory stress test to account for these positions."[64]

Therefore, the Federal Reserve Board has indicated that these deficiencies should be resolved by collecting additional data. In its PPNR Model documentation, the Federal Reserve Board indicates it is "proposing to collect additional data on firms' interest rate risk hedging positions for accounting hedges as part of FR Y-14Q data collection for Schedule B.2. In particular, the Board proposes to request firms to provide quarterly snapshots of their qualified accounting hedging positions at the end of each quarter, noting which portfolio a given derivative is hedging. The Board also proposes collecting data on the notional amount, derivative type, fix and floating rate details, and maturity. . . . Collecting granular data on the underlying accounting hedge positions at each quarter-end will enable the Board to capture the impact of existing hedges, including forward starting hedges, on firms' interest income and expense during the

63 We also support the arguments in the Bank Policy Institute letter on this topic.

64 Proposal at 51,935.

projection horizon."[65] In addition, the Federal Reserve Board asks, "Question A187: The Board is proposing to take into account only the impact of accounting interest rate risk hedges. Should the Board consider all hedges instead? If so, what data should the Board collect to achieve this?"[66]

We recommend that, if the Federal Reserve Board is already collecting additional data to determine the impact of accounting hedges on a firm's interest income and expense, then it should be able to collect data on non-accounting hedges too, in order for the Federal Reserve Board to estimate impact of those hedges on interest income and expense. The data collected would be the same—the data proposed by the Federal Reserve Board ("notional amount, derivative type, fix and floating rate details, and maturity", among others) are not unique to only accounting hedges. The criteria for qualifying as an accounting hedge is rigid and narrow, and not the sole determinants of whether a hedge provides risk mitigation. In other words, it is well recognized in literature[67] that interest rate hedges that may not meet the hedge accounting criteria continue to provide risk mitigation and reduction of volatility in interest income and expenses. Therefore, we recommend extending the proposed FR Y-14Q hedge fields to cover *all interest rate risk in the banking book* ("IRRBB") *hedges*, irrespective of hedge-accounting designation.

We acknowledge that the hedge accounting criteria may provide a "known" set of characteristics that reduce the Federal Reserve Board's need to supply its own criteria for qualification for risk mitigation. And we acknowledge that not all hedges or derivatives within an organization may be appropriate for income and expense offset. However, given that the Federal Reserve Board has already proposed to collect additional data in the FR Y-14Q data collection, we recommend that the Federal Reserve Board also collect data about interest rate risk hedges that meet the following robust governance criteria: As outlined in the Federal Reserve's Supervision and Regulation Letter SR 10-1 (Jan. 11, 2010) ("SR 10-1"), interest rate hedges form part of formally established risk mitigation activities or asset-liability management strategies designed to stabilize and optimize net interest income for open banking book positions. While such hedges may receive either mark-to-market or hedge accounting treatment, all strategies and associated limits must be approved by an asset-liability committee, management or market risk committee or an equivalent governance body, and incorporated into entity level metric reporting (*e.g.*, dNII / dEVE).[68] Where possible, hedging strategies should be centrally executed, subject to independent review and challenge by the second line, and managed within

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65 Federal Reserve Board, *Supervisory Stress Test Model Documentation: Pre-Provision Net Revenue (PPNR) Model* 221 (Oct. 2025, updated Dec. 2025), https://www.federalreserve.gov/supervisionreg/files/pre-provision-net-revenue-models.pdf.

66 *Id.* at 224.

67 *See, e.g.,* Ira G. Kawaller, *Interest Rate Swaps: Accounting vs. Economics*, 63 Fin. Analysts J. 15-18, at 16 (March/April 2007) ("The reason these two effects should be expected to differ is that different discount rates are prescribed for valuing the gains/losses for, respectively, the swap and the hedged item. Thus, even though the *exactly* correct future cash flows are generated by the swap, the two respective present value changes will generally not be equal. Under FAS 133, differences between these two effects are considered to be ineffective. And if the ineffectiveness is sufficiently large, hedge accounting may be disallowed—even though the hedge is working perfectly in an economic sense") (emphasis in original; footnotes omitted), and at 17 (Kawaller recommends "foster[ing] accounting results that more accurately reflect the intended economics of the related hedging transactions.").

