BETTER MARKETS, PHILLIP BASIL

Proposal and Comment Information

Title: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations, R-1887

Comment ID: FR-2026-0007-01-C102

Subject

Docket No. R-1887; RIN 7100-AH20

Submitter Information

Organization Name: Better Markets

Organization Type: Organization

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Submitted Date: 06/18/2026

NONCONFIDENTIAL // EXTERNAL

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June 18, 2026

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Re: Notice of Proposed Rulemaking—Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations, Docket ID OCC-2026-0265, Docket No. R-1887, RIN 1557-AF52, RIN 7100-AH20, RIN 3064-AG29; 91 FR 14952 (March 27, 2026)

Dear Ladies and Gentlemen:

Better Markets[1] submits these comments in response to the joint notice of proposed rulemaking ("Proposal")[2] by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, "the agencies"), that would modify capital requirements for banking organizations that are subject to Category I and II standards and those that engage in significant trading activity.

1 Better Markets is a nonprofit, nonpartisan organization that promotes the public interest in financial reform, regulation, and enforcement in U.S. and global capital markets. We have been a consistent and evidence-based advocate for strong capital adequacy, systemic risk oversight, and financial stability since our founding in the aftermath of the 2008 financial crisis.

2 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. Notice of Proposed Rulemaking. Proposed Rule. *Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations.* 91 FR 14952 (March 27, 2026), available at: https://www.federalregister.gov/documents/2026/03/27/2026-05959/regulatory-capital-rule-category-i-and-ii-banking-organizations-banking-organizations-with.

I. Executive Summary

As described in detail below, Better Markets strongly opposes significant portions of the agencies' Proposal to revise the regulatory capital framework applicable to Category I and II banking organizations and banking organizations with significant trading activity. Better Markets supports thoughtful, evidence-based refinement of capital requirements (including, in certain cases, to broadly align with international standards) to promote a safe and sound banking system in the United States that provides critical banking services to the American people. However, this Proposal does not meet those criteria. While we support certain reforms for the calculation of credit risk that would improve some elements of the capital rule and better align capital requirements with underlying risks, the Proposal suffers from fundamental legal, procedural, analytical, and policy deficiencies that preclude finalization in its current form.

At its core, the Proposal, in combination with the proposal to modify the GSIB surcharge ("GSIB surcharge proposal")[3], seeks to reduce capital requirements for the largest and most systemically important banking organizations in the United States. Yet the agencies have failed to demonstrate that those reductions are justified, failed to demonstrate that they comply with federal law, failed to demonstrate that they are consistent with internationally agreed standards, and, critically, failed to provide the public with the information necessary to meaningfully evaluate their effects.

The singular importance of bank capital is empirically demonstrated as the main determinant of whether banks survive periods of stress. A recent study[4] by researchers at the Federal Reserve Bank of New York, the Federal Reserve Bank of Richmond, and the Massachusetts Institute of Technology's Sloan School of Management, reviewing 160 years of U.S. bank failure data spanning every major financial crisis from the Panic of 1873 through the 2007-2009 global financial crisis ("global financial crisis"), concluded that bank failures are almost always a solvency (i.e., capital) problem, not a liquidity problem. The study found that bank failures—both those accompanied by depositor runs and those that occurred without runs—are "essentially always associated with weak fundamentals, proxied by bank capitalization, profitability, and reliance on expensive funding," and that "runs do not trigger the failure of observably stronger banks." The authors found that low recovery rates on failed banks—averaging 75 cents on the dollar, including for banks that experienced runs—suggest that most failed banks were likely insolvent before the run began, and that the run was a consequence rather than a cause of their distress. The critical policy implication for this Proposal that the authors draw is that

3 *See* Federal Reserve Board. Notice of Proposed Rulemaking. *Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)*. 91 FR 14908. (March 27, 2026), available at: https://www.federalregister.gov/documents/2026/03/27/2026-05961/regulatory-capital-rule-regulation-q-risk-based-capital-surcharges-for-global-systemically-important. For this comment letter "GSIB" refers to a U.S. global systemically important bank holding company and its consolidated group, and "GSIBs" refers collectively to the eight banking organizations considered GSIBs headquartered in the United States.

4 *See* Correia, Luck, and Verner. "Bank Failures: The Roles of Solvency and Liquidity." NBER Working Paper No. 34853, at 3 (February 2026), available at: https://www.nber.org/system/files/working_papers/w34853/w34853.pdf.

"policies focused on maintaining and restoring bank solvency, beyond merely providing liquidity support, are necessary for preventing the most adverse consequences of banking crises." This finding directly bears on the calibration of risk-weighted assets and the level of overall capital requirements. The largest banking organizations are precisely those whose failure would generate the broadest economic distress. The evidence compiled over a century and a half of banking history confirms that the margin of safety provided by strong capital is the variable that most reliably separates banks that survive crises from those that do not. The agencies must bear this evidence in mind in calibrating any adjustment to the calculation of risk-weighted assets, particularly to the trading book, securitizations, and derivatives, in order to ensure that the resulting capital requirements remain robust across the full range of economic conditions.

The Proposal is particularly troubling because three years have passed since the failures of Silicon Valley Bank ("SVB"), Signature Bank, and First Republic Bank, which collectively represented the largest concentration of failed bank assets in a single year in American history.[5] Those failures provided a stark reminder that effective prudential standards, particularly capital requirements scaled to an institution's systemic risk, remain the primary determinant of whether banking organizations survive periods of stress.[6] Rather than strengthening the resilience of the banking system, however, the Proposal would reduce important capital requirements without providing sufficient evidence that the resulting framework would remain adequate during future periods of financial stress. Better Markets has also submitted public comments on the agencies' proposal that would modify the standardized approach for risk-weighted assets and the definition of regulatory capital applicable to banking organizations that are not Category I or II institutions.[7]

Better Markets' primary concerns with the Proposal fall into six principal categories.

First, the agencies have failed to conduct a legally adequate impact analysis. The Proposal relies heavily on a voluntary data collection[8] conducted in 2023 for the agencies' prior proposal ("2023 proposal") to implement the Basel III framework[9], supplemented by assumptions, proxies,

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5 *See* Federal Deposit Insurance Corporation. *Bank Failures in Brief – Summary*. available at: https://www.fdic.gov/resources/resolutions/bank-failures/in-brief/index. The 2023 bank failures amounted to over $548 billion in assets. For context, in 2008 25 banks failed amounting to $373 billion in assets.

6 *Supra* 4.

7 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. Notice of Proposed Rulemaking. *Regulatory Capital and Standardized Approach for Risk-Weighted Assets*. Docket ID OCC-2026-0034, Docket No. R-1888, RIN 1557-AF49, RIN 7100-AH21, RIN 3064-AG23; 91 FR 15332 (March 27, 2026), available at: https://www.govinfo.gov/app/details/FR-2026-03-27/2026-05960.

8 *See* Federal Reserve Board. "Federal Reserve Board launches data collection to gather more information from the banks affected by the large bank capital proposal it announced earlier this year. (October 20, 2023), available at: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.

estimates, and modeling judgments that were never designed to evaluate the Proposal. The agencies are effectively asking the public to comment on the effects of a 2026 capital framework (with an effective date in 2028 or more likely beyond) using a limited 2023 snapshot of the banking system. Since that time, banking organizations have materially altered their balance sheets, funding structures, trading activities, operational-risk profiles, and relationships with nonbank financial institutions. The agencies have not collected the institution-specific data necessary to accurately evaluate the Proposal's effects and therefore cannot reliably quantify its impact on capital requirements, lending, financial stability, or economic growth.

Second, the Proposal raises serious legal concerns regarding compliance with the Collins Amendment. Section 171 ("Collins Amendment") of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") prohibits the agencies from establishing minimum capital requirements that are quantitatively lower than applicable statutory floors.[10] Yet the agencies provide no institution-specific analysis demonstrating that the proposal satisfies that requirement. Nor can the agencies satisfy their statutory obligations through optional election mechanisms or other supervisory accommodations. Congress rightly imposed the obligation on the agencies themselves, not commenters. Before issuing any final rule, the agencies must publish for public comment a detailed demonstration of the Proposal's compliance with the Collins Amendment.

Third, the agencies have selectively departed from internationally agreed Basel standards in a manner that consistently moves in one direction: to lower capital requirements. The Basel Committee on Banking Supervision ("Basel Committee") spent more than 14 years developing the updated credit risk, market risk, operational risk and credit valuation adjustment frameworks ("Basel III final reforms").[11] If the agencies believe those standards should be significantly modified or weakened as the Proposal attempts to do, the appropriate forum is the Basel Committee itself in order to ensure broad international alignment. Unilateral deviations by the U.S. that would weaken capital requirements undermine international consistency, create opportunities for regulatory arbitrage, and significantly weaken the credibility of the agencies. Indeed, the agencies' repeated delays to implement the Basel III final reforms, in combination with the Proposal's significant and material departures from the international framework have already significantly

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9 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. Notice of Proposed Rulemaking. *Large Bank Organizations and Banking Organizations with Significant Trading Activity*; 88 FR 64028 (September 18, 2023), available at: https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant.

10 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 171, 124 Stat. 1376, 1435 (2010) (codified at 12 U.S.C. § 5371).

11 *See* Basel Committee on Banking Supervision, *Basel III: Finalising Post-Crisis Reforms* (December 2017), available at: https://www.bis.org/bcbs/publ/d424.htm.

weakened the credibility of the Basel Committee policy process and have drawn widespread criticism.[12]

Fourth, Better Markets generally supports some of the Proposal's major credit risk reforms, including efforts to improve the treatment of residential mortgages, update credit risk calibrations, modernize certain off-balance-sheet requirements, and improve the overall risk sensitivity of the framework. However, support for those reforms is necessarily conditioned on the agencies first remedying the significant legal and analytical deficiencies identified throughout this comment letter. A sound capital framework requires both sound calibration and a sound rulemaking process. The agencies have not provided either.

Fifth, Better Markets strongly opposes the Proposal's reckless and unjustified reductions in market risk and operational risk capital requirements. The Proposal would counterintuitively increase reliance on internal models and weaken key safeguards that were adopted after the global financial crisis in response to well-documented failures of model-based capital requirements. The Proposal would likewise reduce operational risk capital requirements relative to the Basel III final reforms at a time when operational risk has become increasingly important due to cyber threats, third-party service-provider concentration, cloud-computing dependencies, artificial intelligence, payment-system disruptions, and growing interconnections between banks and nonbank financial institutions. The agencies have failed to demonstrate that operational risk capital requirements under the Basel III final reforms would be excessive or the proposed reductions are in fact warranted.

Sixth, the Proposal is premised on the unsupported assumption that lower capital requirements will increase lending to America's households and businesses. The agencies repeatedly assert that reducing capital requirements will free balance-sheet capacity that banking organizations can deploy to support economic growth and expand credit availability. However, Better Markets[13] and other industry observers have documented that recent reductions in regulatory burdens and increases in bank profitability have not translated into materially greater Main Street lending. That is because: 1) capital constitutes only a small part of loan funding, and most loan funding comes from deposits and other liabilities; and 2) large banks have shown they would rather use "excess" deposits for lower RWA activities, specifically lending to nonbank financial institutions ("NBFIs"), reserves and securities. Therefore, large banking organizations

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12 For example, *see* European Parliament, *The Implementation of Basel III: Progress, Divergence and Implications* (2025), available at: https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/773694/ECTI_IDA(2025)773694_EN.pdf.

13 *See* Phillip Basil and Christopher Appel, Better Markets. *The Main Street Economy Will Suffer If Capital Is Reduced For Wall Street's Eight Megabanks* (April 27, 2026), available at: https://bettermarkets.org/analysis/the-main-street-economy-will-suffer-if-capital-is-reduced-for-wall-streets-eight-megabanks/. "In 2025, lending by the largest six banks to investment funds (like private equity and hedge funds) grew by 50 percent, whereas their lending to the real economy did not grow at all (zero percent)."

have increasingly directed capital toward stock buybacks, dividends, capital markets activities, and lending to NBFIs, including private credit funds, private equity firms, and hedge funds.

As we document in detail in this letter, the Proposal is likely to reinforce and accelerate these trends. Several aspects of the revised credit, market risk, and securitization frameworks create incentives for banking organizations to intermediate credit through structured products and NBFIs rather than through direct lending to businesses and households. As a result, any capital relief generated by the Proposal is more likely to support the continued growth of private credit and other NBFIs than to increase lending to traditional Main Street borrowers.

Furthermore, the updated risk weight frameworks for mortgage and corporate loans would incentivize large banks to make loans to wealthy homebuyers over lower-income households and to large corporations and investment funds over small and mid-sized businesses. Notably, because community banks generally maintain substantial capital buffers, the updated mortgage and corporate loan risk weight frameworks under the standardized approach would provide little benefit to them while materially increasing operational complexity and expense. Their substantial capital buffers, combined with the fact that lending to households, small businesses, and farms is the core business model of community banks, means community banks would have almost no incentive to change their lending behavior and would continue to support small businesses and households of all incomes to the same extent as they do now.

The agencies provide no empirical analysis demonstrating otherwise. They do not evaluate how banking organizations are likely to deploy any capital relief, nor do they assess the Proposal's effects on lending to NBFIs relative to direct lending in a dynamic fashion. Without such analysis, the agencies cannot reasonably conclude that the Proposal will achieve its stated objective of increasing lending to households and businesses. Indeed, the available evidence suggests the opposite: the Proposal is likely to further accelerate the migration of credit intermediation from the regulated banking system to the less transparent and less regulated nonbank financial sector.

For these reasons, Better Markets urges the agencies to withdraw and repropose the rule incorporating this letter's recommendations. If the agencies do not take that necessary and prudent step to repropose, at a minimum, prior to any potential final rule, the agencies must: (1) conduct and publish a comprehensive supervisory data collection; (2) provide institution-level and aggregate impact analyses; (3) publicly demonstrate compliance with the Collins Amendment; (4) justify—or otherwise reverse—any departures from internationally agreed Basel standards; and (5) reopen the comment process to permit meaningful public review of that information.

Absent those steps, the proposal would rest on an inadequate evidentiary foundation, would fail to provide meaningful notice and comment, and would substantially weaken capital requirements for the largest banking organizations in the United States without demonstrating that such reductions are consistent with safety and soundness, financial stability, or federal law.

II. Background

The agencies' Proposal represents a significant reversal of the rationale that has underpinned bank capital regulation since the global financial crisis. For more than a decade, U.S. bank regulators correctly argued that the pre-crisis capital framework materially understated risk, allowed excessive reliance on internal models, failed to adequately capture operational and market risks, and left the largest banking organizations insufficiently resilient during periods of stress. Those conclusions formed the basis for the initial Basel III reforms[14] and now the Basel III final reforms and the agencies' repeated efforts to implement them in the United States.

Yet before those reforms have been fully implemented, the agencies now propose to materially weaken or not apply key elements of the framework. The Proposal would significantly reduce market risk capital requirements, reduce operational risk capital requirements, expand opportunities for model-based capital reductions, and otherwise lower capital requirements for the largest and most systemically important banking organizations in the United States relative to the Basel agreement. Notwithstanding the increased page length of the impact analysis relative to the agencies' 2023 proposal, the agencies provide no compelling evidence that the risks identified by the Basel Committee have diminished, that the Basel Committee's conclusions were incorrect, or that large banking organizations have become materially less vulnerable to market, operational, or financial shocks.

The timing of the Proposal makes this reversal particularly difficult to justify. It has been just three years since the failures of SVB, Signature Bank, and First Republic Bank—the second, third, and fourth largest bank failures in American history.[15] Those failures exposed significant weaknesses in risk management, supervision, and loss-absorbing capacity and prompted extensive reviews by the agencies. The Board's own review of SVB's failure concluded that stronger capital and risk-management practices would have improved the institution's resilience. Yet the agencies now propose to reduce capital requirements for all banks (with the largest decreases in absolute terms for the GSIBs) without explaining why the lessons of the 2023 banking turmoil support lower capital rather than higher capital.

The agencies also cannot justify the Proposal on the basis of congressional direction. As Comptroller Gould observed[16] in testimony before the House Financial Services Committee in

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14 *See* Office of the Comptroller of the Currency and Board of Governors of the Federal Reserve System. Final Rule *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 FR 62018 (October 11, 2013), available at: https://www.federalregister.gov/documents/2013/10/11/2013-21653/regulatory-capital-rules-regulatory-capital-implementation-of-basel-iii-capital-adequacy-transition.

15 For more information on the tailoring framework *see* U.S. Department of the Treasury. Remarks by Graham Steele, Assistant Secretary of the Treasury For Financial Institutions, (July 23, 2023), available at: https://home.treasury.gov/news/press-releases/jy1648 and Graham Steele, *The Tailors of Wall Street*. (2022), available at: https://scholar.law.colorado.edu/lawreview/vol93/iss4/5.

16 Testimony of Jonathan V. Gould, Partner, Jones Day. Before the U.S. House Financial Services Subcommittee on Financial Institutions and Monetary Policy. *Regulatory Recipe for Economic Uncertainty: The Endless Basel Endgame and an Onslaught of Hurried Rulemaking Undertaken by the Biden-Harris Administration*, at 4 (September 25, 2024), available at: https://docs.house.gov/meetings/BA/BA20/20240925/117690/HHRG-118-BA20-Wstate-GouldJ-20240925.pdf.

September 2024, the Basel III Endgame rulemaking "lacks any direct and explicit congressional mandate" and was undertaken on the agencies' "own initiative." The Comptroller's observation as a private sector lawyer applies equally here during his term as Comptroller. Congress has not directed the agencies to reduce capital requirements for the largest banking organizations. Nor has Congress instructed the agencies to weaken internationally agreed market risk and operational risk standards. These changes represent discretionary policy choices by the agencies and therefore require a particularly strong evidentiary and analytical foundation.

The agencies have failed to provide that necessary foundation. As discussed in detail throughout this comment letter, the Proposal rests on an incomplete impact analysis, raises significant questions regarding compliance with the Collins Amendment, selectively departs from internationally agreed Basel standards, and relies on unsupported assumptions regarding the relationship between capital requirements and lending. Most importantly, the Proposal appears likely to reduce the loss-absorbing capacity of the largest banking organizations while increasing incentives to channel credit through nonbank financial institutions and structured-finance markets rather than through direct lending to American households and businesses.

Better Markets supports certain targeted aspects of the Proposal, particularly those elements of the credit risk framework that would improve risk sensitivity and better align capital requirements with underlying risks. However, those improvements cannot justify broader reductions in market risk and operational risk capital requirements or the agencies' unsupported decision to weaken important post-crisis safeguards, including the GSIB surcharge proposal. Before proceeding with any final rule, the agencies should conduct a comprehensive and mandatory data collection, provide a complete and transparent impact analysis, demonstrate compliance with applicable statutory requirements like the Collins Amendment, and repropose the rule for public comment.

III. Comments

A. Reducing Capital Requirements at Global Systemically Important Banks Is A Serious Policy Mistake and Unjustified by the Agencies

The rapid failures of SVB, Signature Bank, and First Republic Bank in 2023 demonstrated what happens when regulatory frameworks fail to keep pace with the actual risk profile of large banking organizations.[17] Those failures and subsequent government bailouts occurred at Category IV institutions, the least systemic category of banking organizations under the agencies' tailoring

[17] Category III and IV banking organizations are generally defined by asset thresholds of \$250–\$700 billion and \$100–\$250 billion in total assets respectively, along with various activity-based criteria. These institutions were the primary banks that failed during the 2023 banking turmoil. *See* Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (April 28, 2023), available at: https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf. *See also* Section III.F of Better Markets comment letter to the agencies' standardized approach proposal that strongly recommends the agencies create a DSIB framework for large banking organizations that are not identified as GSIBs under 12 CFR 217.403.

framework. This Proposal would extend comparable—and in some respects more significant—capital relief to the GSIBs ("Category I") and Category II banking organizations, the institutions whose failure the agencies themselves have concluded would impose the greatest systemic losses on the financial system and the broader economy. That the agencies would choose this moment to reduce capital requirements for the most systemically dangerous banks in the United States is a policy mistake and inconsistent with their safety-and-soundness mandates.[18]

The invocation of the systemic risk exception by the federal government (which required the intervention of the President of the United States) has fundamentally undermined the Proposal's rationale for reducing capital requirements at the nation's largest banking organizations. For years after the global financial crisis, regulators have justified enhanced capital requirements for GSIBs on the grounds that their failure would impose costs on the broader economy far exceeding those associated with ordinary banks. Yet the events of 2023 demonstrated that the federal government was unwilling to permit the disorderly failure of banks with approximately $217 billion (SVB) and $110 billion (Signature Bank) in assets. If a $110 billion bank was sufficiently systemically important to warrant extraordinary government intervention, it is difficult to understand why institutions that are five, ten, or fifteen times larger should be permitted to operate with lower capital requirements.[19]

The Proposal inexplicably never confronts this contradiction. The agencies do not explain why the systemic risk exception was necessary in the failures of SVB and Signature Bank, but reduced capital requirements are appropriate for banking organizations whose size, complexity, interconnectedness, and market significance far exceed those of SVB. Nor do the agencies attempt to reconcile the Proposal with the Board's own review of SVB, which identified weaknesses in risk management, supervision, resilience, and critically, prudential regulation that contributed to the firm's failure.

Indeed, the logic of the Proposal appears backwards. The federal government's actions in 2023 demonstrated that the threshold at which public authorities believe a large bank's failure poses unacceptable risks to financial stability is far lower than previously assumed.[20] The appropriate policy response to that revelation would be to ensure that the largest banking organizations maintain robust levels of loss-absorbing capital. Instead, the agencies propose to

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[18] *See* 12 U.S.C. § 1831p-1 (FDICIA § 39, directing the agencies to establish safety and soundness standards including capital standards); 12 CFR Part 30, Appendix A (OCC); 12 CFR Part 208, Appendix D-1 (Board); 12 CFR Part 364, Appendix A (FDIC) (Interagency Guidelines Establishing Standards for Safety and Soundness, requiring institutions to maintain "adequate capital"); 12 CFR § 3.1(a)–(b) (OCC capital rule); 12 CFR § 217.1(a), (d)(6) (Board capital rule) (reserving authority to impose requirements "commensurate with the Board-regulated institution's risk and consistent with safety and soundness"); 12 CFR Part 324 (FDIC capital rule); 12 CFR Part 252 (Board enhanced prudential standards implementing 12 U.S.C. § 5365).

[19] *See* Federal Deposit Insurance Corporation. *FDIC's Supervision of Signature Bank*. (April 28, 2023), available at: https://www.fdic.gov/sites/default/files/2024-03/pr23033a.pdf.

[20] *See* Better Markets' Comment Letter to the Board's GSIB surcharge proposal on the reference bank, *Section III.A.ii*, for a detailed explanation of the miscalibration of systemic risk as evidenced by the 2023 banking failures.

reduce capital requirements for the institutions whose failure would impose the greatest costs on the American economy and create the strongest pressure for future government intervention.

The Proposal is particularly difficult to justify because it would reduce capital requirements at institutions that engage in activities largely absent from (but far more risky than) SVB's business model, including extensive trading operations, derivatives activities, securities financing transactions, and global capital markets intermediation. These activities were among the principal reasons the Basel Committee strengthened market risk and operational risk requirements following the global financial crisis. Yet the agencies now propose to weaken those safeguards without demonstrating that the underlying risks have diminished.

The agencies must explain why a banking system that required extraordinary government intervention to prevent the failure of a $217 billion regional bank (and an even smaller and less systemically important $110 billion bank) would be safer if the largest and most systemically important banking organizations are permitted to operate with less capital.

i. <u>The Board Has Reduced Capital Requirements for the GSIBs Significantly Since 2019, and This Proposal Would Reduce Them Even More</u>

Notwithstanding the Board's now rescinded series of 2023 capital proposals (which were never finalized), the Board's policy approach in its adopted capital rules since 2018 has been targeted at achieving significantly lower GSIB capital requirements. This effort began with weakening the Board's supervisory stress test through weaker scenarios, which lowered the effective capital requirements that were implemented through the annual Comprehensive Capital Analysis and Review ("CCAR") exercise. The average estimated decline in common equity tier 1 ("CET1") capital ratios across the GSIBs in the 2019 CCAR exercise was 5.7 percent, down materially from an average of 7.1 percent in the 2015 CCAR exercise (the first year the CET1 requirement was fully included in the CCAR exercise).[21]

In 2020, the Board transitioned away from conducting the CCAR exercise and replaced it with the stress capital buffer requirement ("SCB"), and in the process also weakened key, prudent assumptions of the effective capital requirements from the CCAR exercise (e.g., eliminating the assumed growth of a bank's balance sheet and reducing the number of quarters of pre-planned capital actions included in the stress test requirement from 9 to 4 quarters). The average GSIB SCB requirement in 2020 was only 3.5 percent, essentially meaning there was a 2.2 percentage point year-over-year decrease in estimated stress-related capital declines due in part to the weakening of those key assumptions. The average GSIB SCB requirement declined even further to just 3 percent last year, barely above the 2.5 percent minimum of the SCB framework. In fact, last year the SCBs for 5 of the 8 GSIBs were floored at the 2.5 percent minimum due to their stress test results being lower than that figure (in some cases well below).

[21] Better Markets' calculation based on analysis of the CCAR results. *See* Federal Reserve Board. 2019 CCAR Results (June 2019), available at: https://www.federalreserve.gov/publications/files/2019-ccar-assessment-framework-results-20190627.pdf.

As a result, GSIBs with a 2.5 percent SCB "floor" have the same capital requirements for the "capital conservation buffer requirement" as a bank with $20 billion in assets.

More recently, last year, the agencies recklessly lowered the enhanced supplementary leverage ratio ("eSLR") leverage capital requirement that applies to the GSIBs.[22] The leverage ratio is crucially important to the capital requirement framework because 1) as the "backstop," it is the true minimum requirement for banks that optimize their risk-weighted assets and 2) unlike the complex risk-based requirements, it represents the percentage of losses a bank can absorb across all its activities. The original eSLR requirements were 5 percent for GSIB holding companies and 6 percent for their insured depository subsidiaries. This requirement already was low by historic standards, allowing holding companies to have up to 20-to-1 leverage and protecting them against only 5 percent losses (for context, 10-year Treasuries lost 5 percent of value in one week in April 2025). The updated requirements are significantly lower, ranging from 3.5 percent to 4.25 percent, and apply to both holding companies and depository subsidiaries.[23]

As a result of this Proposal and the GSIB surcharge proposal, risk-based requirements will be lowered even further, pushing risk-based capital down towards the true minimum of leverage capital and increasing GSIB leverage and profits. Per the figure below, the weighted average risk-based CET1 requirement for the GSIBs has declined from 12.1 percent in 2019 to 10.6 percent currently. The Proposal, in combination with the GSIB surcharge proposal, would further reduce it to 10.1 percent. Better Markets estimates the reduction to be much more dramatic: an effective 9 percent requirement due mostly to gaming opportunities as described in more detail in *Sections G, H, I, J and K* of this letter, and the inadequacy of the Proposal's impact analysis to consider a non-static approach to firms' optimization of the new expanded risk-based approach ("ERBA") capital framework.

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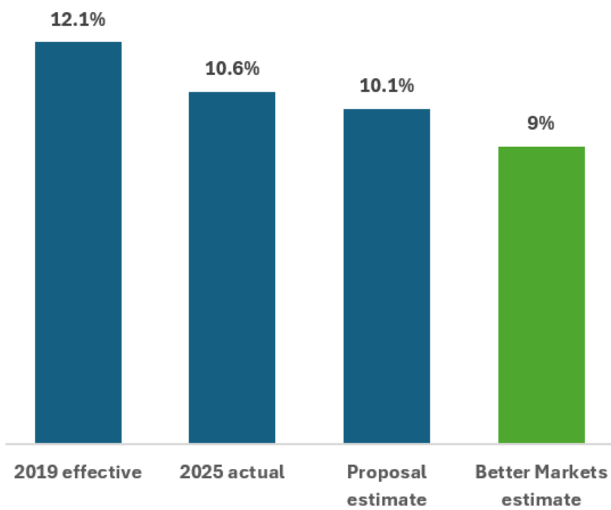
22 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. Final Rule. *Regulatory Capital Rule: Modifications to the Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Their Subsidiary Depository Institutions; Total Loss-Absorbing Capacity and Long-Term Debt Requirements for U.S. Global Systemically Important Bank Holding Companies,* 90 FR 55248 (December 1, 2025), available at https://www.federalregister.gov/documents/2025/12/01/2025-21626/regulatory-capital-rule-modifications-to-the-enhanced-supplementary-leverage-ratio-standards-for-us.

23 For the custodial bank GSIBs, the SLR requirements are even lower due to the statutory exclusion of certain central bank deposits from the denominator of the SLR. The agencies could have prevented this double benefit from the eSLR buffer reduction by not applying all the buffer reduction to their eSLR final rule for those GSIBs but they chose not to. Those firms' supplementary leverage ratios are now non-compliant with the Basel leverage ratio framework.

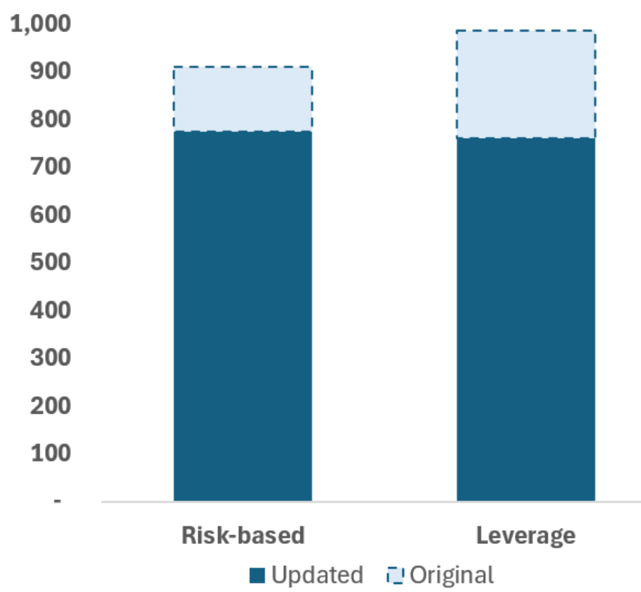
Figure 1: Actual and Estimated GSIB Weighted Average CET1 Requirements



The effect of all these changes would be significantly reduced capital for the GSIBs—around a $130 billion capital reduction across the GSIBs. Notably, the changes would result in a risk-based requirement that is nearly equivalent to the leverage requirement, which ensures the GSIBs would be able to maximize their leverage and therefore maximize their profits. For more information on the calculation methodology for Figure 1 and Figure 2, see the *Appendix*.

Figure 2: Estimated Aggregate GSIB

Tier 1 Risk-based and eSLR Capital Requirements ($B)



ii. <u>The Board's Reference Bank for Applying the GSIB Surcharge Undercuts the Proposed Capital Reductions</u>

As described in *Section III.A.i*, the impact of this Proposal must be viewed in combination with the GSIB surcharge proposal. The GSIB surcharge proposal would reduce capital requirements for the GSIBs due mainly to its unjustified reduction in the method 2 coefficients. However, as explained in detail in Better Markets' comment letter to that proposal[24], the entire premise of the GSIB surcharge rests on the expected impact theory.[25] In other words, a GSIB must hold sufficient capital to reduce its probability of failure until its expected social impact equals that of a "reference bank," the most systemically important institution that public authorities are willing to allow to fail without intervention. The reference bank concept undergirds the entire GSIB surcharge framework. It defines the floor below which GSIB failure risk cannot fall without triggering public costs that the framework is specifically designed to prevent.

This Proposal is contradictory to that premise and undermines the Board's architecture directly. By proposing a framework that would systematically reduce risk-weighted assets for GSIBs and Category II banks, the Proposal lowers the capital base against which surcharges are calculated, effectively reducing the loss-absorbing capacity that the expected impact theory requires these institutions to maintain. A GSIB operating under this Proposal would hold less capital relative to its actual risk exposure than the expected impact theory demands—not because its systemic footprint has shrunk, but because the agencies have revised the measurement methodology in ways that reduce the denominator without a corresponding reduction in systemic risk.

As described in detail in Better Markets' comment letter to the Board's GSIB proposal, the 2023 failures of SVB and Signature Bank require the Board, and the agencies more broadly, to revisit the foundational "reference bank" assumption in its 2015 GSIB surcharge calibration. The Board's white paper calibrated the surcharge by equalizing the expected impact of a GSIB's failure with that of a large non-GSIB reference bank, and it expressly recognized that the surcharge depends on the ratio between the GSIB's systemic loss given default ("LGD") score and the reference bank's LGD score.[26] However, SVB demonstrated that the federal government could not tolerate the disorderly failure of a banking organization with a method 1 score of only approximately 19 basis points without invoking the systemic risk exception and using other extraordinary government interventions.

The agencies in this Proposal have not demonstrated that the revised risk weights produce capital levels consistent with the reference bank standard. They have not published the probability-of-default analysis that would be necessary to make that claim. They have also not explained how a reduction in required capital is compatible with a framework whose explicit purpose is to price the elevated failure risk of the world's most systemically important banks.

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24 *See* Better Markets Comment Letter to the Board's GSIB surcharge proposal in Section III.A.ii, *The 2023 Extraordinary Government Support in Response to SVB and Signature Undercuts the Entire Rationale of the Proposal.*

25 *See* Federal Reserve Board. *Calibrating the GSIB Surcharge.* (July 20, 2015), available at: https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.

26 *Id*.

iii. The Agencies' Statutory Mandates Require a Higher Burden to Reduce Capital Requirements for the GSIBs and Category II Banks

Congress in the Dodd-Frank Act required enhanced prudential standards that increase in stringency based on the risk characteristics of covered companies.[27] GSIBs and Category II banks are, by definition, the covered companies whose risk characteristics are most severe and whose failure would impose the greatest systemic costs. A proposal that would reduce their capital requirements—without a rigorous, publicly available analysis and assessment showing that the revised levels satisfy the reference bank standard under adverse interest rate, credit, and liquidity scenarios—is not consistent with that mandate.

Better Markets recommends that the agencies conduct and publish analysis prior to any final rule demonstrating that proposed capital levels for GSIBs and Category II banking organizations satisfy the reference bank standard included in the Board's white paper calibration for the GSIB surcharge framework.[28] This analysis using the reference bank approach should apply conditions comparable to those that preceded both the global financial crisis and the 2023 bank failures—including rising-rate environments with negative AOCI, concentrated uninsured deposit bases, and rapid liquidity deterioration. This analysis should be subject to public comment before any risk-weight reductions are finalized.

B. The Proposal's Claims Regarding Direct Lending Are Contradicted by Its Treatment of Mortgage Lending, Corporate Exposures, and Securitizations

The agencies and large banking organizations have consistently justified the proposed capital reductions in this and the Basel III proposal on the grounds that lower capital requirements will "free up" balance sheet capacity for direct lending to businesses and households.[29] Better Markets[30] has previously demonstrated that this claim is not supported by the behavioral evidence. In 2025, the U.S. GSIBs grew their lending to NBFIs by over 50 percent, while their lending to households and businesses grew by zero percent,[31] and after the capital proposals were released, not a single one of those CEOs or any CEO of a Category II bank announced a new lending

27 *Supra* 10, 12 U.S.C. § 5365(a)(1). "Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies."

28 *Supra* 25.

29 *Supra* 2, at 15332-15333 (March 27, 2026) (stating that the proposal is designed to "support lending to businesses and households" and "promote economic growth").

30 *Supra* 13.

31 Better Markets' calculation based on data from the Call Report and FR Y-9C.

program. Instead, they announced stock buybacks and dividends, returning the capital funding to shareholders rather than putting it to use for any financial activity, let alone lending.[32]

Furthermore, the argument that reducing (or "freeing up") capital requirements would be used by banking organizations towards additional lending is a long-running fallacy that is nonetheless continually used by the industry—and now the agencies' principals—to promote the industry's agenda of lowering capital requirements. First, capital is only a small portion of the funding that is used for lending, and so a bank would also need to increase its available deposit funding in order to increase lending in the event its capital requirements and capital level both fall. Currently, the weighted average CET1 requirement across the GSIBs is 10.6 percent. Therefore, in a simplified example, a $1 million mortgage with a 50 percent risk weight under the current standardized approach would be funded with about $50,000 of capital funding and $950,000 of deposit funding. If capital requirements were reduced such that only $25,000 of capital funding was required for the mortgage, the bank would need an additional $25,000 in deposit funding for that same loan amount. Neither the industry nor the agencies have described or provided reasoned explanations for where that additional deposit funding would come for their argument around increased lending.

Second, the GSIBs engage in capital optimization, and therefore risk weights define return-on-equity profitability and must be considered on a *relative* basis, because they can make one asset or activity more profitable than another, incentivizing banks to focus on the activities that are more profitable. Last year, the ratio of income to capital was twice as high for GSIBs' trading activities compared to their lending activities. That is likely why they allocate only around 40 percent of their capital towards lending to real economy borrowers (i.e., non-NBFIs).[33]

Third, lower capital requirements for the GSIBs would reduce real economy lending at a systemic level, because the GSIBs lend relatively less than smaller banks. Lower capital for GSIBs relative to community banks would exacerbate the trend of GSIBs enjoying relatively much higher profitability compared to community banks, which allows them to continue to outcompete and acquire nonbank entities and smaller banks. Unfortunately for Main Street borrowers, GSIBs lend out only about 40 percent of their deposits, whereas community banks lend out around 75 percent of their deposits. Therefore, as GSIBs increase their share of the banking system, there will correspondingly be less lending to the real economy.

Not only would the Proposal not boost real economy lending as claimed (and in fact likely will decrease it), the Proposal also would drive more of GSIB lending towards the wealthy individuals, large corporations, and NBFIs as a direct result of the incentives it would create with the updated risk weight frameworks for mortgage lending, corporate lending, and securitizations. First, the Proposal restructures mortgage risk weights in a way that, while improving risk sensitivity, would systematically favor wealthier borrowers at origination over first-time

[32] *See* e.g., JPMorgan Chase. *1Q26 Financial Results*, at 2. "Capital distributed - $8.1B common stock net repurchases," available at: https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/investor-relations/documents/quarterly-earnings/2026/1st-quarter/ba305358-f754-4f76-a59d-5278b3bcf99a.pdf.

[33] Better Markets' analysis based on data from the FR Y-9C.

homebuyers. That is because capital requirements for residential mortgages would change from being a single, fixed risk weight (currently 50 percent) to multiple risk weight buckets that are lower for mortgages with higher down payments and vice versa. That change would better reflect credit risk but ultimately will primarily benefit wealthy homebuyers because they more often use higher down payments (see below *Section III.F.i.4 "Real Estate"*).

Second, the proposed capital requirements would incentivize the largest banks to allocate more lending to large corporations and investment funds than to small businesses. Similarly, the Proposal would shift from a single capital requirement for all corporate loans to having lower requirements for so-called "investment grade" companies and higher requirements otherwise. It is very easy for large companies to show that they are investment grade, because they have debt that trades on public markets that provide grade classifications. Mid-sized companies and small businesses generally do not have this luxury. Therefore, profit-maximizing GSIBs will be incentivized to do more lending to large companies and less lending to Main Street small businesses. The Proposal does allow for independent, qualitative assessments for the investment grade classification, but because those assessments would require additional time and resources, GSIBs likely would use this feature for the most profitable loans, e.g., loans to hedge funds and private equity firms, rather than loans to midsized and small businesses.

Finally, and perhaps the most egregious aspect that runs counter to the increased lending claim, the Proposal would push even more loan origination away from banks and towards NBFIs, despite the claim by the agencies that the Proposal would do the opposite. All NBFI lending depends on leverage provided through bank loans. For example, NBFI mortgage lending is almost entirely funded through securitized loans from banks, i.e., NBFI mortgage lending would not exist without bank financial support. Bank loans to NBFI credit intermediaries are very profitable, which is why GSIB lending to NBFI credit intermediaries increased around 50 percent last year, as opposed to zero growth in direct lending to real economy borrowers.[34]

The firms subject to this Proposal participate actively in securitization markets, collateralized loan obligation ("CLO") warehousing, and structured credit intermediation. For those institutions, the securitization framework creates a capital incentive so powerful that it incentivizes them away from the direct corporate lending the agencies claim to be encouraging, and toward NBFI and structured credit instead.

The reason is simple math, and the agencies do not address it. Under the Proposal, a direct corporate loan considered "investment grade" held on the balance sheet carries a 65 percent risk weight. A senior tranche of a securitization backed by corporate obligations—a CLO senior note, for example—can carry a risk weight as low as 15 percent under the proposed standardized securitization approach ("SEC-SA") floor. The gap between those two numbers is 50 percentage points, a capital cost differential of more than three to one. For a GSIB with an active capital markets business and ready access to CLO and ABS structuring infrastructure, that differential operates as a constant, permanent incentive to transform direct corporate credit exposure into structured exposure rather than hold it on balance sheet at the higher risk weight. A bank that

[34] Better Markets' analysis based on data from the Call Report.

originates a corporate loan, warehouses it into a CLO structure, retains the senior tranche, and distributes the subordinate tranches to private credit investors has effectively achieved a 50 percentage point reduction in the capital cost of that exposure through structural engineering rather than through any reduction in its economic relationship with the borrowing company. GSIBs are precisely the institutions with the balance sheet size, the broker-dealer affiliates, the warehouse lending capacity, and the structured products infrastructure to execute this transformation at scale.[35] The Proposal permits this arbitrage and deepens it by reducing the senior tranche floor from 20 percent to 15 percent and expanding the conditions under which favorable securitization treatment applies.

The consequence for the Proposal's stated lending objectives is therefore direct and self-defeating. For example, the agencies assert that the reduction of the corporate risk weight from 100 percent to 65 percent for investment grade corporates will incentivize more direct corporate lending by covered banking organizations. However, GSIBs and similar banking organizations in total assets do not make capital allocation decisions based on absolute risk weights in isolation. As noted above, they make them based on **relative risk weights** across competing deployment options priced on a risk-adjusted return on capital basis. Therefore, a GSIB facing a choice between, for example, holding a direct corporate loan at 65 percent risk weight and retaining a senior CLO tranche backed by similar corporate obligations at 15 percent experiences a 50 percentage point structural differential that makes the securitized alternative five times more capital-efficient for the same underlying corporate credit exposure. The agencies' repeated assertions that the Proposal will increase direct corporate lending are likely to be overwhelmed by the incentives of their own securitization framework.[36] Nowhere in the preamble and impact analysis do the agencies make any attempt to model, acknowledge, or reconcile this competing incentive structure that, if finalized, will be the basis for any lending decisions by large banks subject to ERBA going forward.

C. *Rushed, Haphazard and Incomplete Impact Analysis*

The agencies' impact analysis is based in substantial part on data collected for a proposal they have formally rescinded.[37] In effect, the agencies abandoned the rulemaking while continuing to rely on its supporting data. The agencies' impact analysis suffers from a fundamental defect: it relies heavily on data collected to evaluate a proposal that no longer exists and is no longer relevant

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35 *See* Office of Financial Research. *2024 Annual Report to Congress* (2024), at 47–52 (documenting the growth of CLO warehouse lending and securitization structuring activity at large regional banking organizations), available at: https://www.financialresearch.gov/annual-reports/files/OFR-AR-2024_web.pdf.

36 *See* Federal Reserve Board Vice Chair for Supervision Bowman. "When Regulation Reshapes Markets: The Migration of Corporate Lending". Hoover Institution Annual Monetary Policy Conference. (May 8, 2026), available at: https://www.federalreserve.gov/newsevents/speech/bowman20260508a.htm.

37 *Supra* 2, footnote 10. "The agencies are rescinding the 2023 proposal. Members of the public that seek to submit comments on the current proposal must submit comments in line with the procedures described in this proposal."

in key respects. Put another way, a "reliance on insufficient empirical data" would be considered arbitrary and capricious under the APA.[38]

The agencies formally rescinded the 2023 proposal and have replaced it with a materially different Proposal. Yet rather than using evidence-based, best practices impact analysis and conducting an updated quantitative impact study and supervisory data collection tailored to the Proposal actually before the public, the agencies have relied substantially on data, assumptions, and modeling exercises developed to evaluate the now-rescinded 2023 proposal. This is particularly evident in areas such as market risk, where the agencies historically have relied on special data collections and quantitative impact studies because existing supervisory reports do not contain sufficient information to estimate the effects of proposed changes.

That approach is analytically indefensible for an issue of such significance to the U.S. economy and financial system. The key purpose of an impact analysis for a rulemaking proposal is to estimate the effects of the proposal under consideration so the public can meaningfully assess the proposal. It is not to estimate the effects of a prior proposal (that the current agency leadership has decided to rescind as opposed to re-propose) and then assume those estimates remain valid after the proposal has been fundamentally rewritten. The agencies themselves acknowledge that the current proposal differs materially from the rescinded 2023 proposal in numerous respects, including the scope of application, the treatment of market risk, operational risk, securitization exposures, mortgage servicing assets, and other key elements of the capital framework. Having formally rescinded the 2023 proposal, the agencies cannot simultaneously continue relying on ill-suited data collected to evaluate it.

The defect is especially severe because the agencies have selectively retained only those portions of the earlier analysis that support the goals of the current Proposal. The underlying data collection was designed to evaluate a broader and substantially different capital framework. Many components of that framework have now been eliminated, modified, or replaced entirely. The agencies do not explain how the earlier data were adjusted to account for those changes, whether the assumptions remain valid, or whether the results continue to provide a reliable estimate of the effects of the Proposal actually before the public.

The result is an impact analysis that cannot accurately measure the effects of this Proposal. Instead, it measures the effects of a very different proposal that the agencies themselves have concluded should not move forward. The Administrative Procedure Act ("APA") requires reasoned decision-making based on the relevant evidence before the agency. It does not permit agencies to pick-and-choose among recycled data collected for a rescinded rulemaking and treat those estimates as a substitute for a genuine analysis of the proposal under consideration.

If the current Proposal is sufficiently different from the 2023 proposal to warrant rescinding and replacing it, then the current proposal requires its own economic analysis, its own quantitative impact study, and its own supervisory data collection. Commenters are entitled to evaluate the effects of the Proposal that is actually before them, not a proposal that has already been withdrawn.

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[38] *See* Business Roundtable v. SEC, 647 F.3d 1144, 1150 (D.C. Cir. 2011)

The agencies have been notified through this comment process of this significant procedural defect that raises serious concerns under the APA.[39] Through this comment letter and others submitted during the public comment process[40], the agencies have been informed that the Proposal's economic analysis relies substantially on data collections, quantitative impact studies, assumptions, and modeling exercises developed for the 2023 proposal—a proposal that the agencies have formally rescinded and replaced. The agencies have likewise been informed that they have not conducted a new data collection, quantitative impact study, or institution-specific analysis designed to evaluate the Proposal before the public.

This distinction is legally significant. An agency may not rely on stale, inapposite, or incomplete data when evaluating the effects of a proposed rule, particularly where the agency has acknowledged that the underlying proposal has materially changed.[41]

Should the agencies nevertheless proceed to finalize the Proposal without conducting a new economic analysis based on data collected for the Proposal itself, they will be doing so with full knowledge of the analytical deficiency identified in the administrative record. Any rule adopted in these circumstances would be legally vulnerable and could be found arbitrary and capricious under the APA. It may also cause future agency leadership to conclude that the final rule rests on a sufficiently robust evidentiary foundation. A future Board of Governors, Comptroller of the Currency, or FDIC Board could reasonably conclude that the rule's economic analysis was fundamentally flawed because it relied on an ill-suited data collection designed to evaluate a rescinded proposal rather than the proposal ultimately adopted. Such a determination could provide an independent basis to revisit, amend, suspend, or rescind the rule, in whole or in part, following the procedures required by the APA.

The agencies cannot cure this defect by relying on *post hoc* rationalizations in a final rule. To remedy this shortcoming, the agencies must conduct a new data collection, publish a revised impact analysis based on the Proposal actually under consideration, and provide the public an opportunity to comment on that analysis before any final rule is adopted. If the agencies choose not to follow this legally and procedurally sound approach, they will be doing so with full knowledge of the analytical deficiency identified in the administrative record.

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39 *See* Owner-Operator Indep. Drivers v. FMCSA, 494 F.3d 188, 199 (D.C. Cir. 2007) ("The most critical factual material that is used to support the agency's position on review must have been made public in the proceeding and exposed to refutation." or Conn. Light & Power Co. v. NRC, 673 F.2d 525, 530-31 (D.C. Cir. 1982) ("An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary.").

40 *See* Better Markets Comment Letter to the Standardized Approach proposal (*supra* 7).

41 *See* Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 43 (1983) (agency action is arbitrary and capricious where the agency "entirely failed to consider an important aspect of the problem"); FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009) (agencies must provide a reasoned explanation when changing policy); Department of Homeland Security v. Regents of the University of California, 591 U.S. 1, 30–32 (2020) (agency must consider important aspects of the problem and reasonably explain its decision).

D. *Lack of Empirical Support for Compliance with the Collins Amendment*

i. The Agencies Are Silent on Collins Amendment Compliance

The Proposal is conspicuously silent on the agencies' statutory requirement to comply with the Collins Amendment.[42]

1) Background on the Collins Amendment

The Collins Amendment was Congress's most direct response to one of the central prudential failures preceding the global financial crisis: the steady erosion of capital requirements at the largest and most complex banking organizations through increasingly specialized, opaque, and institution-specific regulatory frameworks. Congress observed that agencies had repeatedly permitted large banking organizations to operate under capital methodologies that produced materially lower requirements than those applicable to ordinary insured depository institutions, often based on technical arguments regarding risk sensitivity, internal models, or portfolio characteristics. While those changes were frequently presented as modest refinements, their cumulative effect was to weaken the resiliency of the banking system and leave the largest institutions operating with insufficient loss-absorbing capital when the financial crisis arrived.

To prevent a recurrence of that outcome, Congress enacted a simple, statutory rule. The minimum risk-based and leverage capital requirements applicable to insured depository institutions and their holding companies may not be lower than the generally applicable capital requirements in effect for insured depository institutions under the prompt corrective action framework as of July 21, 2010. Congress intentionally constrained the agencies' discretion because it recognized that prudential standards can be weakened incrementally through technical recalibrations, methodological changes, and institution-specific exceptions that appear reasonable in isolation but collectively undermine safety and soundness.

The Collins Amendment therefore serves as a structural safeguard against the very tendency that gave rise to the global financial crisis: the creation of increasingly specialized capital frameworks for large banking organizations that produce lower requirements than those applicable generally across the banking system. The agencies cannot satisfy the Collins Amendment by relabeling a reduction as a recalibration, by averaging reductions against increases elsewhere, or by redefining what constitutes a "generally applicable" framework. Nor can they satisfy the statute merely by making a highly specialized framework theoretically available to other institutions. Congress enacted the Collins Amendment specifically to prevent the largest banking organizations from receiving preferential capital treatment through regulatory design, as this Proposal would do.

If the agencies aim to reduce capital requirements on the GSIBs and other large banks (however foolhardy that may be), the burden rests exclusively with them (and not on commenters) to demonstrate, transparently and institution-by-institution, that the resulting framework remains above the statutory floor and fully complies with the Collins Amendment. That burden belongs to

42 *Supra* 10.

the agencies, not commenters, and it cannot be satisfied through assumption, assertion, or post hoc explanation.

2) The Agencies' Proposal Does Not Comply with the Requirements of the Collins Amendment (and Pretends Like the Public Won't Notice)

The most significant Collins Amendment issue raised by the Proposal is that the agencies appear to be attempting to satisfy Collins Amendment requirements through an optional election into the ERBA, a framework that was specifically designed primarily for the eight largest and most internationally active banking organizations in the United States. The Collins Amendment unambiguously requires that the minimum capital requirements applicable to large banking organizations not fall below the generally applicable capital requirements applicable to insured depository institutions. Historically, the agencies have interpreted this requirement to mean that the standardized approach served as a floor beneath more complex and institution-specific methodologies that applied to the largest and most complex banking institutions.[43] The standardized approach was generally applicable because it actually applied broadly across the banking system.

3) The Proposal's Elimination of the Dual-Stack Structure Destroys the Primary Mechanism Through Which Collins Compliance Has Been Achieved Since 2011

The Proposal would eliminate the dual-calculation requirement that has served as the primary structural mechanism for Collins Amendment compliance since the agencies implemented it in 2011. Under the current framework, Category I and II banking organizations must calculate risk-based capital ratios under both the standardized approach and the advanced approaches, with the lower of the two serving as the binding requirement. The 2023 proposal explicitly preserved this structure, stating that doing so was necessary to "ensure that large banking organizations would not have lower capital requirements than smaller, less complex banking organizations." The Proposal would eliminate that mechanism without providing a substitute that satisfies the same statutory function. The ERBA-as-optional framework the agencies propose in its place does not replicate the dual-stack floor. A voluntary election is simply an option. The agencies cannot satisfy a statutory floor by converting it into a choice.

Instead of preserving the current approach that clearly satisfies the Collins Amendment, this Proposal would apply a different, unorthodox approach. Rather than demonstrating that the revised standardized approach itself satisfies the Collins Amendment, the agencies appear to

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43 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. Proposed Rule. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. 88 FR 64928 (September 18, 2023), available at: https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant. "To ensure that large banking organizations would not have lower capital requirements than smaller, less complex banking organizations, the proposal would maintain the capital rule's dual-requirement structure. Under this structure, a large banking organization would be required to calculate its risk-based capital ratios under both the new ERBA and the standardized approach (including market risk, as applicable), and use the lower of the two for each risk-based capital ratio."

assume that Collins Amendment compliance concerns are resolved because banking organizations that are not required to adopt ERBA may voluntarily elect to use the ERBA instead of the current standardized approach. Under this upside-down logic, a capital framework designed for GSIBs and other highly complex banking organizations becomes "generally applicable" merely because smaller institutions are permitted to opt into it.