68 SR 10-1 does not emphasize accounting qualification, but "re-emphasizes the importance of effective corporate governance, policies and procedures, risk measuring and monitoring systems, stress testing, and internal controls". SR 10-1 at 1.

the entity's approved risk appetite. Individual strategies may target specific underlying positions or portfolios of similar assets or liabilities within the banking book, subject to applicable capacity constraints and stability analysis. Indeed, a firm's hedging strategy need not be focused solely on accounting qualifying hedges, but "[h]edging strategies should be designed to limit downside earnings exposure or manage income or economic value of equity (EVE) volatility."[69] This is consistent with the type of hedges that should be permitted under the stress test.

Not incorporating non-accounting, yet effective, hedges into the Federal Reserve Board's estimates of income and expenses disincentivizes good management practices. The asymmetric treatment of accounting vis-a-vis non-accounting hedges makes stressed non-interest income ("NII") depend on hedge designation rather than the substantive hedge existence/effect, and it will penalize firms (including many FBOs) whose governance includes economic hedging without accounting designation. For example, certain hedges used to stabilize mortgage exposures would not qualify for hedge accounting because they are dynamic hedges that get frequently rebalanced. We believe firms should receive credit for such hedges because they are risk-managing trades that promote safe and sound banking.

This would be a non-complex addition to the data collection (that is already proposed to be expanded) and carries several benefits. First, it fixes a form-over-substance bias that the Proposal injects into supervisory NII. If a hedge is economic but not designated, the supervisory model assumes zero hedge income, even if the bank uses swaps/futures/options to reduce volatility. Further, a firm could feel pressure to designate hedges for accounting optics so they are credited in supervisory NII—even if economic hedging without designation is better aligned to dynamic IRRBB management. Extending the same fields to all IRRBB hedges removes these incentives so supervisory NII reflects actual risk management, not just reporting choices.

Second, the recommendation heavily leverages the Federal Reserve Board's proposed model architecture. The Proposal explicitly states that instrument-level hedge fields will allow the Federal Reserve Board to apply the scenario path of interest rates to compute these cash-flows, and that for terminated accounting hedges it will carry over amortization impacts in NII. Extending the fields to non-accounting hedges means the Federal Reserve Board can run the same two-leg calculation—without the need for a new model.

Finally, the recommendation would improve comparability across firms by incorporating all impacts of qualified hedging programs into the projected bank results regardless of the hedge's accounting treatment. The inclusion of programmatic non-accounting hedges encourages banks to use additional forms of hedges for mitigating interest risk and supports the Federal Reserve Board's stated goal of using simpler, more transparent modeling approaches to enable enhanced comparability of results.

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[69] *Id.* at 8.

G. The dividend add-on component of the stress capital buffer ("SCB") should be eliminated for IHCs.[70]

Under the SCB, a planned dividend in any or all of the fourth through seventh quarters of the nine-quarter capital planning horizon must be added (the "dividend add-on") to an IHC's SCB, while other forms of distributions to shareholders, such as a planned share repurchase, are not.[71] While the Proposal suggests a revision to the timing of the dividends subject to the dividend add-on, in our view, the Federal Reserve Board should instead eliminate this requirement altogether for IHCs. IHCs do not fit the character and types of systemic issues that the dividend add-on was designed to address. The dividend add-on is biased against IHCs in several ways, given their materially different profile as subsidiaries of a larger organization. IHCs effectively do not, and often cannot, distribute capital through share repurchases, and therefore the exclusion for share repurchases, rather than dividends on shares, is a benefit in the SCB framework that is unavailable to IHCs. As wholly owned subsidiaries, IHCs issue dividends to their parent FBOs, which may be deployed elsewhere as needed (and could, in fact, be re-downstreamed to the IHC as needed in stress). The internal dividend does not leave the banking organization (at least initially), unlike dividends from stress test participants that have publicly traded common and preferred stock. The principal rationale for the dividend add-on was based solely on U.S. publicly traded firms and the reputational risks they face in the market with regard to decreasing or eliminating their dividends in periods of stress.[72] Pre-funding for internal dividends on non-publicly traded equity should not be required given their fully discretionary nature and lack of market expectations.