The agencies implicit interpretation cannot be reconciled with the Collins Amendment's text or purpose. Congress enacted the Collins Amendment specifically because it was concerned that increasingly complex and model-driven capital frameworks were producing lower capital requirements at the largest institutions than applied to smaller banks prior to the global financial crisis. Congress responded by requiring a generally applicable floor in the Collins Amendment. The agencies cannot and must not, in a final rule, satisfy that requirement by providing banks not required to apply the ERBA the option to choose the ERBA. If that were sufficient, Congress in the Collins Amendment would have specifically allowed the agencies the option to do so, as the "advanced approaches framework"[44] existed at the time. The Proposal would replace the advanced approaches framework in Subpart E with the ERBA. The agencies cannot find (because it does not exist) any legislative record that any capital methodology could be deemed "generally applicable" simply by making participation optional.

Further, absent the *prima facie* absurdity of a community bank opting into a framework designed for JPMorgan Chase, the agencies provide no evidence that ERBA would even be a viable or attractive framework for the thousands of banking organizations that would theoretically be eligible to elect it. Nor do the agencies attempt to demonstrate that community banks, regional banks, and other non-complex institutions possess the data infrastructure, modeling capabilities, governance structures, personnel, systems, and risk-management frameworks necessary to implement ERBA in a safe and sound manner. The agencies simply assume that the ability to elect a framework is equivalent to the practical ability to use it. The agencies must explain why, if the ERBA is genuinely "generally applicable," the agencies have spent nearly 15 years and hundreds of pages over multiple rulemakings previously explaining that the ERBA was designed for the largest and most internationally active banking organizations.

It is a contradiction in terms. A framework designed for JPMorgan Chase, Goldman Sachs, Morgan Stanley, Bank of America, and Citigroup is not transformed into a generally applicable framework merely because a community bank (that, for example, specializes in agricultural lending) is theoretically permitted to adopt it. The critical point is that "general applicability" requires practical accessibility, not just formal eligibility.

The agencies' failure to address this issue is particularly problematic because the Proposal repeatedly relies on ERBA calibrations and ERBA concepts as justification for reducing standardized approach capital requirements. Yet if ERBA is sufficiently different from the standardized approach to require separate implementation requirements, separate reporting frameworks, separate supervisory expectations, and separate eligibility criteria, then the agencies

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[44] *See* 12 CFR Part 217 Subpart E. "Risk-weighted assets – Internal Ratings-Based and Advanced Measurements Approaches." available at: https://www.ecfr.gov/current/title-12/part-217/subpart-E.

must explain how that same framework suddenly becomes the "generally applicable" benchmark for purposes of the Collins Amendment.

If the agencies intend to rely on optional ERBA election as part of their Collins Amendment rationale, they must provide institution-level evidence demonstrating that the framework is realistically available across for all banking organizations and that its use would not itself produce capital requirements below the statutory floor. At a minimum, the agencies should publish institution-by-institution analysis showing: (1) which institutions could realistically implement ERBA; (2) how many institutions are expected to elect it; (3) the resulting capital impact for every institution that could elect it; and (4) why those outcomes remain consistent with the Collins Amendment.

ii. Commenters Cannot Meaningfully Engage Without the Baseline

The practical consequence of the agencies' failure to publish a Collins Amendment compliance analysis is that the public comment process is structurally compromised. Commenters—including Better Markets, the banking organizations whose capital requirements are subject to change, the consumer groups whose constituents depend on the safety of insured deposits, and the members of Congress whose constituents bear the systemic risk that adequate capital is meant to absorb—cannot evaluate whether the proposed reductions are lawful without knowing whether those reductions violate the statutory floor. "The process of notice and comment rule-making is not to be an empty charade."[45] A comment period that proceeds without this foundational information is a formal exercise in the appearance of public participation without its substance. The agencies cannot cure this deficiency by publishing a Collins analysis after the comment period closes or by including it in a preamble to a final rule. The analysis must be in the public domain, subject to public scrutiny and challenge, before the comment period ends. A prudent approach would be a re-proposal of the changes to the risk weights, including an actual impact analysis, and a full fledged Collins Amendment compliance analysis.

Absent such analysis, the Proposal rests on an unsupported assumption that a framework designed for the largest and most sophisticated banking organizations can be treated as generally applicable merely because participation is theoretically optional. The Collins Amendment was enacted to prevent precisely this type of regulatory maneuver.

iii. Any Final Rule Issued Without A Complete Collins Amendment Analysis Would be Vulnerable to Rescission

The agencies' path forward is clear, and the consequences of failing to follow it are equally clear. Before proceeding with any final rule, the agencies must publish, in the public record and

[45] Conn. Light & Power Co. v. NRC, 673 F.2d 525, 528 (D.C. Cir. 1982) at 530 "To allow an agency to play hunt the peanut with technical information, hiding or disguising the information that it employs, is to condone a practice in which the agency treats what should be a genuine interchange as mere bureaucratic sport."

with sufficient granularity to permit meaningful review by the public, a complete Collins Amendment compliance analysis for every institution affected by the Proposal.

That analysis must establish: (i) the capital requirements applicable to covered institutions as of July 21, 2010; (ii) the capital requirements established by the 2013 Basel III final rule and all other risk-based capital framework changes (SA-CCR, stress capital buffer requirement, etc.); (iii) the net impact of the Proposal on each affected institution; (iv) the potential impact of any election into ERBA by each potential affected institution; and (v) a demonstration, institution-by-institution and framework-by-framework, that the resulting capital requirements do not fall below the statutory floor established by the Collins Amendment.

The agencies must also explain in a separate notice the legal basis for treating ERBA as consistent with the Collins Amendment. Specifically, they must explain how a framework designed for the largest and most internationally active banking organizations can constitute a "generally applicable" capital framework for purposes of the Collins Amendment, particularly where the agencies have repeatedly justified separate capital regimes on the grounds that smaller institutions lack the complexity, scale, systems, and risk profiles of the institutions for which ERBA was designed.

If the agencies proceed to finalize the Proposal without publishing that analysis, any resulting final rule would rest upon an unproven interpretation of the Collins Amendment and an incomplete administrative record. Such a rule would be vulnerable to challenge as arbitrary, capricious, contrary to law, and unsupported by substantial evidence.

The agencies are further on notice that commenters, including Better Markets, have specifically challenged the proposition that an optional election into ERBA satisfies the Collins Amendment. The agencies have likewise been placed on notice that they have failed to demonstrate institution-level, exposure-level, and framework-level compliance with the Collins Amendment. Should the agencies nevertheless proceed without addressing these issues, they will do so with full knowledge that significant questions have been raised regarding the legal validity of the Proposal.

That fact may be relevant in any future judicial review. It may also be relevant to future agency leadership evaluating whether the final rule rests upon a legally sustainable interpretation of the Collins Amendment. A future Board of Governors, Comptroller of the Currency, or FDIC Board could—and in our view should—reasonably conclude that the agencies' interpretation of "generally applicable" is inconsistent with the text, structure, purpose, and legislative history of the Collins Amendment and that reliance on optional ERBA election as a basis for compliance was unlawful. Such a determination could provide an independent basis to revisit, amend, suspend, or rescind the rule, in whole or in part, following the procedures required by the APA.

If the agencies proceed to finalize this rule without publishing that analysis, any resulting final rule will be infirm on its face—a violation of an explicit statutory command enacted by Congress for the express purpose of preventing exactly the kind of unilateral, one-directional capital reduction that this Proposal represents and is unlawful under the Dodd-Frank Act. Affected parties in federal court and future agency principals will have strong grounds to seek rescission of any such final rule. Those grounds will be stronger because the agencies have been provided *explicit* notice in this comment letter of this deficiency during the comment period and chose to proceed regardless.

The agencies cannot cure these defects through post hoc explanations in a final rule. The required analysis must be published, subjected to public scrutiny, and made available for comment before any final rule is adopted.

E. The Proposal Undercuts the Premise (and Future) of the Basel Framework

The history of the Basel III reforms is, in significant part, a history of U.S. regulatory leadership.[46] Following the global financial crisis, U.S. regulators correctly argued that global banking organizations could not be effectively regulated through a patchwork of inconsistent national capital standards. The crisis demonstrated that weaknesses in one jurisdiction could rapidly transmit across borders and that internationally active banking organizations would inevitably exploit gaps and inconsistencies between national regulatory regimes. In response, the United States became one of the principal advocates for stronger and more consistent international capital standards through the Basel Committee.

The reforms that ultimately became known as the Basel III "endgame" package emerged from over a decade of technical analysis, quantitative impact studies, negotiations, and compromises among member jurisdictions. U.S. regulators were deeply involved throughout that process. They participated in the development of the Fundamental Review of the Trading Book ("FRTB"), revisions to the standardized approach for credit risk, operational risk reforms, leverage requirements, and the output floor.[47]

One of the principal criticisms directed at the Basel III final reforms process has been made by European banking organizations that many of the reforms reflected the regulatory preferences of the U.S. agencies. European policymakers repeatedly expressed concern that elements of the framework disproportionately reflected lessons drawn from the U.S.'s global financial crisis experience and the reforms would disproportionately increase capital requirements for European institutions. Nevertheless, after years of negotiation, jurisdictions ultimately reached agreement, and the Basel Committee finalized many of the reforms in December 2017 and the remaining FRTB portion in 2019.[48]

However, since the Basel III final reforms were agreed to, implementation has become another nearly decade-long exercise in delay, revision, and retrenchment. The United States repeatedly assured international counterparts that implementation remained a priority. Most

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46 The central role of the United States in developing the international bank regulatory framework goes back many decades, including to former Fed Chair Paul Volcker. *See* Stefan Ingves, "The Evolution of the Basel Committee" (September 26, 2013), available at: https://bis.org/speeches/sp130926.htm.

47 *See* Government Accountability Office. Bank Capital Reforms: U.S. Agencies' Participation in the Development of International Basel Committee Standards. (March 26, 2025), available at: https://www.gao.gov/products/gao-25-107995.

48 *Supra* 11.

notably, in September 2022, the Board, FDIC, and OCC jointly reaffirmed their commitment to implementing the final Basel III standards and stated that implementation was a regulatory priority.[49] Yet despite those assurances, the United States remains unable to complete implementation nearly nine years after the majority of the standards were agreed to.

What makes the current Proposal particularly troubling is that it arrives after many other jurisdictions have already proceeded with implementation decisions based upon expectations that the United States would ultimately honor its commitments. Japan and Canada have largely completed implementation of the Basel III finalization package. Numerous other jurisdictions have committed substantial supervisory resources and imposed significant compliance costs on their banking sectors in reliance upon the expectation that major Basel Committee members would move broadly together toward implementation.[50]

Rather than completing that process, however, the United States has repeatedly reopened settled questions and substantially reconsidered the framework after the fact. The result has been increasing uncertainty among foreign regulators and growing skepticism regarding whether U.S. commitments in Basel negotiations remain meaningful. That well-earned skepticism of the agencies has now produced negative real-world consequences.[51]

In 2026, the European Union announced a further delay in implementation of the Fundamental Review of the Trading Book, explicitly citing concerns regarding international consistency and uncertainty surrounding U.S. implementation.[52] The United Kingdom has taken similar actions.[53] In effect, foreign jurisdictions are now delaying implementation because they cannot determine whether the United States intends to proceed with standards that it helped negotiate and publicly endorsed.

This development should alarm the agencies, particularly because it reflects a significant loss in their credibility. For decades, the U.S. agencies have argued that international coordination is necessary to prevent regulatory arbitrage and competitive deregulation. Yet the current Proposal is contributing to precisely the opposite outcome. The United States has become the principal

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49 *See* Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. "Agencies reaffirm commitment to Basel III standards" (September 9, 2022), available at: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20220909a.htm.

50 *See* Basel Committee on Banking Supervision. Adoption of key Basel III standards as of 5/31/2026, available at: https://www.bis.org/bcbs/implementation/rcap_reports.htm.

51 *See* Neil Esho. Secretary General of the Basel Committee on Banking Supervision. "Just Get it Done." (December 10, 2025), available at: https://www.bis.org/speeches/sp251210.pdf.

52 *See* European Commission. Commission adopts temporary adjustments to Basel III Market Risk Rules to safeguard EU banks' competitiveness. (June 4, 2026), available at: https://finance.ec.europa.eu/news/commission-adopts-temporary-adjustments-basel-iii-market-risk-rules-safeguard-eu-banks-2026-06-04_en.

53 Prudential Regulatory Authority. "The PRA announces a delay to the implementation of Basel 3.1" (January 17, 2025), available at: https://www.bankofengland.co.uk/news/2025/january/the-pra-announces-a-delay-to-the-implementation-of-basel-3-1.

source of uncertainty in the Basel III final reforms implementation process. Other jurisdictions are increasingly reluctant to proceed because they fear placing their domestic institutions at a competitive disadvantage if the United States ultimately adopts the Proposal's materially weaker framework (especially for market risk).

The resulting dynamic is self-reinforcing. Delays by the agencies have resulted in delays by peer foreign jurisdictions, which are then cited as justification for additional U.S. departures. The international consensus gradually weakens despite no jurisdiction formally rejecting the standards themselves.

The agencies should explain how this outcome advances either financial stability or international competitiveness. More fundamentally, the Proposal raises serious questions regarding the future of international prudential coordination itself. If Basel standards are intended to represent minimum commitments among participating jurisdictions, the agencies should explain how repeated delays and material departures are consistent with those commitments. If, alternatively, Basel standards are now viewed merely as optional policy recommendations that can be substantially rewritten years after negotiations conclude, the agencies should explain why regulators continue to devote enormous public resources to negotiating them.

The current situation is unsustainable. Nearly twenty years after the global financial crisis and almost a decade after the Basel Committee finalized these reforms, the international community remains unable to implement standards that regulators universally acknowledge were necessary to address vulnerabilities exposed by that crisis.

Rather than creating yet another round of jurisdiction-specific modifications and implementation delays, the agencies should use this rulemaking to reaffirm a clear commitment to international coordination and explain how they intend to restore their own credibility to a process that the United States once led but now increasingly appears to be undermining.

The agencies spent years and extensive amounts of limited staff resources urging other jurisdictions to adopt stronger standards. Now the agencies point to delays in those same jurisdictions—delays caused in part by U.S. uncertainty—as justification for weakening the U.S. framework. The agencies are effectively citing the consequences of their own implementation failures as support for additional departures from the agreed standards.

The agencies should also acknowledge a deeper concern. By repeatedly delaying implementation while simultaneously encouraging other jurisdictions to wait for U.S. action, regulators are effectively creating an informal international emergency brake on prudential reform. Any major jurisdiction can slow or derail implementation simply by signaling uncertainty regarding its own intentions. That dynamic transforms what was intended to be a coordinated system of minimum prudential standards into a process in which political hesitation in one jurisdiction becomes a justification for regulatory retreat everywhere else. The Proposal provides no explanation for why the agencies believe that outcome serves the public interest.

i. Administrative Procedure Act and the Domestic Implementation of the Basel Framework

The APA[54] requires agencies to engage in reasoned decision-making. When an agency changes position, it must acknowledge that change, explain the reasons for it, and provide a rational basis for departing from prior policy judgments. An agency may change course, but it may not simply ignore its previous positions or act as though they never existed. "An agency may not, for example, depart from a prior policy *sub silentio* or simply disregard rules that are still on the books."[55]

For years, the agencies repeatedly represented to Congress, market participants, foreign regulators, and the public that implementation of the Basel III final reforms in the United States was a priority.[56] The agencies made those commitments after participating in the Basel negotiations, after the standards had been finalized, and after years of public discussion regarding implementation. Yet the Proposal contains no meaningful discussion of how the agencies' current approach relates to those prior commitments.

If the agencies continue to believe that aligning with the Basel standards remains an important prudential objective for its policy implementation, they must explain why the substantial departures, recalibrations, and capital reductions contained in the Proposal remain consistent with that objective. Conversely, if the agencies have concluded that implementation of the Basel standards is no longer a priority or that material deviations are appropriate, they should explicitly acknowledge that policy change and explain the basis for it. The Proposal does neither.

The Proposal does not provide a basis for the public to understand the agencies' perspective on engagement with the Basel framework. For example, the agencies have not sufficiently identified or explained the principles that govern their current and future approach to international capital standards. They do not explain whether and how Basel standards remain minimum commitments that participating jurisdictions should generally implement. They do not explain (outside of generalities) whether international consistency remains an important regulatory objective. They do not explain in any level of detail consistent with the importance of this Proposal why standards that the agencies helped negotiate and repeatedly endorsed should now be modified in significant respects. Nor do they explain how the resulting framework promotes the international

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54 5 U.S.C. §§ 551–559, 701–706.

55 FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009). ("To be sure, the requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it *is* changing position").

56 *Supra* 49. *See also* Governor Randal K. Quarles. Federal Reserve Board. "Between the Hither and the Farther Shore: Thoughts on Unfinished Business." (December 2, 2021), available at: https://www.federalreserve.gov/newsevents/speech/quarles20211202a.htm. "I had hoped that the US would have led the world in setting out a concrete proposal to implement the Basel III endgame by the end of last year, but the intervention of COVID set back that timetable, and although we are working hard with the other banking agencies to iron out the last issues, our proposal will have to come after my departure."

comparability and regulatory consistency that historically justified U.S. participation in the Basel process.

These omissions are particularly significant because the agencies appear to rely heavily on international competitiveness concerns when justifying aspects of the Proposal, including risk weights for major elements of the Proposal that agencies never justify the calibration of.[57] Yet those concerns arise, at least in part, from implementation delays and deviations that the agencies themselves helped create. The Proposal therefore risks relying upon the consequences of prior regulatory departures as justification for further departures without ever acknowledging the underlying change in policy.

The agencies cannot simultaneously claim credit for leading the Basel III final reforms process, cite Basel negotiations as evidence of the technical rigor underlying their proposals, and then treat the resulting standards as optional when implementation becomes politically difficult. The APA requires the agencies to explain which of these positions reflects current policy.

Before adopting a final rule, the agencies must explain:

1. Whether they continue to view the Basel framework as minimum international commitments that the agencies and other participating jurisdictions are expected to implement;
2. Whether they remain committed to achieving and promoting substantial consistency with the Basel framework;
3. The specific respects in which the Proposal departs from the Basel III final reforms;
4. The empirical and policy basis for each such departure;
5. Whether the agencies are abandoning prior statements describing Basel implementation as a regulatory priority; and
6. How the Proposal advances the objectives of international comparability, regulatory consistency, and reduction of regulatory arbitrage that historically justified U.S. participation in the Basel process.

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[57] The agencies derive authority to promulgate capital requirements from their general safety-and-soundness rulemaking powers and from specific statutory mandates, including the International Lending Supervision Act of 1983 (“ILSA”), 12 U.S.C. § 3907, which directs the agencies to work toward “international convergence of supervisory policies and practices.” No statute requires the agencies to adopt or adhere to Basel Committee standards, and the Basel framework carries no binding legal force in the United States. *See* 12 U.S.C. § 3907; *see also* 12 U.S.C. §§ 93a, 248, 1819, 1831o, 1844(b), 5365, 5371. Accordingly, each element of a domestically implemented Basel standard must independently satisfy the requirements of the Administrative Procedure Act, including the requirement that agency action not be arbitrary or capricious. 5 U.S.C. § 706(2)(A). The agencies may not insulate a policy choice from reasoned-decision making review by attributing it to an international consensus. *See also supra* 41, Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

ii. The Agencies Should Explain Whether They Intend to Subject the Final Rule to Basel Committee RCAP Review and Whether International Compliance Remains a Regulatory Objective

The Proposal also raises fundamental questions regarding the agencies' continued commitment to the Basel Committee's Regulatory Consistency Assessment Programme ("RCAP").[58]

Following the global financial crisis, Basel Committee members recognized that the effectiveness of international capital standards depended not only upon agreement regarding the standards themselves but also upon consistent implementation across jurisdictions.[59] To address that concern, the Basel Committee established the RCAP process to evaluate whether member jurisdictions had adopted regulations that were materially consistent with Basel requirements and to identify deviations that could affect prudential outcomes or competitive equality.

The United States was previously a strong supporter of the RCAP process. U.S. regulators repeatedly emphasized the importance of internationally consistent implementation and participated in assessments of other jurisdictions. RCAP became one of the principal mechanisms through which regulators sought to ensure that Basel standards would function as genuine international minimums rather than merely aspirational guidelines.

The Proposal does not address the RCAP process. The agencies do not identify whether they expect the Proposal to be assessed under the RCAP framework. Further, they do not discuss whether the departures from Basel reflected in the Proposal would affect a future U.S. RCAP determination. They do not estimate whether the Proposal would likely be considered compliant, largely compliant, materially non-compliant, or non-compliant with Basel standards. Nor do they explain whether such distinctions continue to matter as a matter of U.S. regulatory policy.

The agencies cannot simultaneously invoke the credibility, technical expertise, and international legitimacy associated with the Basel process while remaining silent regarding the principal mechanism established to evaluate implementation fidelity. If the agencies believe that the Proposal remains substantially consistent with Basel standards, they should state that conclusion and explain the basis for it. If the agencies believe the Proposal would not satisfy RCAP expectations, they should identify the relevant deviations and explain why those departures are justified.

Accordingly, the agencies should specifically address the following questions before finalizing any rule:

- Do the agencies intend to submit the final rule for RCAP assessment?

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58 *Supra* 50.

59 *See* Basel Committee on Banking Supervision. *Regulatory Consistency Assessment Programme* (2012), available at: https://www.bis.org/bcbs/implementation/rcap_role.htm.

- Do the agencies believe the final rule would receive a finding of compliant, largely compliant, materially non-compliant, or non-compliant implementation under the RCAP framework?
- Have the agencies conducted any internal assessment of likely RCAP outcomes?
- Have the agencies consulted with the Basel Committee regarding the Proposal's consistency with Basel standards?
- Do the agencies continue to believe that RCAP assessments serve an important supervisory purpose?
- Do the agencies believe it is significant if the United States were found materially non-compliant with standards that U.S. regulators helped negotiate and publicly committed to implement?

That omission is particularly notable because other jurisdictions have already adjusted implementation schedules in response to uncertainty surrounding U.S. implementation.[60] The agencies, therefore, cannot reasonably characterize the Proposal as a purely domestic matter. Decisions regarding the degree of U.S. compliance with Basel standards have direct implications for the functioning of the international prudential framework and for the credibility of future U.S. commitments in international regulatory negotiations.

At a minimum, the agencies should clearly disclose whether compliance with RCAP expectations remains a policy objective. If the agencies no longer view RCAP outcomes as significant, they should explain why. If they continue to view RCAP compliance as important, they should explain how the Proposal advances that objective and identify any respects in which they anticipate the United States would be found deficient.

Interested parties cannot meaningfully evaluate the Proposal without understanding whether the agencies believe continued compliance with the international standards they helped create remains an important component of U.S. prudential regulation.

F. Credit Risk

The agencies describe this Proposal as improving the "risk sensitivity" of capital requirements, suggesting the changes better align capital with actual risk under the new ERBA. However, risk-sensitivity done correctly goes in both directions, and nearly every material change to risk weights in this Proposal reduces capital requirements. A framework that is selectively "more sensitive" only when sensitivity reduces capital represents a capital-reducing approach with risk-sensitivity as a *post-hoc* justification.

The agencies present no evidence that any current standardized risk weight is set too high, creating an asymmetric picture where the capital framework has been systematically over-calibrated in one direction. This is implausible given the well-documented history of banks

[60] *Supra* 50.

operating with inadequate capital before and during the global financial crisis and the 2023 regional bank failures.

The appropriate method for applying risk weights to credit risk is to analyze historical loss experience, stress outcomes, and through-the-cycle capital needs, and then derive the appropriate risk weight. This is particularly important given the removal of the internal models based approach and that banking organizations will be utilizing these risk weights to make lending decisions that affect nearly all Americans. However, the record does not show the agencies followed that path here. Better Markets included specific comments about each element of the risk weight changes, including support for certain technical changes in the off-balance sheet and commitment definitions that would improve the capital framework.

i. Mortgage Servicing Assets

Mortgage servicing assets ("MSAs") are complex, interest-rate-sensitive assets whose value can deteriorate rapidly during periods of housing or financial stress. Accordingly, the agencies have long limited the inclusion of MSAs and other intangible assets in regulatory capital because of the high level of uncertainty regarding the ability of banking institutions to realize value from these assets, especially under adverse financial conditions.

Under the current capital rule, MSAs that exceed 25 percent of a banking organization's tier 1 capital are deducted from regulatory capital, which constitutes a very high concentration of MSAs for an individual banking organizations.[61] Therefore, MSAs not subject to the deduction are subject to a 250 percent risk weight. The Proposal would remove that deduction and would apply the 250 percent risk weight to all MSAs.

The agencies should retain the current treatment of MSAs in regulatory capital. The existing Basel III framework appropriately recognizes that MSAs are not equivalent to common equity capital that is unquestionably available to absorb losses in stress. Those current limitations for MSAs reflect the agencies' longstanding recognition that these assets may become difficult to value, monetize, or rely upon during periods of financial instability. Weakening these safeguards would risk overstating the quality and loss-absorbing capacity of regulatory capital.

The Proposal does not provide a sufficient rationale for why the current approach does not appropriately capture the risk of MSAs. It provides vague and unsubstantiated points that MSAs "allow cross-selling of products" and that they are "important for banking organizations to maintain their relationship with borrowers." While worthy objectives, they do not account for the substantial valuation risk that a highly concentrated holding of MSAs can pose to a bank.

The current treatment of MSAs reflects the hard-earned lessons learned during the global financial crisis and its aftermath. During that period, mortgage servicing valuations and servicing operations came under severe strain as delinquencies, foreclosures, operational costs, and litigation

[61] 12 CFR 217.22(a)(2) and 12 CFR 217.22(d).

exposures surged across the financial system.[62] The crisis demonstrated that assets tied to mortgage servicing can become highly volatile precisely when strong capital is most needed. In adopting the Basel III capital framework in 2013[63], the agencies explained that "MSAs like other intangible assets, have long been either fully or partially excluded from regulatory capital in the United States because of the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions." The same core judgment remains sound today, particularly given ongoing uncertainty in residential and commercial real estate markets and the continued sensitivity of servicing valuations to interest-rate conditions.

In their 2016 joint report to Congress[64] on the effect of capital rules on MSAs, the Board, FDIC, OCC, and National Credit Union Administration explained that MSAs "pose certain risks" and therefore warrant limits on inclusion in regulatory capital. Specifically, the agencies emphasized that MSAs are subject to "a high level of uncertainty" regarding their realizable value under adverse financial conditions and noted that the FDIC, acting as receiver for failed institutions, had found MSAs to be "generally unmarketable at book value during periods of market volatility." These findings strongly support retaining a conservative regulatory capital treatment for MSAs rather than further weakening CET1 quality through expanded recognition of intangible assets.

Critically, the agencies' current framework emerged from a deliberate post-crisis effort to improve both the quantity and quality of regulatory capital following the global financial crisis. As the 2016 report explains, the revised Basel III capital framework strengthened eligibility criteria for regulatory capital for intangible assets like MSAs. The agencies considered several alternatives during the Basel III rulemaking process, including full deduction of MSAs from capital, but ultimately adopted the current threshold deduction framework combined with a heightened 250 percent risk weight for amounts not deducted. That balanced approach appropriately reflects the risks posed by MSAs while still recognizing that such assets may retain some economic value under normal conditions.

The historical experience of bank failures further supports maintaining a cautious approach. The agencies' report found that, among the 518 banking institutions that failed between 2007 and 2015, 66 institutions held MSAs at the time of failure, and in several cases "problems with MSAs" were identified as significant contributing factors. In addition, the report documented the dramatic increase in servicing costs following the financial crisis, including a more than fourfold increase in the annual cost of servicing nonperforming loans between 2008 and 2015.

62 *See* Federal Reserve Board. *Report to the Congress on Risk Retention* (October 2010), at 35–37, available at: https://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.html.

63 *Supra* 14 at 62070 and 62073 ("These risks are sufficiently significant that concentrations in these assets warrant deductions from capital, and any exposure to these assets merits a higher-than 100 percent risk weight.").

64 *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and National Credit Union Administration. *Report to the Congress on the Effects of Capital Rules on Mortgage Servicing Assets.* (June 2016), available at: https://www.federalreserve.gov/publications/other-reports/files/effect-capital-rules-mortgage-servicing-assets-201606.pdf.

Further, the report documented that MSAs at 31 of the 36 failed banks that held them after the financial crisis had no net recovery value in a sale transaction. These findings demonstrate that mortgage servicing activities can become operationally and financially burdensome precisely when broader economic conditions deteriorate. Allowing greater amounts of MSAs to count toward regulatory capital risks overstating the resiliency of banking organizations during periods of severe stress.

The existing treatment also appropriately mitigates the risk that banking organizations will increasingly rely on difficult-to-value intangible assets to satisfy minimum capital requirements. Mortgage servicing assets derive their value from assumptions regarding prepayments, interest rates, borrower behavior, servicing costs, and market liquidity, all of which can change abruptly during economic stress. As a result, MSA valuations can be highly procyclical and may fluctuate materially with changes in interest rates and mortgage refinancing activity. Prudential capital standards should prioritize simple, transparent, and reliably loss-absorbing forms of capital rather than increasingly optimistic treatment of assets whose realizable value may evaporate under stress conditions.

The agencies should also consider the broader systemic implications of expanding favorable capital treatment for MSAs. Following the financial crisis, mortgage servicing activity increasingly migrated toward nonbank mortgage servicers, many of which rely on fragile funding structures and operate with significantly weaker prudential safeguards than insured depository institutions.[65] Regulators, including the Financial Stability Oversight Council, have repeatedly warned that mortgage servicing activities can create liquidity strains and contagion risks during periods of market disruption. Allowing banking organizations to count greater amounts of MSAs toward regulatory capital could further increase interconnectedness between insured banks, mortgage servicing markets, and broader housing finance risks at a time when interest-rate volatility remains elevated.

In sum, MSAs are among the most unreliable assets a bank can hold for capital purposes. They are Level 3 assets, model-dependent, and carry no observable market price. MSA valuations are inherently subjective and subject to forecast uncertainty that is exacerbated under adverse financial conditions. The agencies' longstanding policy framework to limit MSA inclusion in regulatory capital reflected a deliberate and evidence-based judgment about the unreliability of these assets as a genuine loss-absorbing buffer. No justification or analysis in the Proposal identifies new evidence that overturns those findings. To the contrary, the 2023 failures of SVB and Signature Bank—driven by interest rate risk that was obscured by inadequate capital treatment—reaffirm the exact principle why regulators should not allow banks to substitute model-generated, stress-sensitive asset values for the real, loss-absorbing capital that protects depositors, the Deposit Insurance Fund, and the broader public.

It is confounding that the agencies are proposing to simultaneously require Category III and IV banks to recognize AOCI in regulatory capital (i.e., because unrealized losses matter) and then allow those same banks to count greater volumes of an illiquid asset that has been shown to

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[65] *See* Government Accountability Office, *Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened* (GAO-16-278) (March 10, 2016), available at: https://www.gao.gov/products/gao-16-278.

be worthless in failure as regulatory capital. Therefore, retaining the current MSA deduction framework is consistent with Congress's intent in the broader post-crisis effort to strengthen both the quantity and quality of regulatory capital. The purpose of common equity tier 1 capital is to ensure that banking organizations maintain substantial, reliable loss-absorbing resources during periods of severe stress, not merely to satisfy minimum ratios during normal economic conditions. The agencies should maintain the current approach to MSAs and not weaken it further.

ii. On Balance Sheet Exposures

1) *Sovereign Exposures*

The Proposal would make significant changes to how GSIBs and Category II banking organizations calculate risk-weighted assets across nearly every exposure class, yet it is silent on one of the treatment of sovereign exposures (the most widely recognized structural deficiencies in the Basel framework).

Under the current standardized approach, exposures to sovereigns denominated and funded in domestic currency receive a zero percent risk weight, meaning that GSIBs are required to hold zero capital in the risk-based capital framework against their holdings of U.S. Treasury securities and other sovereign obligations regardless of the size or concentration of those positions. The Proposal does not revisit, question, or update this treatment in any respect. This silence is especially concerning because the fiscal situation of the United States, sovereign debt sustainability, and Treasury market volatility are subjects of serious concern among regulators, investors, and the institutions the agencies supervise. In other words, declining to re-examine sovereign risk in the Proposal represents a significant policy failure.

The agencies cannot credibly claim this question has not been raised. In January 2015, the Basel Committee established a high-level Task Force on Sovereign Exposures to review the regulatory treatment of sovereign risk. The Basel Committee completed that review and published a discussion paper in December 2017 concluding that the issues raised were important and could benefit from broader discussion.[66] However, the Basel Committee chose to not make any changes to the treatment of sovereign exposures because it had not reached "consensus". The Task Force's report analyzed issues concerning the regulatory treatment of sovereign exposures across the Basel framework and outlined a range of potential policy options, but the Basel Committee ultimately decided not to consult formally on any of them. Nearly a decade later, the agencies have now proposed a comprehensive rewrite of capital requirements for the largest and most complex institutions and have again chosen to leave sovereign risk entirely unaddressed.

The zero percent risk weight rests on assumptions that deserve explicit scrutiny at this juncture. The original decision to assign a zero percent risk weight to sovereign exposures in Basel I was apparently made without empirical analysis and was driven primarily by the recognition of the crucial role of sovereign bonds in the functioning of financial markets, the desire to foster development of local bond markets, and the desire to avoid interference with fiscal and monetary

[66] *See* Basel Committee on Banking Supervision. "The regulatory treatment of sovereign exposures." Discussion Paper. (December 2017), available at: https://www.bis.org/bcbs/publ/d425.pdf.

policy. Regardless of the validity of those considerations at the time, they cannot serve as a permanent exemption from capital requirements in the current context where sovereign default risk, interest rate volatility, and concentrated sovereign exposures at major financial institutions have all demonstrated material systemic consequences.

The April 2025 Treasury market volatility episode—in which 10-year Treasury yields surged more than 60 basis points in a single week, producing price declines of approximately 5 percent on 10-year Treasuries—provided a concrete demonstration of the risks embedded in large, zero-weighted sovereign portfolios. GSIBs carry substantial holdings of Treasury securities and agency obligations on their balance sheets. Under the current framework and as proposed, those holdings generate zero risk-weighted assets and therefore require zero risk-based capital, regardless of their duration, concentration, or potential price volatility.

Better Markets urges the agencies to explain in any final rule why they have chosen not to revisit the zero percent risk weight for sovereign exposures at this time and what analytical basis supports that choice given current conditions. The Basel Committee's own Task Force concluded that all sovereign exposures entail risk and that the existing framework's treatment was worthy of reconsideration. The agencies are not bound by the Basel Committee's decision to do nothing. A Proposal that would recalibrate risk weights across every major exposure class while leaving sovereign risk entirely unaddressed does not present a coherent picture of how the agencies understand the actual risk profile of the institutions they supervise.

The agencies must: (1) publish their analysis of the systemic risk implications of concentrated sovereign exposures at U.S. GSIBs, including the interest rate and duration risk embedded in those portfolios; (2) explain why the zero percent risk weight remains appropriate in light of the Basel Committee's conclusion that sovereign exposures entail risk and the demonstrated price volatility in Treasury markets; and (3) commit to a formal review of sovereign risk capital treatment as part of the next capital rulemaking cycle, rather than allowing a decade-old deference decision by an international committee to serve indefinitely as the de facto U.S. policy position.

2) Government Sponsored Enterprises

The Proposal's analytical failure to reassess the treatment of sovereign risk also extends to its treatment of exposures to government-sponsored enterprises ("GSEs"). Like the zero percent risk weight for sovereigns, the 20 percent risk weight assigned to GSE obligations and Federal Home Loan Bank ("FHLB") equity investments was calibrated decades ago in a financial context that no longer exists. The Proposal carries it forward without any contemporaneous justification any engagement with the significant developments that have significantly changed the GSE landscape since that weight was set by the agencies. Under both the existing standardized approach and the proposed ERBA, FHLB subordinated debt instruments receive a 20 percent risk weight—the same preferential treatment accorded to FHLB senior debt—while preferred stock in all other GSEs receives a 100 percent risk weight. The Proposal does not explain why FHLB equity would warrant treatment equivalent to senior debt, why it warrants more favorable treatment than equity in other GSEs, or why a weight established in 2001 remains appropriate for institutions whose systemic role, risk profile, and demonstrated vulnerability have all changed materially in the intervening quarter century.[67]

The 20 percent risk weight was originally assigned to FHLB member equity based on the agencies' placement of FHLBs in the 20 percent risk weight category, though they noted at the time that they were actively reviewing this treatment and considering the new capital structure being established. That review was conducted in 2001 and was never concluded. The agencies have since carried the 20 percent risk weight through every subsequent capital rulemaking.

Recent events call into question this policy choice.[68] Member banks of FHLBs are required to hold equity in their regional FHLB as a condition of membership and as a prerequisite to accessing advances. The equity is not freely tradeable, cannot be sold to third parties, can only be redeemed by the FHLB itself, and is subject to restrictions on repurchase during periods of financial stress. Therefore, it is an illiquid, captive investment whose value is directly tied to the financial condition of an institution whose own demonstrated vulnerability to member credit concentration has been confirmed by experience.

During the global financial crisis, the FHLBs of Seattle and Chicago saw the value of their investments decline and the value of their capital drop to 1.0 percent and 1.5 percent of their assets, respectively. Although the FHLB of Chicago eventually recovered as its earnings increased, the FHLB of Seattle failed to regain sufficient profitability and was merged with the FHLB of Des Moines without any federal assistance. That effective failure was driven in significant part by the insolvency of Washington Mutual, which had accounted for approximately one-third of the Seattle FHLB's lending—demonstrating that FHLB equity is not insulated from member credit risk and that a single large member's failure can materially impair an individual FHLB's capital position, rendering the equity held by other member banks worth materially less than its book value. A 20 percent risk weight that does not account for this concentration and liquidity risk understates the actual exposure member banks carry.

The 2023 banking crisis reinforced and made more acute these concerns. As SVB faced its liquidity crisis, it used the FHLB system to borrow heavily, becoming the San Francisco FHLB's largest borrower with $20 billion in advances.[69] The FHLB is the lender of next to last resort, and when a bank fails, the FHLB is the only entity that gets paid out ahead of the FDIC—meaning the more indebted a bank is to the FHLB, the greater the losses borne by taxpayers if the bank fails. In the months leading up to the failures of Silvergate, SVB, and Signature Bank, all three banks significantly increased their borrowings from the San Francisco FHLB. The FHLB system was functioning as a liquidity provider of last resort to institutions already in financial distress—a role

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67 *See* Congressional Budget Office. "The Role of Federal Home Loan Banks in the Financial System" (March 2024), available at: https://www.cbo.gov/publication/60064.

68 *See* Better Markets Comment Letter to the Board's GSIB Surcharge Proposal *Section VII.D*. for more information on the systemic risk issues related to banks' exposures to FHLBs.

69 *See* U.S. Government Accountability Office "Federal Home Loan Banks: Role During Financial Stress and Members' Borrowing Trends and Outcomes" (December 2025), available at: https://www.gao.gov/products/gao-26-107373.

it was explicitly not designed to fill and one that directly implicates the credit quality of the equity that all other member banks are required to hold.

This dynamic exposes a procyclical structural flaw that the 20 percent risk weight compounds. When a member bank experiences financial stress, it draws on FHLB advances to fund deposit outflows. Drawing on those advances requires the member to purchase additional activity-based capital stock in the FHLB—increasing the member's FHLB equity exposure at exactly the moment the FHLB's own credit quality may be deteriorating due to concentrated lending to distressed institutions. When the member fails, the FHLB's super-lien priority ahead of the FDIC means the FHLB is made whole at the expense of the FDIC's Deposit Insurance Fund, while the member's equity investment in the FHLB is wiped out and other member banks holding FHLB stock face potential impairment. Board staff have warned that FHLBs face significant rollover risk given the maturity transformation inherent in their business model, and that the greatest source of vulnerability may be the possibility that investors lose confidence in an FHLB's implicit government backstop (a loss of confidence that could destabilize the FHLB system and short-term funding markets more broadly).[70] The GAO similarly found that the bank failures and related liquidity stress of March 2023 highlighted challenges to timely coordination between the FHLBs and Federal Reserve Banks—a breakdown directly relevant to capital adequacy, because the prudential regulators who set the 20 percent risk weight have limited visibility into FHLB lending decisions that can materially affect the credit quality of the equity their supervised institutions are required to hold.

Better Markets urges the agencies to address in the final rule: (1) the empirical basis, if any, for the continued application of a 20 percent risk weight to FHLB equity investments, including a specific analysis of the illiquidity, concentration, and tail-risk characteristics of mandatory member stock; (2) whether the risk weight should be recalibrated to reflect the demonstrated vulnerability of individual FHLBs to member concentration risk, as confirmed by the near-failure of FHLB Seattle in 2008; (3) whether the activity-based stock purchase requirement—which forces distressed member banks to increase their FHLB equity exposure precisely when FHLB credit quality is most likely to be impaired—creates a procyclical dynamic that the current risk weight fails to capture; and (4) how the FHLB's super-lien priority over the FDIC interacts with the capital treatment of FHLB equity, given that the super-lien directly increases DIF losses whenever a heavily indebted FHLB member fails.

3) Exposures to Depository Institutions

The Proposal would assign risk weights to exposures to depository institutions, foreign banks, and credit unions based on a grading system (i.e., Grade A, Grade B, and Grade C), in which Grade A institutions receive the most favorable risk weight treatment and Grade C institutions receive the least favorable risk weight treatment. The key determinant of Grade A classification is whether the counterparty institution meets its minimum regulatory capital

70 *See* Federal Reserve Board. "The Increased Role of the Federal Home Loan Bank System in Funding Markets, Part 3: Implications for Financial Stability" (October 18, 2017), available at: https://www.federalreserve.gov/econres/notes/feds-notes/the-increased-role-of-the-federal-home-loan-bank-system-in-funding-markets-part-3-20171018.html.

requirements, with Grade A status available to institutions that also maintain a CET1 ratio of at least 14 percent and a Tier 1 leverage ratio of at least 5 percent. This structure embeds CET1 ratios as the primary signal of counterparty creditworthiness. Better Markets urges the agencies to reconsider that approach. The recent record of major bank failures demonstrates, with actual examples, that CET1 ratios are an often unreliable indicator of actual safety and soundness and that a grading framework anchored to them will systematically understate counterparty risk, resulting in procyclical capital requirements.

For example, at the end of 2022, Credit Suisse had a CET1 ratio of 14.1 percent and an average liquidity coverage ratio of 144 percent, both of which were comparable with those of other large banks, including HSBC and Barclays. Similarly, at the end of 2022, SVB's CET1 ratio was 15.3 percent. Under the Proposal's framework, both institutions would have qualified as Grade A counterparties at year-end 2022—the highest possible classification, carrying the most favorable risk weights available. Within months, SVB had failed in the largest single-day bank run in U.S. history, Credit Suisse had been emergency-acquired by UBS under Swiss government direction, and Signature Bank—which also reported "strong" capital ratios at year-end 2022—had been closed by the FDIC and its uninsured depositors provided forbearance from losses under the Systemic Risk Exception.

CET1 ratios measure a firm's risk-weighted assets relative to its CET1. However, the risk weights assigned to assets are a function of the framework the Proposal is constructing — a framework that systematically underweights interest rate risk, concentration risk, runnable funding risk, and other exposures that actually drove these failures. Even under this updated framework, a bank that holds a large portfolio of held-to-maturity securities avoids marking unrealized losses against regulatory capital. A bank that funds itself with concentrated, uninsured, confidence-sensitive deposits (like stablecoin reserves) carries no additional capital charge for that structural vulnerability. CET1 ratios built on these inputs will appear robust until they are not. Therefore, building a counterparty risk grading system on top of them amplifies rather than corrects the underlying measurement problem.

Banks Subject to Enforcement Actions or Consent Orders Should Be Automatically Classified as Grade B

The Proposal's grading framework focuses primarily on quantitative capital thresholds and does not incorporate the supervisory record of counterparty institutions as a determinant of grade classification. This is a significant gap that must be addressed. An institution operating under a formal enforcement action or a consent order has material deficiencies that implicate the creditworthiness assessment that the grading framework is designed to capture. However, the Proposal allows such institutions to retain Grade A classification so long as their CET1 ratio and leverage ratio remain above the specified thresholds.

The SVB, Signature Bank, and Silvergate failures illustrate exactly why this matters. Each of those institutions had received supervisory findings and outstanding examination deficiencies in the period before their failures. The existence of those findings was a far more accurate leading indicator of their eventual collapse than their reported CET1 ratios. A grading framework that ignores the supervisory record in favor of capital ratios that have been shown to be lagging indicators will persistently misclassify the counterparties whose failure risk is most elevated.

Better Markets urges the agencies to require that any depository institution, foreign bank, or credit union that is subject to a formal enforcement action or consent order to be automatically classified as Grade B—irrespective of its reported CET1 ratio or leverage ratio—for as long as that supervisory action remains outstanding. This would only require that banks dealing with such an institution under a public supervisory action to hold capital commensurate with the supervisory risk signal that the agencies' own supervisors have applied. Allowing Grade A treatment to persist for institutions under active enforcement is inconsistent with the stated goal of making the capital framework more risk-sensitive.

Trust Banks Should Be Classified as Grade C Under Question 17

Question 17 of the Proposal asks whether certain categories of institutions should be treated differently within the grading framework. Better Markets urges the agencies to classify all trust banks and limited-purpose trust institutions as Grade C.

Trust banks operate under fundamentally different business models than full-service commercial banks. They do not take deposits in the traditional sense, do not have access to Federal Reserve emergency liquidity facilities on the same terms as insured depository institutions, and are not subject to the full suite of prudential requirements—including FDIC deposit insurance—that backstop the obligations of commercial bank counterparties. Their balance sheets are concentrated in custody and fiduciary activities, their funding models are structurally different, and their resolution in a stress scenario would not follow the established FDIC framework that applies to insured commercial banks. These structural differences mean that an exposure to a trust bank carries materially different risk characteristics than an equivalent exposure to a full-service insured depository institution.

The agencies should not allow the same grade—and the same favorable risk weights—to apply to counterparties whose structural risk profiles are categorically different. Classifying all trust banks as Grade C would require covered banking organizations to hold capital that more accurately reflects the distinct liquidity, resolution, and structural risks that trust bank counterparty relationships entail. The agencies should address this explicitly in the final rule and not leave it to supervisory discretion on a case-by-case basis.

4) Real Estate

Better Markets supports the Proposal's loan-to-value based framework for residential real estate risk weights. The current standardized approach that assigns a flat 50 percent risk weight to most qualifying first-lien residential mortgages regardless of the borrower's equity position, creditworthiness, or the property's cash flow characteristics is a static and blunt instrument that treats fundamentally different credit risks identically. The shift to an LTV-based graduated framework is an appropriate conceptual direction. It improves risk sensitivity, better aligns capital requirements with actual credit risk, and brings U.S. practice into closer alignment with international standards. Better Markets recommends the agencies to finalize this structural improvement.

However, the framework as proposed contains two features—the categorical exclusion of private mortgage insurance from LTV calculations and the absence of any mechanism to prevent large banks from optimizing toward low-LTV jumbo lending—that together risk producing a capital framework that is technically more risk-sensitive while being practically worse for the borrowers the housing finance system should better serve.

The fundamental concern is that under the Proposal, a low-LTV jumbo mortgage to a high-net-worth borrower—a loan that poses minimal credit risk—would receive a 20 percent risk weight. A high-LTV loan to a first-time homebuyer—a creditworthy borrower whose only disadvantage is a smaller down payment—would receive a 50 to 70 percent risk weight even if the loan carries private mortgage insurance ("PMI"). The capital framework therefore creates a structural incentive for covered banking organizations to concentrate their residential mortgage portfolios at the low-LTV, high-balance end of the market, where risk weights are lowest and returns on capital are highest, and to avoid or curtail lending to first-time homebuyers, lower-income borrowers, and others who depend on high-LTV financing to enter the housing market.

The history of post-crisis capital reforms has repeatedly demonstrated that large, sophisticated banking organizations (precisely the ones subject to this Proposal) respond to risk-weight differentials by optimizing their portfolios toward lower-weight exposures. Better Markets expects the same outcome for residential mortgage lending under the Proposal. A framework that, at origination, assigns a 20 percent risk weight to a $2 million jumbo mortgage and a 70 percent risk weight to a $300,000 FHA-eligible loan with PMI will result in a strong and clear incentive for high-end mortgage lending and an active disincentive for exactly the lending that Congress and the agencies have repeatedly identified as a policy priority. Furthermore, the scaled risk weights provide little benefit for higher-LTV mortgages even as the loans roll forward—for example, based on a standard amortization schedule, it would take about five years for a 90 percent LTV mortgage to drop to 80 percent LTV.

The largest mortgage lenders among the GSIBs already prioritize low-LTV mortgage originations (often referred to as "jumbo mortgages"). In fact, the average LTV on mortgages originated by the three largest mortgage lenders from 2022-2024 was 67 percent, whereas the average for community banks was 77 percent. The difference in support for low-LTV mortgage borrowers between community banks and the three largest mortgage lenders is even more dramatic when focusing on the highest LTV mortgages originated, as can be seen in the table below.

Table 1: Share of Mortgages Originated by Institution Type and LTV Range

	Average LTV	(84,96]	(96,108]
3 Largest Mortgage Lenders	66.6	14.6	5.7
Community Banks	76.7	24.5	18.6

Source: Home Mortgage Disclosure Act Data, Better Markets' calculations

The Proposal would create a strong incentive for this dynamic at covered institutions to worsen, whereas community banks would not face the same incentives because 1) over 40 percent of community banks use the community bank leverage ratio framework,[71] 2) they maintain large capital buffers and so engage far less in capital optimization, and 3) they hold a significant portion

71 Better Markets' analysis based on Call Report data.

or in some cases all their mortgages on their balance sheet to maturity, payoff, or default. Additionally, the agencies did not justify the lower mortgage risk weights for Category I and II institutions relative to the risk weights that would apply to community banks despite the data showing that community banks have historical loan charge-off rates that are 60 percent lower than non-community banks.[72]

Better Markets therefore urges the agencies to evaluate, before finalizing the residential real estate framework, whether the LTV-based risk weight schedule—taken together with the PMI exclusion addressed below—produces portfolio incentives that are consistent with the agencies' statutory obligations and the broader public interest in broad and equitable access to mortgage credit. The framework should be risk-sensitive. However, risk sensitivity should not become a mechanism for steering large bank capital away from first-time homebuyers and toward the already well-served jumbo market. The agencies have not analyzed this incentive effect in the Proposal and must do so before finalization.

The Exclusion of Private Mortgage Insurance from LTV Calculations Is Empirically Unjustified and Inconsistent with the Proposal's Own Risk-Sensitivity Objectives

The Proposal would prohibit banking organizations from recognizing PMI when calculating the loan-to-value ratio used to determine residential real estate risk weights. This exclusion is one of the most consequential and least-justified policy choices in the entire real estate section, and the Proposal provides no reasoned empirical basis for it. Under the APA, an agency must provide a rational connection between the facts it finds and the policy choices it makes. The Proposal's silence on why PMI is categorically excluded from LTV calculations—when the entire framework is premised on the risk-sensitivity benefits of LTV-based gradation—may render the rule vulnerable to challenge as arbitrary and capricious.

The exclusion reflects an entrenched view of PMI that was arguably defensible in response to the global financial crisis, when several PMI providers became financially distressed and claims payment was uncertain. However, those experiences were nearly two decades ago. The PMI industry has been fundamentally restructured in the intervening period. For example, PMI providers are now subject to the GSE Private Mortgage Insurer Eligibility Requirements ("PMIERs"), which impose rigorous capital, liquidity, and counterparty standards that did not exist during the financial crisis. The GSEs—which backstop the vast majority of high-LTV residential lending—require PMI precisely because it serves as an effective first-loss credit enhancement that has, post-reform, performed as intended. The agencies cannot justify importing a crisis-era skepticism about PMI into a 2026 capital framework without demonstrating that the post-reform

72 Better Markets' analysis based on historical quarterly net charge-off rate data provided with the FDIC's Quarterly Banking Profile, available at: https://www.fdic.gov/quarterly-banking-profile/qbp-time-series-spreadsheet-first-quarter-2026.xlsx. The Quarterly Banking Profile contains aggregate data for all FDIC-insured institutions for each quarter dating back to 1984, including performance ratios disaggregated between community and noncommunity banks. Better Markets' analysis of the net charge-off rate in this dataset, across the full period 1984–2025, which includes multiple stress periods, shows aggregate community bank charge-off rates averaging approximately 60 percent below average noncommunity bank rates.

PMI industry continues to pose the credit risks that motivated the exclusion. However, the Proposal makes no attempt to do so.

The practical consequences of the exclusion are material and regressive to Americans. A borrower with a 90 percent LTV loan covered by PMI—a structure the GSEs routinely approve and guarantee—would receive the same risk weight as a 90 percent LTV loan with no credit enhancement whatsoever, despite facing categorically different credit risk. A bank holding the PMI-covered loan must hold capital as though the PMI did not exist, which is inconsistent with the actual credit risk of the borrower. The result is a systematic overstatement of capital requirements for high-LTV loans with PMI, which will directly reduce the availability of credit for first-time homebuyers and lower-income borrowers who are most dependent on PMI-backed financing to access the housing market.

Better Markets urges the agencies to replace the categorical exclusion of PMI with a partial recognition approach—specifically, allowing banking organizations to recognize PMI coverage at 50 percent of face value when calculating the effective LTV ratio for risk weight purposes. This approach would mirror the conservative, haircut-based approach the framework already applies to other forms of credit risk mitigation, and it appropriately captures the risk-reducing effect of PMI without assuming that it eliminates credit risk entirely. A 50 percent recognition factor would acknowledge that PMI provides genuine and quantifiable credit protection while maintaining a meaningful capital buffer against the residual risk that PMI does not cover. The agencies must either adopt this approach or provide in the final rule a specific, empirically grounded explanation for why a reformed, PMIER-compliant PMI industry should receive zero recognition in a risk-sensitive capital framework.