If the Federal Reserve Board does not eliminate the dividend add-on altogether, the Federal Reserve Board should appropriately scale the dividend add-on for the IHCs of FBOs given the unique characteristics described above. For example, the Federal Reserve Board could look to the capital actions of U.S. domestic BHCs subject to the SCB in the prior five years to determine the average ratio of share repurchases (not added to the SCB) versus dividends (added to the SCB). The dividend add-on for IHCs could then be scaled based on such ratio to level the playing field among all firms subject to the SCB. In this approach, assuming 50% of U.S. domestic BHC capital actions in the past five years were share repurchases that were not required to be added to the SCB, while 100% of IHC

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70 The Proposal asks about the dividend add-on component in Question 30 ("Question 30: What would be the advantages and disadvantages of the proposed change to the dividend add-on component of the stress capital buffer requirement?"). Proposal at 51,874.

71 12 C.F.R. § 225.8(f)(2)(i)(C). The Proposal proposes to change the dividend add-on to cover dividends issued in quarters five through eight to align with the proposed change to the jump-off date. Proposal at 51,874.

72 Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 80 Fed. Reg. 18,160, 18,166 (proposed April 25, 2018) ("A reduction in dividends by a publicly-traded firm could be interpreted by market participants as a signal of long-run deterioration in firm profitability, which could lead to a negative stock price reaction. Hence, even if the outlook for a publicly traded firm has significantly worsened, public pressure and competition may deter the firm from reducing dividend payments. Requiring a firm to pre-fund one year of dividends reflects the assumption that the firm will strive to maintain its current level of dividends even during times of stress."). This policy goal is wholly inapposite to IHCs.

capital actions were dividends (as discussed above, IHCs effectively do not distribute capital through share repurchases), the dividend add-on for IHCs would be reduce by 50%.

Further, the dividend add-on miscalibrates capital requirements because it essentially serves as a floor to the amount of any distribution that can be paid regardless of over-capitalization of the entity. If the dividend add-on were a true pre-funding, an organization should be permitted to reduce its SCB by the amount of a dividend in order to use those pre-funded resources to distribute to shareholders. However, the amount of any dividend add-on is binding through the entire year (which equates to the four-quarter period that is pre-funded under the SCB rules) during which a particular SCB is effective. A firm should have enough capital in any quarter not to fall below minima and stress losses after it pays its dividend. However, currently, a firm must maintain its capital above its minima, its stress losses and its dividend add-on, even after it pays its dividend.[73] Therefore, if the Federal Reserve Board does not eliminate the dividend add-on altogether, it should reduce the SCB over time as dividends are paid.

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We appreciate your consideration of our comments on the Proposal. If we can answer any questions or provide any further information, please contact me at 646-213-1147, bzorc@iib.org or Stephanie Webster, General Counsel at 646-213-1149, swebster@iib.org.

Very truly yours,

Beth Zorc
Chief Executive Officer
Institute of International Bankers

[73] Former Vice Chair Quarles recognized this redundant penalty. *See* Randal K. Quarles, Vice Chair for Supervision, Federal Reserve Board, Refining the Stress Capital Buffer (Sept. 5, 2019) ("The second element of the SCB proposal that I believe should be removed is the requirement for banks to pre-fund the next four quarters of their planned dividend payments. The stress tests currently require banks to set aside sufficient capital today to 'pre-fund' expected capital distributions, both dividends and repurchases, for all nine quarters of the capital planning horizon. Removing the pre-funding of dividend requirement would simplify the SCB proposal. Additionally, the SCB already has a mechanism for curbing dividends and other distributions when a bank's capital ratio falls into the buffer. Requiring pre-funding of dividends is a needless redundancy. Even worse, the pre-funding of dividends could lead to a conflict with the mechanics of the SCB—the SCB could call for a restriction of dividend payments even when those payments had been pre-funded.").