The Flat 95 Percent Commercial Real Estate Risk Weight for Smaller Banks Is Inconsistent With the Proposal's Risk-Sensitivity Objectives and Disproportionately Burdens Community Banks

The Proposal would apply a sophisticated, LTV-based risk weight grid to commercial real estate exposures at Category I and II banking organizations, while imposing a flat 95 percent risk weight on CRE exposures at all other banking organizations—including the community banks that are most concentrated in commercial real estate lending. This disparity is analytically incoherent and directly contradicts the Proposal's stated objective of improving the "risk sensitivity" and "consistency" of the capital framework across institutions.

The agencies offer no empirical basis for the conclusion that a flat 95 percent risk weight accurately captures the credit risk of CRE exposures across all loan types, geographies, and LTV levels for smaller institutions. A well-underwritten, low-LTV stabilized income-producing CRE loan originated by a community bank presents fundamentally different credit risk than a speculative high-LTV construction loan at the same institution. The flat 95 percent weight treats them identically because the agencies have declined to extend the risk-sensitive framework they developed for large banks to the institutions that most need it.

The consequences of this disparate treatment would fall disproportionately on community banks. Community banks hold a significantly larger share of their assets in CRE relative to large banks, and CRE lending to small businesses, local developers, and community projects is a core function of community banking that large institutions are far less likely to perform. Imposing a flat 95 percent risk weight on all CRE regardless of LTV or loan structure overstates capital requirements for well-underwritten CRE exposures, reduces the return on capital for community bank CRE lending, and will cause some institutions to curtail CRE lending in the communities they serve (precisely the outcome the Proposal's preamble claims to want to avoid).

The APA requires the agencies to treat similarly situated parties consistently and to explain material differences in treatment. The Proposal provides no reasoned explanation for why CRE exposures at smaller banks do not warrant the same LTV-based granularity applied to identical exposure types at large banks, and it provides no data demonstrating that the 95 percent flat weight is appropriately calibrated to the actual loss history of community bank CRE portfolios. The specific figure of 95 percent—a 5 percent reduction from the current 100 percent—appears to be a token reduction rather than a risk-calibrated choice[73], and the Proposal's preamble does not adequately explain how that figure was derived or what loss data supports it. This is especially concerning considering that the data show that community banks have historical loan charge-off rates that are 60 percent lower than non-community banks.[74]

Better Markets urges the agencies to extend the LTV-based CRE risk weight framework to all banking organizations in the final rule, or alternatively to provide in the final rule a specific, data-supported explanation for why the flat 95 percent risk weight is appropriately risk-sensitive for community bank CRE portfolios. If the argument involves the operational risk charge for CRE for larger banking organizations, the agencies must show their analysis. The current approach—a seemingly sophisticated table for large banks and a flat higher rate for small banks—would invert the risk-sensitivity principle the Proposal articulates and imposes the least nuanced treatment on the institutions that are most dependent on CRE lending for their core business. That outcome is inconsistent with both the Proposal's stated objectives and the agencies' obligations under the APA to provide a reasoned explanation for material differences in regulatory treatment.

5) Retail Exposures

The Proposal introduces a tiered risk-weight structure for retail exposures under the ERBA that represents a meaningful improvement in risk sensitivity over the current flat 100 percent standardized risk weight applied to virtually all non-mortgage consumer exposures. In concept, Better Markets is open to more differentiated retail treatment and supports the stated goal of aligning requirements more closely with actual credit risk. However, the proposed framework contains significant deficiencies that would produce a retail capital regime that is analytically ungrounded in key respects, susceptible to structural arbitrage, and incomplete on its face with respect to products already material to the largest U.S. credit card portfolios. Each deficiency must be corrected before any final rule is adopted.

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73 *See* Better Markets comment letter to the Standardized Approach Proposal for additional concerns on the calibration approaches included in the proposal.

74 *Supra* 72.

The 45 Percent Transactor Risk Weight Lacks the Empirical Justification Required for a Capital Reduction of This Magnitude

Under the Proposal, a revolving retail exposure qualifies as a "transactor" and receives a 45 percent risk weight instead of the 75 percent risk weight that applies to other regulatory retail revolving exposures if the obligor has paid the full outstanding balance at each of the prior twelve payment due dates. Both weights represent reductions from the current 100 percent risk weight in the standardized approach and broadly align with the Basel III final reforms. Yet the Proposal does not provide the empirical foundation that a calibration of this consequence requires. The agencies have not published data demonstrating that historical charge-off rates, stress-period loss experience, or default rates for qualifying transactor exposures support a 45 percent risk weight, and the cycle repayment lookback that defines transactor status is short enough to capture a temporary pattern of full-balance payments that does not necessarily reflect durable creditworthiness.

The agencies have not justified why the largest banking organizations should receive materially lower risk weights for retail exposures than the four thousand other U.S. banks that would remain subject to the existing standardized approach. Under that Proposal, retail exposures would receive a 90 percent risk weight as "other assets" with no distinction with a transactor and revolver. The agencies justify this preferential treatment under ERBA by pointing to repayment history, exposure-size limits, and diversification. However, those features are not unique to the largest banking organizations.

Many community and regional banks also maintain diversified portfolios of small-dollar consumer loans, credit card exposures, auto loans, overdraft lines, and other retail credits. If a borrower's full and timely repayment history, small exposure size, or portfolio diversification warrants a 45 percent or 75 percent risk weight at a Category I or II banking organization, the agencies must explain why the same characteristics do not warrant comparable treatment at the more than 4,000 other U.S. banks. Conversely, if the existing 100 percent risk weight or proposed 90 percent risk weight remains appropriate for the rest of the banking system, the agencies must explain why it is excessive for the largest, most complex, and most systemically important banks. This is especially concerning considering that the data actually show that community banks have historical loan charge-off rates that are 60 percent lower than non-community banks. [75]

This unexplained asymmetry is especially difficult to defend because the largest banks already benefit from scale, diversification, sophisticated data analytics, and broader funding advantages. The Proposal would add a regulatory capital advantage on top of those structural advantages by lowering the marginal capital cost of qualifying retail credit at the largest banking organizations. That result would tend to steer retail credit toward the largest institutions and away from smaller banks, not because the underlying borrower is safer, but because the regulatory capital rules assign materially different risk weights to similar exposures depending on the size and regulatory category of the lender.

The agencies should not adopt a framework that gives the largest banks a preferential capital charge for ordinary consumer credit unless they can demonstrate that the lower risk weights

[75] *Id.*

are justified by exposure-level risk rather than institutional status. The Proposal does not provide that demonstration. It does not show that a transactor credit card exposure at a Category I or II bank is less than half as risky as a comparable exposure at a community bank. It does not show that a qualifying revolver at a large bank is 50 percent less risky than a comparable exposure at another bank. Importantly, it also does not provide empirical evidence showing that the proposed 45 percent and 75 percent calibrations are appropriate across the credit cycle.

The agencies should therefore either retain the current approach for these retail exposures, create a standardized retail risk weight for all banking organizations or provide a reasoned, data-supported explanation for why retail exposures with the same borrower-level and product-level characteristics should receive different capital treatment depending on whether they are held by one of the largest banking organizations or by the rest of the banking system.

Better Markets therefore urges the agencies to take two steps before finalizing any transactor or revolver risk weight. First, the agencies should publish the empirical basis for the 45 percent risk weight calibration and 75 percent risk weight calibration, including data on historical loss rates and stress-period behavior for qualifying revolving exposures across different institution types and portfolio compositions, and subject that analysis to public comment. Second, the agencies should condition the use of the 45 percent risk weight by electing institutions that are not Category I or II banking organizations on a supervisory process confirming that those institutions' payment-history classification systems are sufficiently accurate and auditable to support reliable transactor identification. Absent these safeguards, the Proposal imports a capital discount calibrated to the largest banks' portfolios into institutions where that calibration has not been validated and where the supervisory consequences of misclassification would fall most heavily.

6) Subdebt Exposures

The Proposal would introduce a new exposure category for "subordinated exposures"—defined generally as debt obligations and other non-equity claims that are contractually subordinated to the general obligations of the obligor. The Proposal would assign a risk weight of 150 percent for subordinated debt exposures.

Better Markets supports applying elevated capital requirements to subordinated debt exposures because they present materially greater loss severity than senior obligations and whose higher risk weight accurately reflects their position in the capital structure. However, the Proposal's definition of a subordinated exposure is vague in ways that will generate significant supervisory and compliance problems, and the agencies must address those problems before finalization.

The core issue is the Proposal's definition of subordinated debt. The Proposal defines subordinated exposures by reference to contractual subordination to "other obligations" of the obligor. However, it does provide guidance on how that standard applies across the wide variety of instruments that U.S. banking organizations hold in practice. The category of instruments that could plausibly satisfy or not satisfy that definition is substantially broader and more heterogeneous than the Proposal appears to acknowledge.

Consider, for example, contingent convertible instruments ("CoCos") and other regulatory capital instruments issued by foreign banking organizations may be contractually subordinated to senior debt but structurally senior to common equity and may contain conversion or write-down features that alter their effective subordination depending on market conditions or regulatory triggers. Whether a CoCo issued by a foreign bank and held by a U.S. covered banking organization constitutes a subordinated exposure under the Proposal's definition—and therefore attracts a 150 percent risk weight—is not clear from the regulatory text. The answer will determine the capital treatment for a large and growing portfolio category at major U.S. dealers and custodians.

Structured notes and hybrid instruments may be senior in name but functionally subordinate in substance—for example, senior notes issued by a special purpose vehicle where the underlying collateral is itself a pool of subordinated obligations. Whether such instruments should be classified as subordinated exposures requires a look-through analysis that the Proposal neither mandates nor discusses. Instruments that are structurally subordinated by virtue of holding company status (for example, where the obligor is a holding company whose only meaningful assets are equity interests in operating subsidiaries) present another classification challenge. A banking organization holding senior debt of a holding company whose subsidiary creditors effectively rank ahead of it in any insolvency may face greater loss severity than a holder of formally subordinated debt of a well-collateralized operating company. The Proposal does not address structural subordination, and its silence will produce inconsistent treatments for economically similar exposures.

Preferred securities and trust preferred securities, which occupy a hybrid position between debt and equity in the capital structure and have variable subordination profiles depending on issuer structure and the governing documents, raise further classification questions. The Proposal does not distinguish between these instruments and straight subordinated bonds, despite their materially different risk and liquidity profiles.

Because the 150 percent risk weight for subordinated exposures is materially higher than the 65 percent risk weight for investment-grade corporate exposures or the 20 to 50 percent risk weights for higher-grade bank exposures, a misclassification in either direction has significant capital consequences. An institution that incorrectly classifies a subordinated instrument as a senior investment-grade corporate exposure may materially understate its risk-weighted assets. An institution that incorrectly classifies a structurally complex but effectively senior instrument as subordinated will face an unwarranted capital penalty. Neither outcome is acceptable, and both are likely absent clearer guidance.

The supervisory burden that will accompany this definitional ambiguity is substantial. Examiners will need to make instrument-level judgments about contractual subordination for thousands of positions across large, complex portfolios—many of which involve foreign-law governed instruments whose subordination terms may not be readily interpretable under U.S. legal standards. The agencies have not addressed the additional examination resources, legal expertise, or coordination with foreign supervisors that accurate classification of cross-border subordinated exposures will require. This is a significant oversight given that the same Proposal removes internal models for credit risk on grounds that supervisory inconsistency is harmful to the integrity of the capital framework and concurrently introduces a new, vaguely defined exposure category that will reproduce precisely that inconsistency through definitional ambiguity rather than modeling discretion.

The problem is compounded by the Proposal's silence on instruments that change their subordination status over time. An instrument may be issued as a senior obligation but become functionally subordinated following a downgrade, restructuring, or covenant violation. The Proposal does not specify whether the applicable classification and risk weight should reflect the instrument's contractual status as of origination or its effective status at the time of capital calculation.

The agencies should address these deficiencies in any final rule through the following measures. First, the agencies should provide a clear, comprehensive definition of contractual subordination that specifies the legal and structural criteria that must be present for an instrument to be classified as a subordinated exposure, with explicit guidance on structural subordination, holding company instruments, hybrid instruments, and contingent capital instruments. Second, the agencies should clarify whether and how a look-through analysis is required for instruments whose subordination status depends on the structure of underlying collateral or issuing vehicles. Third, the agencies should specify how the classification should be determined for instruments with variable or contingent subordination features, including CoCos and instruments with write-down provisions. Fourth, the agencies should require covered banking organizations to document their classification determinations for all instruments classified as subordinated or borderline exposures, and should require those determinations to be reviewed by legal counsel with expertise in the governing law of each instrument. Fifth, the agencies should publish interagency supervisory guidance addressing the most common categories of ambiguous instruments—including those described above—prior to the effective date of any final rule, so that institutions and examiners are applying consistent criteria from the outset.

The agencies have stated that a central objective of the ERBA is to improve consistency—meaning that similar risks should attract similar capital requirements across different banking organizations. A subordinated exposure category defined with sufficient ambiguity to generate divergent classifications for the same instrument at different institutions is directly contrary to that objective. Better Markets urges the agencies to address these definitional deficiencies comprehensively in the final rule rather than deferring to supervisory discretion that history has shown will produce the inconsistencies the agencies are attempting to avoid.

7) Project Finance

Better Markets supports the Proposal's differentiated risk weight framework for project finance exposures under the ERBA. The Proposal's two-phase structure with a 130 percent risk weight for exposures in the pre-operational phase and a 100 percent for project finance exposures in the operational phase. The pre-operational/operational distinction is economically well-grounded: construction-phase project finance is exposed to completion risk, cost overrun risk, and the absence of an established revenue stream, all of which increase the probability of default materially relative to a facility that has reached commercial operation with contracted cash flows. Recognizing that distinction in capital requirements is appropriate and aligns the U.S. framework with the Basel III final standards as implemented by the European Union and other major jurisdictions.

Better Markets also supports the Proposal's decision not to adopt the preferential 80 percent risk weight for high-quality project finance exposures included in the Basel III final standards. A preferential tier gated by supervisory determinations about project quality would reproduce, in a project finance context, exactly the classification-driven capital optimization that the Proposal's elimination of internal models for credit risk was designed to prevent. Banking organizations subject to a 100/80 percent split in the operational phase would face a persistent financial incentive to structure transactions and interpret criteria to qualify for the lower tier, generating the supervisory inconsistency and race-to-the-bottom dynamics that objective, uniform standards are designed to avoid. The 100 percent operational-phase risk weight is clear, consistent, and appropriate.

The prudential soundness of this framework nonetheless depends on how rigorously its key classification—the transition from pre-operational to operational phase—is supervised and administered in practice, and on how it interacts with two other elements of the Proposal that the agencies have not adequately addressed. Better Markets urges the agencies to address the following.

The Operational Phase Definition Requires Clearer Standards and Supervisory Oversight.

The Proposal defines the operational phase by reference to a project having "positive net cash flow that is sufficient to support the debt service and expenses of the project" and "outstanding long-term debt that is declining." While those criteria are sensible in concept, they leave the determination of when a project has crossed from pre-operational to operational phase substantially to the banking organization's own judgment and underwriting criteria. This is a meaningful vulnerability as a banking organization under capital pressure has a direct financial incentive to declare commercial operation at the earliest defensible moment, reducing the applicable risk weight from 130 to 100 percent on exposures that may remain substantively in a construction or ramp-up phase. The Proposal provides no guidance on what evidence must support the operational phase determination, what minimum operating history is required, how to treat projects with partial operations or phased completion, or what supervisory review occurs at or after the reclassification.

The agencies should address this by requiring covered banking organizations to maintain contemporaneous documentation of each pre-operational to operational phase reclassification, including a cash flow analysis demonstrating sufficiency under stressed as well as base-case assumptions, a debt service coverage calculation, and the identity and seniority of the approving credit officer. Those determinations should be subject to standard examination review and should be explicitly included as a focus area in horizontal supervisory reviews of institutions with material project finance portfolios. The agencies should also issue interagency supervisory guidance prior to the effective date of any final rule specifying that an operational phase determination must be supported by demonstrated—not projected—positive net cash flow over a minimum operating period, the length of which the agencies should define. Without that clarity, the pre-operational to operational transition will be administered inconsistently across institutions and across examiners, undermining the risk sensitivity the two-phase framework is designed to achieve.

Project Finance Construction Facilities and the Off-Balance Sheet CCF Framework.

Project finance transactions routinely involve significant undrawn commitments at financial close (construction draw facilities, revolving working capital facilities, and contingency facilities) that are nominally unconditionally cancellable but operationally uncancellable once financial close occurs. A lender that cancels a committed construction draw at a critical stage of a project exposes itself to contract liability, reputational damage, and syndicate relationship consequences that make cancellation effectively impossible in practice. The project entity has no alternative funding source, and the banking organization's exposure to the overall transaction depends on the project being completed. These dynamics are more acute in project finance than in ordinary corporate lending precisely because the SPV structure eliminates any source of repayment other than project completion.

This concern reinforces the broader argument Better Markets makes below in *Section III.iii.2* regarding the 10 percent CCF for unconditionally cancellable commitments. In the project finance context, the structural inability to cancel is especially pronounced, and a zero CCF applied to construction draw facilities materially understates the banking organization's realistic exposure during the pre-operational phase. The agencies should confirm in the final rule that project finance construction facilities are subject to the 10 percent CCF that Better Markets recommends for all UCCs (in the standardized approach and ERBA) and should address explicitly whether the operational characteristics of project finance construction facilities — including syndicate obligations and SPV dependency — inform the cancellability analysis under the revised commitment definition.

8) Corporates

The Proposal would permit a banking organization to assign a 65 percent risk weight (a 35-percentage point reduction from the current 100 percent corporate risk weight in the standardized approach) to any corporate exposure that the banking organization itself determines is investment grade using its own internal credit risk rating system. Better Markets has serious concerns with this approach.

Allowing banking organizations to apply a preferential capital treatment to their own portfolios based on their own internal judgments, without prior supervisory validation of either the rating system or individual determinations, is structurally vulnerable to gaming and will produce exactly the inconsistency and capital optimization that the Proposal's elimination of internal models for credit risk was designed to prevent.

The agencies explain in this Proposal that the advanced approaches framework—which also relied on internal models to calibrate credit risk—produced "substantial and unwarranted differences in capital requirements across similar exposures that are unrelated to differences in risk," that "horizontal supervisory reviews found material deviations in loss rates at different banking organizations with respect to the same defaulted exposure," and that "various analyses conducted by the Basel Committee demonstrated significant divergence across banking organizations in credit risk-weighted assets calculated under the internal models-based approaches that could not be explained by differences in the riskiness of banking organizations' portfolios." That is precisely the indictment of internal-model-based capital treatment that justifies removing the advanced approaches framework. The investment-grade corporate risk weight mechanism would reintroduce the same structural problem by allowing large banks to use an internal rating systems to determine which of their corporate borrowers qualify for a 35-percentage point risk weight reduction, with no clear *ex ante* supervisory check on the result.

The incentive to game this determination is direct. A banking organization with a large corporate lending portfolio has an immediate financial interest in classifying as many obligors as investment grade as its internal system plausibly permits. The 35-percentage point reduction in risk weight translates, at a typical CET1 ratio of 10 to 12 percent, into a meaningful release of capital per dollar of exposure—capital that can be redeployed into additional lending, returned to shareholders, or used to satisfy buffer requirements. That incentive will predictably generate pressure on credit officers to adopt lenient rating criteria, pressure on model developers to calibrate systems toward higher investment-grade rates, and pressure on validators to accept rating distributions that favor capital efficiency over credit accuracy. The pressure would be most acute for the most profitable types of corporate loans, in particular loans to hedge funds and private equity firms, which already are experiencing rapid growth at the GSIBs.

Furthermore, it will also generate divergence because two banking organizations holding identical exposures to the same corporate borrower may reach different investment-grade determinations and therefore apply different risk weights, producing the inconsistency the agencies say they want to eliminate.

The Proposal's procedural safeguards do not adequately address these risks. The requirement that the internal rating system be used "to inform material business or risk management decisions"—such as accounting, loan pricing, or capital planning—is a sensible baseline but does not constrain how generously the system defines investment grade. A banking organization can simultaneously use an internal rating system for loan pricing purposes and calibrate it to classify a materially larger share of its portfolio as investment grade than an objective external assessment would support. The two functions are not in tension; they are in fact aligned, because more lenient investment-grade criteria produce both lower reported risk-weighted assets and lower loan pricing to borrowers (outcomes that are commercially attractive and mutually reinforcing). The requirement for annual validation, including benchmarking against external information, likewise does not solve the problem: benchmarking is a retrospective exercise, validation occurs after the capital benefit has already been taken, and the agencies explicitly note that external benchmarking "may" be used but provide no standard for what degree of divergence from external ratings would require a system to be recalibrated or a prior investment-grade determination to be reversed.

Most tellingly, the agencies appear uncertain that the proposed safeguards would be adequate. Question 28 asks whether banking organizations should be required to obtain prior supervisory approval of their internal credit risk rating systems before applying the 65 percent risk weight and explicitly invites comment on "the benefits that a preapproval process may provide versus the operational burden imposed by such a process." The fact that the agencies are asking such a question confirms that the framework as proposed was not fully thought through in the Proposal process. An agency that is genuinely confident that annual validation and benchmarking requirements are sufficient to ensure consistent and conservative investment-grade determinations does not need to ask whether prior approval might be necessary.

With respect to Question 28, prior supervisory approval is absolutely necessary and should be required. Further, the operational burden of obtaining it is not a valid reason to forgo it when the alternative is allowing banking organizations to self-certify their way to a 35-percentage point risk weight reduction across potentially large portions of their corporate portfolios.

The history of internal ratings-based approaches provides ample evidence of what happens when capital treatment depends on institutional self-assessment without robust *ex ante* supervisory constraints. The advanced approaches experience documented by the agencies in this very Proposal is the most recent and comprehensive example. However, the pattern predates Basel II. In fact, the agencies themselves note that Congress legislatively mandated minimum capital ratios in the International Lending Supervision Act of 1983 precisely "in response to the failure of examiner-discretion-based approaches to setting bespoke capital requirements."[76] Substituting institution-specific investment-grade determinations for examiner-discretion-based capital requirements would replicate this precise issue.

Better Markets urges the agencies to adopt the following requirements in the final rule, in order of preference.

1. First, the agencies should require prior supervisory approval of each covered banking organization's internal credit risk rating system—including its definition of which rating grades constitute investment grade—before that system may be used to support the 65 percent risk weight, paralleling the prior-approval mechanism the agencies already apply to the models-based approach for market risk and to the 65 percent investment-grade risk weight as the agencies themselves contemplate in Question 28.
2. Second, if prior approval is not adopted, the agencies should require covered banking organizations to disclose publicly, on at least an annual basis, the percentage of their corporate exposure portfolio classified as investment grade under their internal systems, segmented by industry and exposure size, so that market participants and supervisors can identify outliers and assess whether classification rates are consistent with observable credit conditions.
3. Third, the agencies should establish an interagency supervisory expectation—published as binding guidance, not merely as examination considerations—specifying maximum investment-grade classification rates relative to external reference points such as the share of rated corporate issuers carrying investment-grade ratings from recognized credit rating organizations, with institutions exceeding those benchmarks by a specified margin required to justify the deviation in writing to their primary supervisor.
4. Fourth, regardless of which of the above mechanisms is adopted, the agencies should require the validation process to include a specific finding on whether the banking organization's investment-grade classification rate is consistent with observable default

[76] Pub. L. 98-181, Title IX, 97 Stat. 1278 (1983) codified at 12 U.S.C. §§ 3901–3912.

experience and external benchmarks, and should require that finding to be reported to the board of directors and made available to examiners as a standard component of safety and soundness review.

The 65 percent investment-grade corporate risk weight is the most significant source of potential capital optimization in the Proposal's credit risk framework. The agencies should not finalize it without supervisory guardrails that are meaningfully stronger than those currently proposed.

iii. Off Balance Sheet Exposures

1) Definition of Commitment

Better Markets supports the Proposal's revisions and clarifications to the definition of "commitment," (for both the ERBA and the standardized approach), which are necessary to ensure that banks appropriately capitalize exposures that create genuine contingent credit and liquidity risk. For too long, some banking organizations have relied on vague contractual language, discretionary terminology, and technical structuring to argue that certain arrangements are not legally binding commitments and therefore should not attract capital requirements, even where those arrangements create strong economic expectations of support or funding.

This type of regulatory arbitrage undermines the credibility of the capital framework and permits banks to take on material off-balance-sheet exposures without holding sufficient loss-absorbing resources against them. Clarifying the scope of commitments is particularly important given the increasingly complex ways banks provide liquidity backstops, warehouse financing, subscription facilities, and other contingent obligations to NBFIs and capital markets vehicles. The agencies are correct to recognize that capital requirements should reflect the underlying economic substance and risk of these exposures, rather than permitting banks to avoid capital through ambiguous drafting or formalistic distinctions untethered from real-world stress behavior.

2) Credit Conversion Factors

The 40 Percent CCF for Commitments Is a Necessary Improvement and Must Be Aligned Across All Capital Frameworks

The Proposal would apply a 40 percent credit conversion factor ("CCF") to all non-cancellable commitments regardless of original maturity, replacing the current split treatment of 20 percent for commitments with an original maturity of one year or less and 50 percent for longer-dated commitments. The Proposal would also raise the CCF for unconditionally cancellable commitments ("UCCs") from 0 to 10 percent. Better Markets supports both changes. The maturity-based CCF bifurcation has generated well-documented arbitrage for many years: sophisticated originators have structured revolving credit facilities with nominal maturities at or below one year to capture the 20 percent CCF while providing functionally equivalent longer-term credit availability. The unified 40 percent CCF would eliminate that cliff-effect and imposes a more appropriate and consistent charge on the economic substance of commitment activity.

<u>Commitments that are Not Unconditionally Cancellable</u>

Better Markets supports a uniform 40 CCF for commitments that are not unconditionally cancelable, replacing the existing binary structure that assigns a 20 percent CCF to commitments with an original maturity of one year or less and a 50 percent CCF to those exceeding one year. The current maturity-based framework has created a powerful structural incentive for gaming that the agencies have long acknowledged but never adequately addressed. Banks routinely structure revolving facilities and other commitments with nominal maturities of 364 days—not because one year is the economically meaningful tenor of the underlying credit relationship, but precisely because it triggers the more favorable 20 percent CCF.

The borrower and lender both implicitly understand that the facility will be renewed, and the credit risk exposure is functionally continuous. The capital treatment, however, reflects the legal fiction of sub-one-year maturity rather than the economic substance of multi-year exposure. A uniform 40 percent CCF would eliminate the current cliff effect at twelve months entirely, removing the arbitrage opportunity at its root rather than relying on examiner judgment to identify when a renewal pattern has become abusive. The proposed rate is also appropriately calibrated to reflect the likelihood of a draw on the commitment.

Question 33: The SLR CCF applicable to non-cancellable commitments for Category I and II banking organizations should be aligned with the 40 percent ERBA CCF schedule. This change would be consistent with how the CCF for unconditionally cancellable commitments should align with both at 10 percent CCF and also apply to the Board's GSIB surcharge framework.

Question 34: Better Markets strongly supports aligning both the SLR and GSIB surcharge denominator treatment of commitments with the ERBA CCF schedule, using a 40 percent factor for non-cancellable commitments. The GSIB surcharge framework is also susceptible to off-balance-sheet arbitrage (and other more significant, year-end window dressing as described in Better Markets' comment letter to the GSIB surcharge proposal). A GSIB that expands its revolving credit commitment book while carefully managing drawn balances can reduce its systemic footprint score on the short-term wholesale funding and interconnectedness indicators without reducing—and potentially while increasing—the systemic risk it would pose in a stress drawdown scenario. Aligning the surcharge denominator treatment with the 40 percent ERBA CCF would close that gap and ensure the surcharge captures the full economic footprint of a GSIB's off-balance-sheet credit intermediation activity. Consistent treatment across all capital metrics is essential: commitment structures that provide functionally equivalent credit availability regardless of nominal maturity or cancellability should face equivalent capital treatment in every metric—risk-based capital, the SLR, and the GSIB surcharge framework alike. The history of the commitment CCF is, in part, a history of gaming through structural arbitrage. The final rule should address this concern holistically.

<u>Unconditionally cancelable commitments</u>

Better Markets urges the agencies to apply the 10 percent credit conversion factor for UCC proposed under the ERBA.[77] As is already recognized in the SLR, unconditionally cancellable

[77] *Supra* 2 at 14978.

commitments are not in practice genuinely risk-free, and the longstanding 0 percent CCF treatment significantly understates the likelihood of actual exposure.

The case for a non-zero UCC CCF is well established. As the agencies themselves have recognized in the SLR framework, unconditionally cancellable commitments are not in practice genuinely risk-free. Banks have historically demonstrated meaningful reluctance to cancel credit lines during periods of borrower stress—precisely when drawdown risk is highest—due to reputational concerns, relationship preservation, and litigation risk. The behavioral assumption embedded in a 0 percent CCF, that banks will freely and routinely exercise cancellation rights, is therefore not borne out by experience. A 10 percent CCF is a modest and empirically defensible correction to a treatment that has persisted largely for competitive rather than prudential reasons.

A UCC that is nominally cancellable but behaviorally persistent presents the same economic exposure as a committed line, and the agencies' attempt to address that equivalence through the no-pre-set-limit provision is narrow, easily arbitraged, and institution-size dependent in ways that undermine its purpose. A uniform 10 percent CCF for all UCCs is the more direct, durable, and structurally coherent solution.

A uniform 10 percent CCF across both frameworks would also align U.S. capital standards with the Basel III final rule as adopted by the European Union and other major jurisdictions. Divergence from that international standard on a provision that affects a broad and growing category of retail credit exposure creates an unlevel competitive playing field and introduces the kind of cross-border regulatory arbitrage that the Basel framework was designed to prevent.

Better Markets is also urging the agencies to apply the 10 percent UCC CFF in the standardized approach, as well as the arguments outlined above for large banking organizations apply equally to all banks.

Commitments with no pre-set spending

The Proposal's treatment of commitments with no pre-set spending limit would address a major gap in the current capital framework that has allowed charge card issuers to avoid appropriate capital requirements on their credit product. Under the existing rule, commitments with no pre-set limit do not receive any treatment as an off-balance sheet exposure under both the risk-based framework and the supplementary leverage ratio framework. Specifically, charge cards—which technically carry no fixed credit limit, with authorization decisions made dynamically at the point of sale—have been structured or interpreted to qualify for that treatment at some institutions. This approach is analytically indefensible, and the agencies are correct to address it directly.

A charge card represents a real, recurring extension of credit well understood by the borrower and the charge card issuer. Cardholders make purchases against it, balances accumulate between billing cycles, and the issuing bank bears the credit risk of those balances in exactly the same way it bears risk on a revolving credit card with a stated limit. The absence of a contractually specified ceiling does not reduce the economic exposure—if anything, it increases uncertainty about maximum potential drawdown, which is precisely the kind of tail risk that capital requirements are designed to address. Treating that exposure as zero for capital purposes simply because the product is structured without a pre-set limit is a form of regulatory arbitrage that undermines the integrity of the off-balance sheet framework as a whole.

The Proposal would require banking organizations to use the largest drawn amount over the prior 24 months as a proxy for the undrawn exposure amount when calculating capital requirements for commitments with no pre-set credit limit (e.g., to products such as charge cards where the credit maximum is not contractually fixed). Better Markets supports this approach. The 24-month largest-drawn-amount proxy provides a consistent, observable, and auditable reference point that appropriately eliminates that inconsistency. That said, the inconsistency in no pre-set limit exposure measurement has been identified in supervisory horizontal reviews for many years, and the agencies should have standardized this treatment sooner.

The agencies should also commit to active monitoring of the Proposal's 24-month lookback period for charge card exposures. Given this treatment is novel and its behavioral assumptions—particularly regarding the relationship between credit limits, utilization patterns, and actual loss experience—have not been validated across a full credit cycle under the revised standardized approach, the agencies should establish clear supervisory benchmarks at regular intervals within the 24-month window and should be prepared to revisit the framework's calibration if observed data diverge from the assumptions underlying the rule. A novel treatment of this kind demands ongoing oversight to ensure the exposure conversion factors and risk weights assigned to charge card facilities accurately reflect realized credit risk.

The Proposal's Capital Treatment of Pay-Over-Time Products for Charge Cards Quickly in a Separate Rulemaking

For the purposes of a charge card like product, the Proposal would distinguish between retail commitments with a pre-set credit limit and those without one, applying the 24-month proxy to the latter.

The agencies should resolve this question through a separate proposal subject to public comment and not finalize any treatment in this final rule. The agencies should address whether: (i) installment balances within charge card accounts should be carved out and treated as on-balance-sheet term loan exposures subject to the applicable retail risk weight; (ii) the full account, including both transactional and installment components, should remain subject to the 24-month proxy; or (iii) a bifurcated treatment should apply based on the proportion of the account balance subject to installment terms as of the reporting date. The agencies should commit to closely monitor pay-over-time programs for charge cards during any transition period, because the capital economics of these products directly affect origination incentives in ways that are relevant to both capital adequacy and consumer protection.

G. Credit Risk Mitigation

The Proposal would significantly expand recognition of credit risk mitigation ("CRM") techniques while simultaneously reducing several prudential safeguards that historically limited excessive reliance on collateral, guarantees, and structured risk transfers. Better Markets strongly cautions the agencies against repeating one of the central mistakes of the pre-2008 capital framework: allowing sophisticated financial engineering to substitute for genuine loss-absorbing capital.

The global financial crisis demonstrated that many forms of purported "risk mitigation" failed precisely when they were most needed. Credit protection providers became impaired, correlations converged toward one during stress, collateral values deteriorated rapidly, and legal and operational assumptions underlying hedging arrangements proved unreliable. Excessive regulatory confidence in CRM mechanisms contributed materially to undercapitalization across the banking system, particularly among the largest and most interconnected institutions. The agencies should therefore ensure that any expanded recognition of CRM remains conservative, simple, transparent, and resistant to gaming during periods of market stress.

Better Markets is particularly concerned that aspects of the Proposal appear designed to facilitate lower risk-weighted assets through increasingly complex structuring arrangements rather than through genuine reductions in economic risk. In practice, sophisticated institutions frequently optimize capital treatment through collateral substitutions, maturity mismatches, synthetic guarantees, and multi-layered hedging arrangements that reduce measured capital requirements without materially reducing systemic vulnerability. The agencies should not permit CRM recognition to become another avenue for regulatory arbitrage that weakens the credibility of minimum capital standards.

The agencies should not permit recognition of collateral where enforcement rights are subject to bankruptcy stays merely because the bank has a "well-founded basis" that it can exercise rights "in a timely manner." That standard is too subjective and examiner-dependent (which will become increasingly challenging to supervise with the recent cuts by the agencies to staffing levels and, critically, expertise). The agencies must explain how their supervisors will be able to apply consistent and effective supervision to this vague standard. If a stay can delay liquidation, the collateral is not the same as immediately available loss absorption, especially in a stress market. The agencies should either retain the current stricter approach or require a materially higher floor than 20 percent for stayed collateral.

The agencies should also reject the proposed full recognition of certain credit derivatives that omit restructuring as a credit event. The proposed unanimous-consent/legal-review exception is far too legalistic and ignores practical workout dynamics. A banking organization can still suffer economic loss through amendments, forbearance, maturity extension, collateral release, or priority changes that do not cleanly trigger CDS protection. The current 40 percent haircut should remain the default, with no broad exception.

Question 51: The Eligible Guarantor Definition Must Not Be Gated on an Internal Investment Grade Determination

The Proposal requires that an eligible guarantor—an entity whose guarantee may be recognized for risk-based capital purposes—have "issued and outstanding an unsecured debt security without credit enhancement that is investment grade." Critically, as footnote 158 of the Proposal clarifies, a banking organization does not need to apply its internal credit risk rating system criteria—the criteria Better Markets elsewhere urges the agencies to subject to prior supervisory approval—in order to determine whether an entity satisfies the investment grade requirement for eligible guarantor status. The internal rating system criteria are required only when a banking organization seeks to apply the 65 percent risk weight to the substituted exposure.

This two-track structure is internally inconsistent in a way the agencies do not acknowledge. Under the Proposal, a banking organization may recognize a guarantee from an entity it characterizes as investment grade for eligible guarantor purposes—without using a validated, supervised internal rating system—and then apply the 65 percent risk weight to the guaranteed exposure only if it separately confirms investment grade status through its supervised internal rating system. The first determination is made without the guardrails the agencies impose on the second. A banking organization that is willing to accept a looser investment grade determination for guarantor eligibility purposes can reduce the risk weight on a guaranteed exposure to whatever the substituted guarantor risk weight produces—which may be substantially below 100 percent—without ever invoking the 65 percent investment grade corporate risk weight directly. The two-track structure therefore creates an indirect path to preferential capital treatment that bypasses the internal rating system discipline the agencies impose on the direct path.

Better Markets urges the agencies to close this gap in the final rule by requiring a consistent investment grade determination standard for both purposes. If a banking organization must apply its supervised internal credit risk rating system to determine investment grade status for purposes of the 65 percent risk weight, it should be required to apply the same system—subject to the same validation, independence, and benchmarking requirements—when determining whether a potential guarantor satisfies the investment grade prong of the eligible guarantor definition. A rule that imposes discipline on one path to preferential risk weight treatment while leaving an alternative path unsupervised does not achieve consistency.

On the collateral haircut formula, the Proposal's use of CUSIP count as a diversification proxy is especially vulnerable to gaming. A portfolio can have many CUSIPs but highly correlated issuers, sectors, sponsors, structures, ratings, or collateral types. The denominator should not mechanically decline with the square root of the number of CUSIPs unless the bank demonstrates low correlation, issuer diversification, and no wrong-way risk.

Questions 53 and 54: Cross-Border Credit Derivatives and Cross-Entity Reference Exposures Require Careful Treatment

On Question 53, Better Markets urges the agencies to approach cross-border credit derivatives with significant caution. The conditions that permit full recognition of a no-restructuring credit derivative (unanimous consent requirements and U.S. Bankruptcy Code or equivalent insolvency regime) are calibrated to U.S. legal standards and domestic insolvency practice. The equivalence of foreign insolvency regimes is genuinely variable. For example, what constitutes an orderly, predictable creditor process under U.S. Chapter 11 standards is not uniformly replicated across major foreign jurisdictions, including jurisdictions with administrative rather than judicial insolvency proceedings, regimes with broad regulatory discretion to override creditor rights, or regimes with limited track records of complex corporate restructuring. A banking organization's legal conclusion that a foreign regime provides "similar features" to the U.S. Bankruptcy Code—which the Proposal would permit on the basis of internal legal review—should be subject to supervisory challenge, not merely documentation. The agencies should require that cross-border no-restructuring recognition determinations be reviewed by the banking organization's primary supervisor before the capital benefit is taken, and should publish a list of jurisdictions whose insolvency regimes have been assessed as meeting the equivalence standard rather than leaving the determination entirely to institution-specific legal judgment.

On Question 54, Better Markets does not support permitting recognition of credit derivatives where the reference exposure is to a different legal entity than the hedged exposure, even where the parent is subject to a cross-default or cross-acceleration provision. The legal entities are separate. A cross-default clause provides a contractual trigger but does not guarantee that a credit event on one entity will produce an economically equivalent outcome to a credit event on the other, particularly in resolution or bankruptcy, where automatic cross-default provisions may be stayed, modified, or challenged. Recognizing such credit derivatives as full CRM for the hedged exposure overstates the protection they provide and introduces legal basis risk that will not be fully capitalized. The agencies should maintain the current requirement that the reference exposure and the hedged exposure be to the same legal entity.

Question 55: Collateral Revaluation Under the Simple Approach Must Be More Frequent

The Proposal retains the current capital rule's requirement that financial collateral under the simple approach be revalued at least every six months, while acknowledging that in practice most collateral agreements for liquid collateral provide for more frequent valuation. The agencies ask whether revaluation should be required quarterly. Better Markets supports a more frequent revaluation requirement and urges the agencies to require, at minimum, quarterly revaluation as the regulatory floor, with more frequent revaluation required for volatile or illiquid collateral categories.

The six-month revaluation interval is indefensible as a minimum standard for liquid financial collateral. A six-month gap between mandatory revaluations means that collateral values recorded for capital purposes may be materially stale during precisely the periods of market volatility when collateral adequacy matters most. The 2020 dash for cash and the 2023 banking crisis produced significant collateral value movements within hours (not months). A banking organization that last revalued its collateral in January may be applying a January valuation to a March exposure against collateral that has declined materially—under the Proposal, the capital framework would permit that mismatch for up to six months. If the purpose of collateral recognition is to reduce the risk-weighted asset amount for a secured exposure, that purpose is undermined by allowing collateral values to lag market reality by half a year.

The agencies' own observation that most collateral agreements for liquid collateral already require more frequent valuation confirms that daily or at least weekly revaluation is operationally routine for the relevant instruments. A quarterly regulatory floor imposes no meaningful burden beyond what institutions already do in practice and would meaningfully improve the accuracy of collateral-adjusted risk weights. For less liquid or harder-to-value collateral—including non-dollar financial collateral, discussed below—even quarterly may be insufficient, and the agencies should require banking organizations to document and justify their revaluation frequency for such positions.

The agencies should also strengthen the Proposal by: (1) applying conservative haircuts and stress assumptions to all collateral recognition frameworks; (2) imposing stricter operational and legal certainty standards for guarantees and eligible hedges; (3) limiting recognition of CRM arrangements involving highly correlated counterparties or wrong-way risk; and (4) requiring enhanced public disclosure regarding the extent to which reported capital ratios rely on CRM recognition rather than common equity capital. Banking organizations should not be permitted to transform risky exposures into artificially low-risk exposures merely through contractual engineering.

The agencies should also more fully explain how the Proposal complies with the Collins Amendment's requirement that standardized capital requirements operate as a credible floor. If CRM recognition becomes excessively permissive, the Proposal risks recreating many of the weaknesses Congress sought to prevent after the financial crisis, including the systematic understatement of credit risk through internal optimization strategies. A capital framework that depends too heavily on assumptions about hedge effectiveness and collateral liquidity during stress is not a resilient framework.

H. Derivatives and Counterparty Credit Risk

Better Markets strongly supports robust and conservative capital requirements for derivatives and counterparty credit risk exposures. Derivatives markets remain among the largest sources of opacity, interconnectedness, contagion transmission, and leverage within the financial system. The global financial crisis demonstrated how rapidly derivatives-related losses and counterparty uncertainty can destabilize even the largest financial institutions, requiring extraordinary government intervention to prevent broader economic collapse.

While the Proposal includes targeted revisions to counterparty credit risk methodologies and credit valuation adjustment ("CVA") requirements, Better Markets is concerned that several aspects of the Proposal appear to prioritize capital relief, modeling flexibility, and balance-sheet efficiency over systemic resiliency. In particular, the Proposal's broader effort to reduce overall capital requirements across large banking organizations raises serious concerns that derivatives exposures may once again become undercapitalized relative to their true tail risks.

The Proposal also appears to continue excessive reliance on quantitative assumptions regarding collateral liquidity, close-out enforceability, and margin effectiveness under stress. Yet recent episodes of market dysfunction—including the March 2020 Treasury market disruption and the 2023 banking crisis—demonstrated that liquidity can evaporate rapidly even in markets traditionally viewed as deep and resilient. Capital requirements should therefore assume stressed liquidation environments rather than ordinary market functioning.

Better Markets further urges the agencies to strengthen the treatment of wrong-way risk, concentration risk, and interconnected exposures involving NBFIs, private credit funds, hedge funds, and other leveraged counterparties. As the financial system increasingly migrates risk outside the traditional banking sector, large banking organizations remain heavily exposed through derivatives, financing transactions, clearing relationships, and liquidity support arrangements. A derivatives capital framework that fails to adequately capture these interconnected risks, importing fragility from the shadow banking sector directly back into insured banks and bank holding companies.

i. Cleared Derivatives and Central Counterparty Exposures

The Proposal's treatment of cleared derivatives and central counterparty ("CCP") exposures warrants separate scrutiny that the agencies have not included in the Proposal. The post-crisis regulatory framework deliberately channeled a significant portion of bilateral derivative activity into central clearing, on the premise that CCPs reduce systemic risk through multilateral netting, margin collection, and mutualized default management.[78] However, that premise, while generally sound, does not support the inference embedded in the Proposal's favorable capital treatment of cleared exposures that CCP-cleared derivatives carry materially lower risk than their bilateral equivalents in all market conditions.

CCP exposure introduces a distinct and underappreciated risk concentration: a bank's capital requirement for its cleared derivative book is now a function not only of its own counterparty credit quality and collateral management but of the financial resilience of the CCP itself, the adequacy of the CCP's default fund, the behavior of other clearing members under stress, and the enforceability of loss mutualization arrangements that have never been tested in a major clearing member default. The agencies treat CCP exposures as categorically safer than bilateral exposures for capital purposes, but that categorical treatment has never been validated against an actual CCP stress event of systemic scale. The favorable risk weights assigned to trade exposures and default fund contributions assume that CCP default management frameworks will function as designed under conditions of correlated clearing member distress—an assumption that remains untested and that the Bank for International Settlements[79], the Financial Stability Board, and the Office of Financial Research have each identified as a material unresolved vulnerability in the post-crisis financial architecture.

The Proposal provides no analysis of how covered banking organizations' capital requirements for CCP exposures would perform if a major CCP entered its recovery or resolution framework, if default fund contributions were drawn upon at a scale that exceeded the first-loss tranche, or if variation margin haircutting or partial tear-up mechanisms were invoked.[80] They are the explicit tools provided for in CCP rulebooks and resolution frameworks, and their invocation would produce losses at clearing members that current capital requirements for cleared exposures are not calibrated to absorb. The agencies must explain, in any reproposal, how the favorable capital treatment assigned to cleared derivative exposures remains appropriate given the

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78 *See* Group of Twenty, Leaders' Statement. The Pittsburgh Summit (September 24–25, 2009), available at: https://2009-2017.state.gov/e/eb/ecosum/pittsburgh2009/resources/165081.htm.

79 *See* Bank for International Settlements. *The CCP-Bank Nexus in the Time of Covid-19*, BIS Bulletin No. 13 (April 2020), available at: https://www.bis.org/publ/bisbull13.pdf.

80 *See* Financial Stability Board. Committee on Payments and Market Infrastructures and International Organization of Securities Commissions. *Central Counterparty Financial Resources for Recovery and Resolution* (March 9, 2022). The report finds that "for non-default losses, a cyber theft scenario was considered and resolution authorities would have needed to trigger resolution for the majority of CCPs". available at: https://www.fsb.org/2022/03/central-counterparty-financial-resources-for-recovery-and-resolution/; *see also* https://www.bis.org/publ/othp46.htm.

acknowledged uncertainty surrounding CCP resilience under severe but plausible stress, and must publish scenario analysis demonstrating that covered banking organizations' capital against CCP exposures remains adequate if default fund contributions are partially or fully depleted in a major clearing member default scenario.[81]

ii. The Agencies Should Not Finalize Cross-product netting Under SA-CCR

Better Markets is especially concerned by provisions that would permit broader recognition of diversification and netting benefits across derivatives and related financing transactions. We specifically urge the agencies to not expand recognition of cross-product netting between derivatives and repo-style transactions to banking organizations subject to the Proposal. The Proposal would allow SA-CCR treatment for repo-style transactions and derivatives under qualifying cross-product master netting agreements, but that approach assumes close-out, collateral liquidation, and correlation stability precisely in periods of stress when markets are least reliable.

The agencies have embedded one of the most consequential and least justified changes in this entire Proposal in a single paragraph of the derivative contracts section, described in anodyne terms as promoting "consistency" and better reflecting "risk-reducing effects of netting arrangements and collateral." The Proposal's dramatic expansion of the universe of capital-reducing netting recognition available to covered banking organizations—including community and regional banks—by allowing any institution that elects SA-CCR to recognize qualifying cross-product master netting agreements for non-cleared transactions and to net non-cleared repo-style transactions against derivative exposures with the same counterparty.

Cross-product netting assumptions can materially understate risk during stress events because correlations and liquidity relationships that appear stable during normal market conditions often break down abruptly during periods of volatility and disorderly deleveraging. The Basel framework historically treated many of these exposures conservatively for precisely this reason. To the extent the Proposal departs from international standards by permitting more favorable netting treatment, the agencies must fully quantify the resulting reduction in capital requirements and explain why such deviations are justified prudentially rather than competitively.

In addition to being a major inconsistency with the international capital standard, the Proposal would create a capital-arbitrage issue that appears driven by exogenous public policy goals that are tangential to the bank capital framework. Derivative exposures and securities financing transactions have different liquidity profiles, default dynamics, settlement mechanics, collateral risks, and close-out frictions. Allowing banks to offset those risks can materially reduce measured exposure without a commensurate reduction in actual stress loss. The agencies should continue to require separate calculations for derivatives and repo-style transactions, or at minimum

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81 *See* Gadgil, Lumsdaine, and Paddrik. "The Impact of CCP Liquidity and Capital Demands on Clearing Members Under Stress" Office of Financial Research Working Paper. The OFR report finds that "while large clearing members have sufficient resources to meet CCP demands during periods of heightened risk, the size of these demands is material and has fluctuated over time" (July 1, 2025), available at: https://www.financialresearch.gov/working-papers/2025/07/01/the-impact-of-ccp-liquidity-demands-on-clearing-members-under-stress/.

impose a conservative floor on any cross-product netting benefit. This is another significant omission from the impact analysis, which has not even attempted to quantify this effect.

The mechanism by which this change operates makes it more troubling, not less. The Proposal does not mandate cross-product netting recognition—it would make it available to any covered banking organization that elects to use SA-CCR in place of the current exposure methodology ("CEM"). While that decision is presented as voluntary, the capital incentive to elect SA-CCR once cross-product netting recognition is available is powerful and predictable. Institutions with bilateral books that include both derivatives and repo-style transactions with the same counterparties will face immediate competitive and financial pressure to elect SA-CCR precisely to access the cross-product netting offset, producing capital reductions that the agencies have not analyzed, have not stress-tested, and have not validated as appropriate for the risk profiles of smaller covered banking organizations. Describing this as a voluntary election does not insulate the agencies from the consequences of making the election attractive—it simply transfers the decision about whether to claim unjustified capital relief from the regulator to the regulated institution, which is precisely the wrong place to put it.

The Proposal's justification— that covered banking organizations electing SA-CCR should apply "the same revised SA-CCR framework" as Category I and II institutions "to promote consistency"—inverts the logic of tiered regulation. Consistency is not a prudential value that overrides the question of whether a given framework element is appropriate for a given institution. The entire architecture of the capital rule rests on the premise that different institutions face different requirements because their risk profiles, complexity, and risk management capabilities differ materially. Cross-product netting recognition has been historically confined to banking organizations using internal models methodology because recognizing netting offsets across derivatives and securities financing transactions ("SFTs") requires accurate modeling of co-movement under stress, robust legal review across multiple product types and jurisdictions, and supervisory validation that the netting set captures the economic relationship it purports to reflect.

Further, the absence of any updated impact analysis for this change is disqualifying on its own terms. The Proposal's impact analysis estimates aggregate effects on risk-weighted assets and capital requirements across covered banking organizations, but provides no decomposition of the effect attributable specifically to the extension of cross-product netting recognition through the SA-CCR election. The agencies do not disclose how many covered banking organizations currently hold both derivatives and repo-style transactions with the same counterparties under qualifying cross-product master netting agreements, how large those offsetting positions are in aggregate, what the capital reduction would be if those institutions elected SA-CCR and claimed cross-product netting offsets, or how those capital reductions are distributed across institution sizes. Without that analysis, neither the agencies nor commenters can assess whether the proposed change produces capital requirements that are commensurate with actual risk, whether the change is concentrated among a small number of larger covered banking organizations or distributed broadly, or whether the aggregate capital reduction is consistent with the safety and soundness objectives the Proposal claims to advance.

The agencies cannot finalize this provision without producing and publishing that analysis in full, subjecting it to public comment, and demonstrating affirmatively—not by assertion—that cross-product netting recognition under SA-CCR produces capital requirements for covered banking organizations that are calibrated to their actual risk exposures under stress conditions representative of the full credit cycle.

As detailed above, the Collins Amendment requires that the agencies demonstrate, before finalization, that capital requirements for covered institutions do not fall below the statutory floor established as of July 21, 2010—and that demonstration must account for every source of capital reduction in the rulemaking, including reductions that operate through methodological elections rather than through explicit changes to risk weights. The agencies have placed on notice in this comment letter that the cross-product netting provision generates an unquantified, unanalyzed, and unvalidated capital reduction. Therefore, proceeding to finalize this provision without demonstrating the full impact of this change (and its compliance with the Collins Amendment) would not be defensible under the statute or under the APA.

I. Market Risk

i. <u>The Proposed Market Risk Framework Is Structurally Designed to Minimize Market Risk Requirements Rather Than Meeting the Basel Framework's Goal of Improving Market Risk Capture</u>

The primary objective of the Basel III final reforms was to enhance the risk capture of the market risk activities of the largest banking organizations that engage most heavily in such activities. This set of critical reforms (which took nearly seven years and four consultative documents) is also known as the Fundamental Review of the Trading Book ("FRTB").[82]

The Basel Committee undertook the FRTB in response to the manifest failures of the pre-crisis market risk framework, which the global financial crisis exposed as grossly insufficient and failed to capture the variety of risks from trading activities. Value-at-risk models, which formed the core of the prior market risk regime, systematically underestimated tail risk and allowed banks to hold insufficient capital against trading book exposures precisely when those exposures became most dangerous (i.e., it was procyclical). The shift to expected shortfall, the tightening of the internal models approval process, and the revised and tighter boundary between the trading and banking books together reflected the Basel Committee's recognition that the existing framework had produced capital requirements that were neither risk-sensitive nor sufficiently conservative to absorb stress losses.

However, despite estimating a slight increase in market risk-related capital requirements, the Proposal intentionally fails to align with the internationally-accepted FRTB framework, which

[82] *See* Basel Committee on Banking Supervision, *Minimum Capital Requirements for Market Risk* (January 2019), available at: https://www.bis.org/bcbs/publ/d457.htm (the revised finalization of FRTB) and previous consultation documents: *Minimum Capital Requirements for Market Risk* (January 2016) (the initial finalization), available at: https://www.bis.org/bcbs/publ/d352.pdf, Basel Committee on Banking Supervision, *Consultative Document: Fundamental Review of the Trading Book: Outstanding Issues* (December 2014), available at: https://www.bis.org/bcbs/publ/d305.pdf; *Consultative Document: Fundamental Review of the Trading Book* (May 2012), available at: https://www.bis.org/publ/bcbs219.pdf.

is the most critical element to the Basel III final reforms. Indeed, of the major changes to the calculation of RWA in this Proposal, market risk is the most important to be aligned with the international standard in order to avoid arbitrage and gaming. Indeed, the Proposal estimates a 9 percent increase in market risk-related capital requirements (under the combined effect of the GSIB proposal and stress testing proposals)[83], but this is unjustifiably below the 2023 proposal's estimated 77 percent increase and significantly below the estimated impact of international counterparts (as shown in the Proposal's alternatives). That is because in the Proposal, the agencies deviated significantly from the Basel standards in several material areas, whereas the 2023 proposal and international counterparts have adhered much closer to the internationally agreed-upon standards in implementing FRTB. Furthermore, and notably, most of the Proposal's material deviations satisfy recommendations made by banking organizations and industry advocacy organizations in response to the 2023 proposal (more below).

The negligible estimated increase in market risk-related capital requirements, material deviations from the Basel standards, and the Proposal meeting nearly all the desires of the industry—in combination—prove that the market risk framework in the Proposal was designed to minimize, if not reduce, market risk-related capital requirements. This is an intentionally direct contradiction to the primary objective of the Basel revisions and, if implemented, will result in an international race to the bottom, something that already has begun with the European Union's and United Kingdom's delay in their FRTB implementation.[84]

ii. <u>The Proposed Market Risk Output Ceiling Cannot be Finalized as It Would Undermine the Entire Rationale of the Basel Framework</u>

Many of the capital-reducing deviations from the Basel standards are detailed below, but the most material structural deviation is proposing to have the standardized non-default capital requirement ("NDCR") serve as a cap to the models-based NDCR rather than serve as the basis of a floor. This deviation is being proposed without actual justification, only that "there could be instances when the higher capital requirements are not commensurate with the risk profile of the banking organization's market risk covered positions." That is not a sufficient justification under the APA. In fact, the agencies' statement that "there could be instances when the higher capital requirements are not commensurate with the risk profile"—is an assertion that any capital standard could generate a requirement that seems "high" to someone. That standard, applied consistently, would justify eliminating every post-crisis capital requirement in the agencies' capital framework and the Basel framework more broadly.

First, capital requirements must be conservative by design, especially considering the primary goal of the Basel III market risk modifications was to ensure market risks are sufficiently well capitalized. Second, the justification for the cap can go both ways, and therefore, is nonsensical. That is, there also could be instances when the models-based NDCR is much lower

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83 *Supra* 2 at 15108.

84 *Supra* 52 and 53.

than the risk profile of the banking organization's market risk covered positions rather than higher (and therefore "not commensurate"), which could be used as justification for a floor rather than a cap by the same logic. Indeed, the Basel market risk standards use the standardized NDCR to set a floor to the models-based NDCR rather than a cap. As such, Better Markets is not recommending that justification of the proposed cap be provided, because there is no possible justification that is consistent with safety-and-soundness for such an approach. Rather, the agencies should instead include the standardized NDCR-based floor that was included in the 2023 proposal.

The Basel Committee adopted the standardized NDCR floor specifically because internal models have a well-documented tendency to *underestimate* risk, particularly in stress conditions when capital adequacy matters most. The global financial crisis provided the empirical proof that value-at-risk models, and later the internal models approach ("IMA") frameworks that succeeded them, systematically produced lower capital requirements than warranted during periods of market stress. The NDCR floor was the Basel Committee's policy response to that failure, requiring that models-based capital never fall below a standardized minimum. By proposing to stand that design on its head (i.e., where the models-based measure produces *lower* capital than the standardized approach, the standardized floor is binding; but where it produces *higher* capital, the agencies want to cap it at the standardized level and give the difference back to the bank).

The result is a one-way ratchet to lower capital for market risk. A bank that uses models for market risk can never face market risk capital requirements higher than the standardized NDCR, regardless of what its own internal models indicate about the risk profile of its trading book. The agencies have effectively created a ceiling on model-based risk capture at precisely the moment when those models are identifying elevated risk. This is the opposite of what a prudential capital framework is supposed to do. No Basel Committee member—including the United States—agreed to this structure in the 2019 final FRTB standard.

The agencies must explain with specificity and empirical support why inverting the NDCR relationship would improve or, at a minimum, be consistent with safety and soundness, and why the model-based estimate should be discarded when it suggests a bank needs more capital than the standardized approach requires.

The agencies' failure to provide that explanation is a textbook violation of the APA's requirement for reasoned decision-making.[85] An agency must examine the relevant data and articulate a satisfactory explanation for its choice, including a rational connection between the facts found and the choice made. When an agency reverses a prior position—in this case the 2023 proposal's floor structure, which the agencies themselves adopted from the international standard they helped negotiate — it must acknowledge the change and provide a reasoned basis for it. The Proposal does neither. It does not acknowledge that it is inverting the Basel standard, explain why inverting the standard improves risk capture or provide empirical evidence that the models-based NDCR is systematically too high relative to actual trading book risk. It simply asserts the conclusion and moves on.

85 *Supra* 41.

Therefore, the agencies should not finalize this structure. Better Markets urges the agencies to restore the standardized NDCR as a floor to the models-based NDCR, consistent with the Basel standard and the 2023 proposal, and to withdraw the cap structure entirely.

The Agencies' COVID Rationale in Footnote 258 Exposes the Fundamental Incoherence of the Cap Structure

Footnote 258 of the Proposal contains a revealing sentence that exemplifies many of the worst aspects of this Proposal. In justifying the agencies' decision to use the standardized non-default capital requirement as a cap rather than a floor on models-based market risk capital, the agencies offer this illustration: "periods of sudden and extreme market volatility (such as the COVID pandemic) may significantly increase the number of aggregate trading portfolio backtesting exceptions, which can result in models-based non-default capital requirement being unduly conservative relative to the market risk to which the banking organization is exposed."[86]

The agencies have concluded that when a global pandemic triggers sudden and extreme market volatility—i.e., the tail risk event that market risk capital requirements exist to address—the resulting increase in capital requirements is a defect. A backtesting-driven capital requirement that rises during COVID is "unduly conservative relative to the market risk to which the banking organization is exposed." This reasoning inverts the entire logic of prudential capital regulation. Backtesting exceptions arise because realized trading losses exceed model predictions— meaning in effect that the models were wrong in the direction that endangers safety-and-soundness and financial stability. An increase in backtesting exceptions during COVID is the framework performing exactly as intended: identifying, with empirical precision, that internal models were underestimating risk as risk materialized. The appropriate regulatory response to that signal is heightened capital, not a permanent cap that prevents the signal from binding.

The agencies' characterization of COVID-era capital requirements as "unduly conservative" is also empirically unsupportable on its face. At the onset and throughout the COVID period, the Federal Reserve, Treasury, and Congress deployed trillions of dollars in emergency facilities to prevent dysfunction across the precise markets—investment-grade corporate bonds, agency MBS, commercial paper, money market instruments—where the eight GSIBs are the dominant broker-dealers. The suggestion that banks operating in those markets were holding excess capital relative to actual risk exposure is a regulatory rationalization working backwards from a desired policy outcome. Moreover, the proposed cap structure means the one moment when models-based requirements reliably do what they are supposed to do (i.e., increase to reflect elevated actual risk during stress) is the moment the agencies propose to override them. A capital framework that defaults to the standardized measure precisely when model-based estimates diverge upward from it is a framework that guarantees the largest dealer banks will never hold model-justified capital when model-justified capital matters most.

The agencies cannot justify a permanent structural change to the market risk framework on the basis of a single illustrative footnote that asserts a conclusion without evidence. Before finalizing any cap structure, the agencies must produce and publish the following: (1) the actual desk-level and aggregate backtesting exception data for covered banking organizations during the

86 *Supra* 2 at 10520.

COVID period; (2) a quantitative analysis demonstrating that the observed exceptions reflected model conservatism rather than model underperformance, including a comparison of realized losses to predicted losses across the trading book; (3) an explanation of the methodology the agencies used to distinguish "unduly conservative" capital outcomes from accurate capital outcomes during a period of genuine market stress; and (4) a showing, grounded in that data, that the proposed cap structure—rather than the Basel framework's floor structure—would have produced capital levels more consistent with actual risk during the COVID episode.

Without that analysis, Footnote 258 is an assertion. The agencies cannot permanently invert an internationally agreed prudential standard on the basis of an example they have not examined or provided the public sufficient data or explanation to respond to.

iii. The Aggregation Methodology Provides Unearned Diversification Benefits

Another structural deviation from the Basel standards that is designed to reduce market risk-related capital requirements is in the aggregation methodology for banks utilizing the models-based NDCR. Specifically, for the models-based NDCR, the Basel standards simply add the models-based NDCR of the model-eligible positions to the standardized NDCR of the model-ineligible positions. The Proposal, on the other hand, states that such a methodology "would disregard potential diversification effects between these two types of market risk covered positions," and therefore the Proposal instead would add the models-based NDCR of the model-eligible positions to the difference between the total standardized NDCR and the standardized NDCR of the model-eligible positions. The Proposal's approach would by design result in a lower total NDCR under the models-based measure relative to the Basel approach because it implicitly captures "diversification effects," which is a euphemism for diversification benefits and reductions since diversification results in reductions.

First, the NDCR under the models-based measure would be capped by the standardized NDCR, and so there is no possible justification for attempting to recognize diversification benefits. Second, the Proposal's approach is extremely crude and conceptually mixes outputs from two completely different measures. Instead, the agencies should use the approach from the Basel standards, which would prevent any conceptual mixing of different measures and avoid the unjustifiable recognition of diversification benefits within the models-based measure.

iv. The Risk Factor Eligibility Test Is Unnecessarily Weak

Another major structural deviation from the FRTB is in the risk factor eligibility test ("RFET") to determine whether a risk factor qualifies to have capital requirements calculated using only the models-based measure. As compared to the FRTB, the Proposal makes it significantly easier for a risk factor to qualify for a models-based capital measure. First, to make the determination around qualification, the Basel standards rely only on a quantitative test composed of strict standards around data availability—a sensible requirement considering data is the foundation of creating robust models—whereas the Proposal relies on a much looser quantitative test that allows unreliable data substitutes as well as a subjective qualitative test. Second, the Proposal introduces a third category of risk factors that must only meet the qualitative test criteria, allowing even more risk factors to be at least partially included in the models-based capital measure. The result of the Proposal's framework would be to allow an overly broad set of risk factors to be included in the models-based capital measure, risk factors that should not be included because there is not sufficient and reliable data to calibrate models. This surely would result in lower and unreliable capital requirements. The agencies should use only the quantitative risk factor eligibility test as defined in the Basel standards.

Removing the Spearman Correlation Test Undermines Risk Factor Data Quality Without Justification

The Proposal would eliminate the Spearman correlation test, which under the Basel framework, serves as a quantitative validation mechanism for the RFET by assessing whether modeled risk factor returns are consistent with observable market data. The agencies' impact analysis itself acknowledges that eliminating the Spearman test is estimated to increase model approvals by approximately 20 percentage points—meaning that roughly one-fifth of trading desks that would have failed the RFET under the Basel standard are expected to qualify under the Proposal's weaker standard. The agencies offer no explanation for why a 20-percentage-point increase in model approvals represents an improvement in risk capture or is consistent with safety-and-soundness.

The Spearman correlation test exists because internal model risk factors are only as reliable as the data underlying them. A risk factor that fails the Spearman test—in effect, meaning that the modeled returns are not well correlated with observed market prices—is a risk factor for which the bank does not have adequate data to support an accurate model. Eliminating the test simply removes the checkpoint that identifies when data quality is insufficient. The result is that risk factors with inadequate data support will be incorporated into models that generate binding capital requirements.

The agencies describe the elimination of the Spearman test as "reducing burden." However, put another way, it would only reduce the burden of large banking organizations demonstrating sufficiently high data quality. The agencies must explain with empirical support why the Spearman correlation test produces false negatives at a rate that justifies its removal, and must quantify the impact of removing it on the reliability of the RFET. Absent that explanation, the removal is arbitrary, particularly given the agencies' estimate of a 20-percentage-point increase in model approvals.

v. <u>The Three-Year PLA Transition Creates an Unjustified, Structural Capital Decrease</u>

The Proposal includes a three-year transition period during which banking organizations may apply the models-based approach to trading desks even if those desks fail the profit-and-loss attribution ("PLA") test. Critically, during the transition period, there would be no automatic capital consequences for PLA test failures. In effect, the Proposal could create a three-year window in which banks can use internal models to generate lower capital requirements without any supervisory backstop if those models prove unreliable.

The purpose of the PLA test is precisely to determine whether a bank's internal model accurately captures the actual risk of a trading desk. If a desk fails the PLA test, the model is, by definition, not reliably measuring the risks it is supposed to measure. Under the Basel standard, failure of the PLA test triggers mandatory reversion to the standardized approach—the capital consequence that gives the test a backstop in case a bank does not meet the standard. The Proposal would eliminate that consequence for three years. A bank that knows it will face no capital consequences for PLA failures during the transition period has no incentive to invest in model accuracy during that period. Instead, it has every incentive to apply the models-based approach as broadly as possible while it can and to delay corrections to failing models until the three years have elapsed. This element of the Proposal is completely inconsistent with the agencies' safety-and-soundness statutory mandate.[87]

The agencies have provided no empirical or analytical basis for this three-year window. They do not explain why three years is appropriate rather than one year or six months. They do not explain why the absence of automatic capital consequences is warranted given the explicit purpose of the PLA test. They do not explain how supervisors are expected to respond to PLA failures during the transition period, if not through the standardized approach backstop. This is particularly significant because the modeling infrastructure required to pass the PLA test—desk-level expected shortfall, profit and loss ("P&L") decomposition, risk factor capture—represents years of investment.

The agencies must explain: (1) the empirical basis for the three-year duration; (2) how supervisors will respond to PLA failures during the transition period in the absence of automatic capital consequences; (3) how such an approach would have been effective or not between 2006 and 2009 for the largest banks subject to the market risk framework and (4) how this structure is consistent with the FRTB, which prescribes immediate reversion to the standardized approach for desks that fail the PLA test. Absent that explanation, the transition provision is an unqualified, time-limited regulatory giveaway to banks that have not yet made the investments necessary to pass the test.

The Fallback Capital Requirement Provides an Additional Cushion Against Capital Consequences for Model Failures

Beyond the PLA transition and RFET liberalization, the Proposal introduces a fallback capital requirement for positions where a banking organization cannot calculate either the standardized NDCR or the models-based NDCR. The fallback applies during periods of systems failure, data unavailability, or operational disruption. Under the FRTB, the fallback is calibrated conservatively by applying the standardized approach with an add-on multiplier to ensure that operational limitations do not result in capital relief. The Proposal's fallback provisions are less clearly specified and do not include an equivalent conservative add-on. The agencies have not disclosed what the fallback capital requirement would equal in specific scenarios, how it interacts with the NDCR cap, or how long a banking organization may remain on the fallback before supervisory consequences apply.

The fallback provision matters because it is the third mechanism—alongside the PLA transition and the RFET qualitative test—through which the Proposal insulates covered banking organizations from the capital consequences (higher) of model inadequacy. First, a banking

[87] *Supra* 18.

organization that cannot pass the PLA test during the three-year transition faces no automatic capital consequence. Second, a banking organization whose risk factors cannot satisfy the quantitative RFET can qualify them through the new qualitative test. Third, a banking organization that faces operational difficulties calculating the required NDCR measures may use the fallback rather than immediately reverting to a conservative standardized treatment. Together, these three provisions systematically reduce the disciplinary force of model-based capital requirements.

The agencies must explain why all three provisions operating simultaneously does not produce a framework in which model failures routinely avoid capital consequences—which is the opposite of what the FRTB was intended to achieve.

vi. <u>The Proposal Narrows the Residual Risk Add-on Without Empirical Justification</u>

The residual risk add-on ("RRAO") is the Basel framework's capital backstop for instruments subject to residual risks not captured by the sensitivities-based method — the complex, correlation-sensitive, or exotic instruments whose risk profiles cannot be fully characterized by delta, vega, and curvature sensitivities. The RRAO applies a gross notional charge to these positions as a conservative, model-independent safeguard against the possibility that the primary ("sensitivities-based method") SBM calculation materially understates their risk.

The Proposal modifies the list of instruments subject to the RRAO to narrow its scope relative to the FRTB. Specifically, the Proposal excludes from the RRAO certain structured products and multi-underlying instruments that would be subject to the add-on under Basel's framework, on the basis that their risks are adequately captured by the sensitivities-based method. The agencies provide no empirical analysis supporting this exclusion. They do not identify which specific instruments are excluded, quantify the aggregate RRAO capital reduction resulting from the narrowed scope, or explain why the SBM adequately captures residual risks for the excluded instruments that the Basel Committee determined were not adequately captured.

The RRAO is specifically designed to address the tails of the risk distribution—the scenarios where standard sensitivity-based approaches break down. Excluding instruments from the RRAO based on a judgment that their risks are "adequately captured" by the SBM contradicts the entire rationale for the add-on. Specifically, if the SBM adequately captured their risks, the Basel Committee would not have subjected them to the RRAO in the first place.

The agencies must identify every instrument excluded from the RRAO under the Proposal that would be subject to it under FRTB, quantify the resulting capital reduction, and provide empirical analysis demonstrating that the SBM adequately captures residual risks for each excluded instrument. Absent that analysis, the RRAO scope reduction is an unjustified capital reduction in precisely the category of instruments that the RRAO was designed to protect against.

vii. <u>The Proposal's Internal Risk Transfer Framework Creates Unanalyzed Capital Arbitrage Pathways</u>

The FRTB significantly tightened the boundary between trading book and banking book positions specifically to prevent banking organizations from moving positions between frameworks to minimize capital requirements (also known as "regulatory arbitrage"). The strict boundary was a central design element of the post-crisis market risk reform: if positions can migrate freely between regulatory books, the expected shortfall-based market risk framework loses its force because institutions will simply designate risk-generating positions as banking book exposures where capital requirements are lower. The Basel Committee devoted substantial analytical effort to the boundary precisely because pre-crisis experience demonstrated that boundary arbitrage was a primary mechanism through which trading book capital requirements were systematically gamed.

The Proposal introduces or expands internal risk transfer ("IRT") frameworks for interest rate risk, equity risk, CVA risk, and credit risk between the banking book and trading book. Better Markets supports certain types of internal risk transfer—well-governed, conservative IRT frameworks can serve legitimate risk management purposes. However, the Proposal's IRT provisions are more permissive than the Basel standard in specific respects that the agencies do not acknowledge or justify, and the agencies provide no analysis of how the IRT framework interacts with the NDCR cap to determine whether the combined effect is to reduce market risk capital below what the Basel standard would require.

The interest rate risk IRT provisions are particularly concerning. Under the Proposal, a banking organization may transfer interest rate risk from the banking book to the trading book through an internal risk transfer, with the trading book receiving a market risk covered position and the banking book receiving an offsetting internal transaction. The conditions under which this transfer is recognized—including the requirement that the IRT be "reasonably expected to offset" the interest rate risk in the banking book—are judgment-dependent and subject to limited supervisory validation at origination. An institution with a large banking book interest rate exposure has a direct capital incentive to transfer that exposure into the trading book if the resulting market risk capital requirement is lower than the banking book capital requirement, including after the NDCR cap operates. The agencies have not analyzed whether the NDCR cap structure creates conditions under which IRT is reliably more capital-efficient than retaining the exposure in the banking book, nor have they disclosed how many institutions are expected to use interest rate IRTs or what the expected aggregate capital effect would be.

The equity risk IRT framework raises similar concerns. The Proposal permits IRT of equity risk under conditions that are less restrictive than the analogous Basel provisions, including with respect to documentation requirements, supervisory notification timing, and the conditions under which the banking book side of the IRT is treated as an internal hedge eligible for recognition. An institution that holds equity exposures in the banking book that generate substantial capital requirements under ERBA has a capital incentive to transfer those exposures to the trading book if the resulting market risk capital treatment is more favorable. The Proposal does not quantify this incentive, does not analyze the aggregate portfolio effects of equity IRTs, and does not explain how the current IRT documentation requirements prevent institutions from designing IRT structures that optimize across regulatory frameworks rather than reflect genuine risk management practices.

The agencies must provide, before finalizing any IRT framework:

a) a quantitative analysis of the expected aggregate capital effect of the IRT provisions for each risk category, using institution-specific data from covered banking organizations;

b) an explanation of how the proposed IRT documentation and supervisory notification requirements prevent IRT structures from functioning as regulatory capital arbitrage mechanisms;

c) a comparison of the proposed IRT conditions against the Basel standard, identifying each respect in which the Proposal is more permissive and explaining the empirical or policy basis for each divergence; and

d) scenario analysis demonstrating that the IRT framework combined with the NDCR cap does not systematically produce market risk capital requirements below what would result from applying either framework in isolation without IRT recognition.

viii. The $20 Million Net Short Position Threshold Has No Empirical Basis

The Proposal would establish a $20 million threshold for net short risk positions that must be designated as “market risk covered positions” regardless of their accounting classification. Therefore, below $20 million, a net short risk position need not be designated as a market risk covered position. The $20 million threshold has no direct analog in the Basel market risk framework. The agencies have provided no empirical basis for this specific calibration.

The Proposal does not explain why the $20 million figure (rather than e.g., $10 million, $50 million, or another dollar figure) is the appropriate threshold below which the systemic risk concerns that justify treating net short positions as market risk covered positions no longer apply. It also does not analyze the distribution of net short positions across covered banking organizations to determine what percentage of net short exposure falls below the threshold and therefore outside the market risk framework.

A threshold that excludes a material volume of net short positions from the market risk framework produces a systematic understatement of market risk RWAs. The agencies must disclose the empirical basis for the $20 million figure, provide data on the distribution of net short positions across covered banking organizations relative to this threshold, and quantify the aggregate market risk RWA reduction attributable to positions that fall below the threshold and are therefore excluded from market risk capital requirements. Absent that disclosure, the $20 million threshold is an arbitrary bright-line calibration that the APA does not permit the agencies to adopt without reasoned justification.

ix. The Proposed Market Risk Framework Incorporates Nearly All the Major Industry Recommendations from the 2023 Proposal, Reducing Market Risk Capital without Justification

The Proposal would incorporate nearly every major recommendation made by banking organizations and industry advocacy organizations that were submitted in response to the agencies 2023 proposal by either directly incorporating the recommendation or excluding the aspects of the

2023 proposal identified by the industry. The result of the agencies incorporating those recommendations in the Proposal would be to materially reduce market risk capital requirements, and yet the agencies have incorporated them without sufficient justification, as noted in this letter.

Two comment letters in particular deserve specific attention because the correspondence between their recommendations and the Proposal's content is so precise and comprehensive.

The comment letter jointly filed by the Bank Policy Institute ("BPI") and the American Bankers Association ("ABA")[88] in response to the 2023 proposal included the following specific recommendations for the market risk capital framework. The Proposal would implement nearly all of them:

BPI/ABA Recommendation: "The standardized approach does not sufficiently recognize the benefits of diversification." The BPI/ABA letter argued that the 2023 proposal's standardized approach "does not sufficiently recognize the benefits of diversification" and demanded that the agencies revise the aggregation methodology to capture diversification between model-eligible and model-ineligible positions. The Proposal includes precisely this revision, replacing the Basel additive methodology with a U.S.-specific formula that implicitly captures diversification benefits between model-eligible and model-ineligible positions (a structural deviation from the FRTB that the agencies justify using language nearly identical to BPI/ABA's demand).

BPI/ABA Recommendation: The PLA test "lacks empirical support" and should not "result in automatic add-ons or model ineligibility." BPI/ABA argued that the PLA test eligibility requirements "lack empirical support and have the potential to introduce volatility and uncertainty into capital requirements, as banks could be forced to switch between applying models-based and standardized approaches due to the inability to pass arbitrary tests."[89] BPI published a separate research paper explicitly titled "The New Profit and Loss Attribution Tests: Not Ready for Prime Time," arguing the PLA test should be "for reporting and monitoring purposes only." The Proposal adopts a three-year transition period during which no automatic capital consequences apply for PLA failures—the exact outcome BPI recommended.

BPI/ABA Recommendation: The FRTB-IMA market risk capital requirements should be capped at the standardized approach level. BPI/ABA argued that the agencies should "address the excessive calibration of market risk capital requirements" and that implementing FRTB without adjusting the GMS would "lead to a considerable over-capitalization." As noted above, the Proposal would invert the Basel floor structure so that the standardized NDCR now serves as a cap

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88 *See* comment letter from Bank Policy Institute and American Bankers Association, " Re: January 16, 2024 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity" (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)" (January 16, 2024), available at: https://www.federalreserve.gov/apps/proposals/comments/FR-0000-0086-01-C310.

89 Bank Policy Institute. *The New Profit and Loss Attribution Tests: Not Ready for Prime Time*, Bank Policy Institute (December 14, 2023), available at: https://bpi.com/the-new-profit-and-loss-attribution-tests-not-ready-for-prime-time/.

on models-based capital—converting what the agencies themselves proposed as a floor in 2023 into a ceiling in 2026, at the precise threshold BPI demanded.

The Proposal would implement nearly all the above recommendations directly from the letter. As another example, the Proposal would incorporate recommendations made by the International Swaps and Derivatives Association ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") in a letter to the 2023 proposal.[90] Their letter recommended, among other things, that the agencies cap total FRTB-IMA capital at the FRTB-SA level, convert the PLA test to a "monitoring process" with no automatic capital consequences, recognize diversification between modelled and non-modelled risk factors, loosen the RFET to make IMA more accessible, recalibrate the non-modellable risk factor ("NMRF") rho parameter, exempt client-cleared derivative transactions from CVA, remove the SFT minimum haircut floor entirely, and permit cross-product netting of bilateral OTC derivatives and SFTs. The Proposal implements every one of these recommendations. The ISDA/SIFMA letter even explicitly used the phrase "cap the total FRTB-IMA capital at FRTB-SA"—and the Proposal does exactly that, inverting the internationally agreed floor structure into a ceiling at the precise request of the associations whose members benefit most from lower market risk capital.

The agencies have provided no independent empirical analysis justifying any of these changes. They have simply adopted, in sequence, the demands of the two largest market risk industry trade associations, the output of whose combined member quantitative impact study ("QIS") data the agencies then incorporated into their own impact analysis without independent verification—using the regulated entities' own numbers to justify giving those same entities what they asked for.

Goldman Sachs also submitted a comment letter regarding the 2023 proposal.[91] Several of its recommendations mirror those from the aforementioned trade association letters, which would all result in lower capital requirements compared to the FRTB. And yet these industry recommendations were implemented without sufficient justification. For example, the Proposal does not even attempt to provide a justification for allowing banking organizations the option to choose the full look-through approach or one of the modified look-through approaches for equity exposures to investment funds.

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90 *See* ISDA and SIFMA. Comment from the International Swaps and Derivatives Association, Inc. and the Securities Industry and Financial Markets Association (January 16, 2024), available at: https://www.federalreserve.gov/SECRS/2024/February/20240220/R-1813/R-1813_011724_156753_496678267479_1.pdf.

91 *See* comment letter from The Goldman Sachs Group, Inc., Re: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity (OCC Docket No. ID OCC-2023-0008; Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29); Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15) (Federal Reserve Docket No. R-1814; RIN 7100-AG65)" (January 16, 2024), available at https://www.federalreserve.gov/apps/proposals/comments/FR-0000-0086-01-C185.

It is a virtual impossibility that every industry recommendation in response to the 2023 proposal was deemed justifiable by the agencies under the APA. Therefore, a failure to provide a reasoned justification for each included industry recommendation is a clear indication that the agencies included those recommendations in the Proposal solely to satisfy the industry's wishes, which is a violation of the APA standards on a scale that is truly unprecedented and inconsistent with the agencies' safety-and-soundness statutory mandates. If the agencies decide to continue with putting forth the industry recommendations, the Proposal must be reissued with legitimate, APA compliant justifications for each of the industry's recommendations made in response to the 2023 proposal.

x. The Agencies Must Provide Desk-Level Impact Data Before Finalizing Any Market Risk Framework

The market risk capital requirements in this Proposal will be determined almost entirely at the trading desk level—through desk-level PLA tests, desk-level model approvals, and desk-level RFET determinations. Yet the agencies' impact analysis is conducted at the aggregate level, using the same 2023 QIS data that the Board collected for a materially different proposal (particularly for the implementation of the FRTB). The agencies have not provided commenters with desk-level data, desk-level model approval projections, and desk-level impact estimates for the specific combination of NDCR cap, diversification adjustment, Spearman removal, and RFET liberalization (all critical elements of the Proposal's market risk framework).

Therefore, commenters cannot meaningfully provide input given this lack of necessary information. The agencies have supervisory access to the trading desk-level data necessary to estimate the Proposal's actual market risk capital impact. Before finalizing any market risk framework, the agencies must collect and publish desk-level impact data for public comment, including: (1) estimated desk-level model approval rates under the RFET with and without the Spearman test (for the firms that agencies expect may apply for model-approval); (2) estimated aggregate capital impact of the NDCR cap versus floor at current trading book compositions; (3) estimated capital impact of the diversification aggregation adjustment relative to the Basel additive methodology;. Without this data, neither the public nor the agencies themselves can know what market risk capital requirements the Proposal would result in practice.

J. CVA Risk

The Proposal's revisions to credit valuation adjustment ("CVA") capital requirements represent one of the least transparent and most consequential sources of capital reduction in the entire rulemaking. CVA capital requirements exist for a specific reason: derivative counterparties can deteriorate in creditworthiness during periods of market stress, causing mark-to-market losses on banks' derivative portfolios that are real, material, and correlated with broader systemic distress.[92] The Basel Committee identified CVA risk as a primary source of losses during the global financial crisis—larger, in fact, than outright counterparty defaults—and the post-crisis framework was explicitly designed to ensure banks held capital commensurate with that exposure.[93] The Proposal would apply a much weaker version of the Basel CVA framework in ways the agencies have not empirically justified and that are inconsistent with the historical record of CVA losses during stress.[94]

The agencies present the CVA revisions as a technical alignment with the Basel III standards adopted internationally. That framing obscures the substance of what the Proposal actually does: it reduces CVA capital requirements by expanding access to the basic CVA approach ("BA-CVA") for institutions that do not qualify for the full standardized CVA approach ("SA-CVA"), modifies eligibility criteria in ways that permit more favorable treatment for a broader set of covered institutions, and preserves or expands the scope of CVA exemptions that allow institutions to hold zero CVA capital against material derivative exposures. The aggregate capital reduction attributable specifically to these CVA changes is not disclosed anywhere in the Proposal's impact analysis. The agencies cannot finalize CVA revisions of this magnitude without disclosing that figure and demonstrating, with supporting data, that the revised CVA capital levels remain adequate to absorb losses of the type and magnitude observed during the global financial crisis.

i. The CVA Exemption Scope Remains Too Broad and Has No Empirical Justification

The Proposal preserves broad exemptions from CVA capital requirements for transactions with certain counterparty types, including sovereigns, central banks, multilateral development banks, non-financial end-users, and pension funds. While some of these exemptions may have narrow policy justifications, the agencies' blanket preservation of the exemption scope is inconsistent with the empirical record and with the agencies' own stated commitment to ensuring that capital requirements reflect actual risk. Furthermore and notably, the preservation of certain

92 *See* Fleming, Liu, Podjasek and Schurmeier. "The Federal Reserve's Market Functioning Purchases" Federal Reserve Bank of New York Staff Report No. 998 (December 2021). The report documents how March 2020 selling pressure "overwhelmed dealers' capacity to intermediate trades, contributing to a marked deterioration of market functioning." available at: https://www.newyorkfed.org/research/staff_reports/sr998.

93 *See* Basel Committee on Banking Supervision. "Capital treatment for bilateral counterparty credit risk finalised by the Basel Committee" (June 1, 2011) "During the financial crisis, however, roughly two-thirds of losses attributed to counterparty credit risk were due to CVA losses and only about one-third were due to actual defaults" available at: https://www.bis.org/press/p110601.htm. *See also* Basel Committee on Banking Supervision, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (June 2011), available at: https://www.bis.org/publ/bcbs189.pdf.

94 *See* Basel Committee on Banking Supervision. "High-Level Summary of Basel III Reforms" (December 2017), at 14. "CVA risk was a major source of losses for banks during the global financial crisis, exceeding losses arising from outright defaults in some instances", available at: https://www.bis.org/bcbs/publ/d424_hlsummary.pdf.

exemptions, especially the exemption of financial end-users, satisfies recommendations from industry comments made in response to the agencies' 2023 proposal.

CVA losses are driven by counterparty credit deterioration combined with changes in the mark-to-market value of derivative exposures. The credit quality of an exempted counterparty category does not eliminate a bank's CVA exposure to that counterparty. Instead, it represents an assumption—unvalidated in the Proposal—that credit deterioration among exempted counterparties will not produce material CVA losses. That assumption was not uniformly correct during the global financial crisis, when sovereign credit spreads widened significantly across multiple jurisdictions and non-financial corporate counterparties experienced rapid credit deterioration during the acute phase of the stress event. A capital framework that excludes from CVA requirements entire categories of counterparties based on their classification rather than their actual credit risk profile is applying an assumption where an analysis is required.

The agencies also provide no empirical analysis in the Proposal demonstrating that historical CVA losses on exempt counterparty categories were de minimis, that exempt counterparties exhibited lower CVA volatility than non-exempt counterparties under stress, or that any of the exempt categories present genuinely different CVA risk profiles that justify zero capital treatment. Without that analysis, the exemption scope represents an assertion of safety, not a demonstration of it. Before finalizing any exemption from CVA capital requirements, the agencies must produce historical CVA loss data stratified by counterparty category, covering at minimum the global financial crisis period and the March 2020 financial stress, and demonstrate that exempted categories produced CVA losses that were immaterial relative to capital across the covered institution population.

ii. CVA Losses Are Pro-Cyclical and the Proposal Does Not Model That Dynamic

The core danger of CVA exposure for banking organizations is its behavior in the extreme tail events. In effect, CVA losses are much more highly correlated with broader market stress (i.e., when credit spreads widen, derivative mark-to-market values shift, and counterparty credit quality deteriorates simultaneously). The result is that CVA losses tend to be largest precisely when bank capital is most constrained, amplifying pro-cyclical dynamics rather than buffering against them. The Basel Committee identified this correlation explicitly in its post-crisis analysis and designed CVA capital requirements to ensure banks held ex ante buffers against this tail scenario.

The Proposal's impact analysis presents estimated CVA capital effects as point estimates using current portfolio data and current market conditions. It does not model how CVA capital requirements would perform in a stressed environment involving simultaneous credit spread widening, counterparty deterioration, and derivative mark-to-market losses of the type observed during the global financial crisis. It does not disclose how the revised BA-CVA formula would have performed against actual CVA losses observed at regional and mid-size institutions during prior stress events. It does not present scenario analysis under a parallel shift in credit spreads or under conditions of correlated counterparty distress. A prudential capital requirement that is justified through point-in-time analysis calibrated to benign credit conditions—without any demonstration that it remains adequate in the tail scenarios that CVA capital was designed to address—is precisely the kind of calibration error that the post-crisis reform effort was intended to prevent.

Before finalizing any CVA capital revisions, the agencies must publish scenario analyses demonstrating that revised CVA capital requirements remain adequate under stress conditions comparable to the acute phases of the global financial crisis and the March 2020 financial stress. Those analyses must be conducted for the covered institution population specifically—not for the GSIBs' portfolios and CVA losses that formed the calibration basis for the underlying BA-CVA and SA-CVA frameworks. The agencies must also disclose the aggregate CVA capital reduction attributable to the Proposal's revisions and include that figure in the Collins Amendment compliance analysis required elsewhere in this letter.

iii. Wrong-Way Risk Is Inadequately Addressed in the CVA Framework

The Proposal does not meaningfully address wrong-way risk in the context of CVA capital. Wrong-way risk—the condition in which the creditworthiness of a counterparty is adversely correlated with the mark-to-market value of the derivative exposure to that counterparty—is among the most dangerous and historically consequential sources of CVA loss. It represents the scenario in which a bank's CVA exposure is largest at precisely the moment the counterparty is least able to perform, compounding both counterparty credit risk and CVA loss simultaneously.

The empirical record on wrong-way risk is extensive and unambiguous. Monolines and financial guarantors that provided credit protection on structured credit products were deeply wrong-way counterparties during the global financial crisis—their credit quality deteriorated in direct proportion to the increase in the mark-to-market value of the protection they had sold. AIG's derivative exposures exhibited textbook general wrong-way risk, as its credit deterioration was correlated with broad market stress that simultaneously increased the value of the protection it had sold to dealer banks.[95] The CVA losses realized on these counterparties were far larger than standard CVA models predicted precisely because those models did not adequately capture the correlation between counterparty credit quality and exposure value.

The Proposal does not require covered banking organizations to conduct specific wrong-way risk analysis under BA-CVA, to apply conservative add-ons for identified wrong-way risk exposures, or to disclose the extent to which their CVA exposures include counterparties whose credit quality is structurally correlated with the value of the derivative positions they support. It does not explain how BA-CVA capital—calibrated on average credit spread dynamics rather than specific wrong-way risk scenarios—provides adequate capital against the kind of correlated deterioration that has historically produced the largest CVA losses. This is a material omission in the prudential framework that the agencies cannot cure through general assertions about the conservatism of supervisory CVA parameters.

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95 *See* Paddrik and Rajan. "Bounding Wrong-Way Risk in Measuring Counterparty Risk." Office of Financial Research Working Paper No. 15-16 (October 2015). "Counterparty risk has taken on heightened importance since the failures of major derivatives dealers Bear Stearns, Lehman Brothers, and AIG Financial Products in 2008." available at: https://www.financialresearch.gov/working-papers/files/OFRwp-2015-16_Wrong-Way-Risk-in-Measuring-Counterparty-Risk.pdf.

The agencies must require all covered banking organizations using BA-CVA to identify, report, and apply a regulatory capital add-on for specific wrong-way risk exposures, defined as derivative counterparties whose reference credit quality is structurally correlated with the mark-to-market value of the bank's net exposure to that counterparty. That requirement could be a simple flag-and-floor approach, consistent with the methodology used in the SA-CCR framework for margined exposures to capture the most significant wrong-way risk concentrations without imposing undue operational burden.[96] However, what is not acceptable from a safety and soundness perspective is a CVA capital framework that ignores wrong-way risk entirely for covered banking organizations on the grounds that BA-CVA is a "simplified" approach. Simplified frameworks can be conservative, or they can be permissive. The agencies have proposed the latter without explaining why that is the appropriate calibration choice for institutions that may hold highly concentrated, correlated, or structurally wrong-way CVA exposures relative to their capital bases.

iv. <u>The Collins Amendment Analysis Must Include CVA Capital Reductions</u>

As described elsewhere in this letter, the agencies have not demonstrated compliance with the Collins Amendment. That deficiency is particularly relevant to the Proposal's CVA capital revisions. CVA capital requirements were not part of the pre-Dodd-Frank Act capital framework (as they were introduced through the 2013 Basel III rulemaking[97]) and the interaction between the CVA capital increases from Basel III and the CVA capital reductions included in the Proposal creates precisely the kind of netting and offsetting dynamic that the Collins Amendment compliance analysis is required to make transparent. It is incumbent on the agencies to show their work on this issue, not for commenters to attempt to assess compliance.

Therefore, the agencies must disclose: (i) the CVA capital requirements that were established for covered institutions in the Proposal by the 2013 Basel III final rule; (ii) the aggregate and institution-category-level CVA capital reduction that results from the Proposal's revisions to BA-CVA eligibility, exemption scope, and supervisory parameters; and (iii) a demonstration that those reductions, combined with reductions in other exposure categories, do not bring any covered institution below the statutory Collins floor on any applicable capital measure. The agencies cannot treat CVA capital as a free-floating technical adjustment immune from statutory compliance requirements. If the Proposal reduces CVA capital for covered institutions—and it does—that reduction must be accounted for in the Collins Amendment analysis with the same rigor the Amendment demands for every other element of the rulemaking.

K. Securitizations

i. <u>Better Markets Strongly Opposes the Securitization Framework's Multiple Capital Giveaways and Urges the Agencies to Reject Provisions That Will Drive Lending Into Non-Bank Financial Institutions</u>

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96 *See* Basel Committee on Banking Supervision. *Guidelines for Counterparty Credit Risk Management* (August 2024), available at: https://www.bis.org/bcbs/publ/d588.pdf.

97 *Supra* 14.

Better Markets strongly opposes many of the capital reductions embedded in the Proposal's securitization framework. Securitization markets were the transmission mechanism of the global financial crisis. Highly leveraged, opaque, and structurally complex securitization structures amplified losses that would have been contained within individual loan portfolios and distributed them across the global financial system in ways that regulators, investors, and the institutions themselves did not understand and could not measure. The post-crisis capital reforms reflected a hard-won recognition that securitization introduces risks—waterfall complexity, servicer dependency, correlation among underlying exposures, liquidity risk in stress, legal risk in enforcement—that are not present when a banking organization simply holds the underlying assets directly, and that those additional risks require additional capital, not less.

The Proposal reverses that lesson in several significant ways. Taken together, the reduction of the securitization floor from 20 to 15 percent, the introduction of the look-through approach with the same 15 percent floor for senior exposures, the expansion of overlapping exposure treatment across credit and market risk books, and the liberalization of eligible clean-up call definitions collectively represent a substantial weakening of the securitization capital framework relative to the current rule. Better Markets opposes each of these changes on their individual merits, and opposes them categorically as a package that will—predictably and materially—accelerate the migration of credit risk from the regulated banking system into NBFIs.

When banking organizations face lower capital requirements for securitization exposures, the economics of originate-to-distribute lending improve relative to hold-to-maturity lending. The same dynamic operates in reverse: when a banking organization retains a senior tranche at a 15 percent risk weight rather than holding the underlying loans at 100 percent or more, it has a structural incentive to expand securitization activity, transfer the credit-risk-bearing tranches to investors outside the regulatory perimeter, and retain only the thinnest slice of exposure necessary to satisfy alignment-of-interest requirements. The result is credit risk that migrates to hedge funds, insurance companies, CLO managers, and other NBFIs that are subject to no equivalent capital framework, no equivalent liquidity requirements, and no equivalent supervisory oversight. The agencies' own economic analysis acknowledges that the Proposal may incentivize some migration of activities toward banking organizations—while simultaneously creating conditions that accelerate migration in the opposite direction through a more permissive securitization framework. The agencies do not reconcile this tension, and the resolution is not obvious.

A framework that lowers securitization capital requirements across the board will, on balance, push credit intermediation toward NBFIs, not away from them, and incentivize large banking organizations to increase their support for NBFI credit intermediation by redirecting lending dollars towards NBFI credit intermediaries at the expense of direct lending to borrowers. In fact, in 2025, GSIBs' lending to NBFI credit intermediaries increased by over 40 percent, while non-NBFI lending (i.e., lending to real economy borrowers) did not increase at all—zero percent.[98] The GSIBs are actively and strategically moving away from direct lending to real economy

[98] Better Markets analysis' based on data from the Call Report lending to non-bank credit intermediaries.

borrowers and towards indirect lending to NBFI credit intermediaries, and a key driving factor is the favorable securitization risk weight framework.

Indeed, Call Report data analyzed by the firm Bank View has confirmed that securitization exposures have grown rapidly across the banking system and have benefited from the favorable risk weight framework.[99] As shown in the chart below, total on-balance-sheet securitization exposures held by U.S. insured banks increased from approximately $275 billion in 2020 to over $900 billion by 2025, more than tripling in five years. Yet the associated RWAs generated under the existing securitization capital framework increased far more slowly, from roughly $75 billion to around $200 billion over the same period. As a result, securitization exposures have expanded much faster than the capital required to support them, with effective risk weights remaining near or below 20 percent for much of the period.

This trend is particularly notable because it demonstrates that securitization has become an increasingly important mechanism for reducing measured capital requirements relative to the size of underlying exposures. Banks added approximately $700 billion of additional securitization exposures between 2020 and 2025, while associated RWAs increased by only about $125 billion. In other words, each additional dollar of securitization exposure generated only a fraction of a dollar of incremental RWA, whereas direct lending to, for example, corporate borrowers would have generated dollar-for-dollar RWA.

Against this backdrop, the agencies' Proposal to further reduce risk weights on certain securitization positions—including lowering the floor for senior securitization tranches from 20 percent to 15 percent—moves in precisely the wrong direction. The chart below illustrates that the current framework has already permitted very substantial growth in securitization activity while maintaining relatively low capital requirements.

Before further reducing capital requirements, the agencies should demonstrate with empirical evidence that existing requirements materially overstate risk. Additionally, the agencies must study and release analysis and conclusions regarding excessive migration of assets away from direct lending and into securitization structures designed primarily to achieve capital relief. The current framework has resulted in such excessive migration, and the Proposal would exacerbate that dynamic. As such, in the spirit of encouraging banks to fulfill their intended purpose of taking deposits and lending those deposits directly to real economy borrowers, the agencies should consider either: 1) a cap on the amount of securitization exposures allowed or 2) substantially increasing the risk weight for such exposures above a defined threshold.

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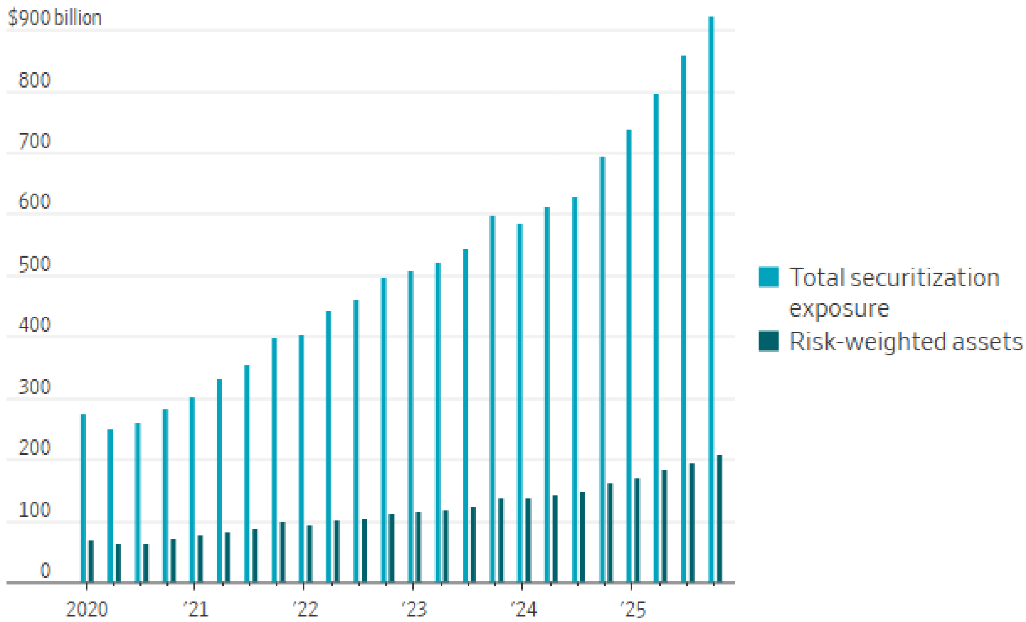
99 See Demos, Telis. Wall Street Journal. "New Bank Regulations Could Favor Loans to Private Credit" (March 25, 2026), available at: https://www.wsj.com/finance/regulation/new-bank-regulations-could-favor-loans-to-private-credit-674e1106.

Comparison of select U.S. insured-bank securitization assets and resulting risk-weighted assets after applying capital rules for securitization exposures



Note: Total is adjusted total on-balance sheet securitization exposure excluding trading book and investment portfolio. Capital rules refer to simplified supervisory formula approach.
Source: BankviewUSA.com

ii. <u>The 15 Percent Floor for Certain Securitization Exposures Is Too Low and Inverts the Risk Hierarchy</u>

The Proposal would reduce the risk-weight floor for certain securitization exposures from 20 percent under the current Simplified Supervisory Formula Approach ("SSFA") to 15 percent under the proposed SEC-SA. Better Markets strongly opposes this reduction and urges the agencies to maintain the current 20 percent floor.

The floor exists because the SEC-SA formula, however improved relative to the SSFA, cannot capture all of the risks of a securitization exposure. The agencies themselves state that the floor "is intended to ensure that banking organizations maintain a minimum level of capital to account for risks that may not otherwise be captured by SEC-SA, such as modeling risks and correlation." If that is the purpose, then reducing the floor from 20 to 15 percent means accepting that a category of risks that the formula cannot capture will now receive a 25 percent less capital requirement. The agencies provide no analysis of what risks fall below the formula's capture, whether those risks have declined relative to when the 20 percent floor was set, or whether 15 percent is empirically sufficient to cover them. The sole justification offered is alignment with the Basel III final reforms—a justification that is not independent, since the Basel standard itself may not be correctly calibrated and U.S. law neither requires nor presumes that it is.

More fundamentally, the resulting capital requirements hierarchy is incoherent. Under the Proposal, a banking organization holding a senior tranche of a private-label CLO can receive a 15 percent risk weight under ERBA, while a direct exposure to a GSE such as Fannie Mae or Freddie Mac carries a 20 percent risk weight. A privately structured securitization tranche, whose performance depends on waterfall mechanics, servicer behavior, correlation among hundreds of underlying loans, legal enforceability of the trust structure, and the reliability of rating agency assessments of attachment and detachment points, is assigned lower minimum capital than a direct exposure to an entity like a GSE whose obligations carry the explicit or implicit backing of the United States federal government and which has never defaulted. The agencies must explain, on first principles of credit risk rather than by reference to international standards, how that capital ordering is consistent with a coherent theory of risk (but they have not done so).

The global financial crisis provided the empirical answer. Super-senior tranches of mortgage-backed securities and CDOs—instruments that in 2006 carried risk weights consistent with, or below, what the Proposal now contemplates for senior securitization exposures—experienced severe and in many cases total losses. AAA-rated CMBS tranches, CLO senior tranches, and ABCP conduit exposures all demonstrated that senior structural position does not eliminate tail risk under conditions of correlated stress. A 15 percent risk weight floor would not provide a meaningful buffer against scenarios of that severity.

iii. The Look-Through Approach Is a Capital Reduction Mechanism in Disguise

The Proposal would introduce a new "look-through approach" for senior securitization exposures that allows a banking organization to assign a risk weight equal to the weighted average risk weight of the underlying exposures, subject only to the 15 percent floor. The agencies characterize this as improving risk sensitivity; however, it is more accurately characterized as a mechanism for large banking organizations to reduce capital requirements on senior tranches whenever the weighted average risk weight of the underlying exposures falls below the SEC-SA formula output.

Under the Proposal, a senior tranche of a prime residential mortgage securitization, where the underlying exposures receive relatively low risk weights under the ERBA, could produce a look-through weighted average risk weight substantially below what the SEC-SA would generate, floored at 15 percent. The banking organization that holds the senior tranche would apply the lower of the two—the look-through result—and hold correspondingly less capital. However, the look-through approach ignores precisely the risks that justify applying higher capital to a securitization exposure than to the underlying assets held directly: the waterfall structure, the servicer risk, the legal complexity, the correlation assumptions embedded in tranche mechanics, and the liquidity risk that arises from holding a structured instrument rather than the underlying loans.

Question 77 asks whether the 15 percent floor is appropriate for the look-through approach. Better Markets' answer is no. The floor should be at least 20 percent, and the look-through approach itself should not be available where the SEC-SA produces a higher result. A risk-sensitivity mechanism that allows banking organizations to bypass the primary SEC-SA calculation whenever doing so reduces capital is a selective override of the formula in the direction that favors institutions.

iv. The Overlapping Exposure Expansion Across Credit and Market Risk Books Invites Regulatory Arbitrage

The Proposal would expand the overlapping exposure treatment—which currently permits banking organizations to hold capital only for the greater of two duplicative securitization exposures rather than for both—to apply where one exposure is subject to the ERBA and another is subject to the market risk framework. The agencies frame this as avoiding double-counting. In our view, it as an invitation to regulatory arbitrage.

The conditions under which two securitization exposures in different regulatory books genuinely overlap—legally, economically, and temporally—are narrow and fact-specific. A securitization exposure in the banking book and a related position in the trading book may be legally distinct instruments with different maturities, different liquidity profiles, different accounting treatments, and different responses to stress. Basis risk between the two positions is real: the banking book exposure may deteriorate in credit quality at a different rate and through different mechanisms than the trading book position. Operational risk in the hedging relationship—the possibility that the trading book position cannot be efficiently managed or liquidated during stress—is not captured by simply taking the greater capital charge. The Proposal would permit a banking organization to recognize the overlap "provided the banking organization is able to calculate and compare the capital requirements for the relevant exposures," with no additional stress-testing or supervisory pre-approval requirement.

Better Markets recommends that the agencies not to adopt this expansion. If they do, they must at minimum require banking organizations to demonstrate genuine legal, economic, and temporal overlap under stress conditions—not merely under normal market conditions—before any capital reduction is recognized, and must require supervisory pre-approval for each instance of cross-book overlap recognition.

v. The Proposal's Synthetic Excess Spread Prohibition Is Correct

Better Markets supports the Proposal's prohibition on recognizing capital relief for synthetic securitizations that include synthetic excess spread. Synthetic excess spread is retained first-loss support by another name. An originating banking organization that absorbs losses from the underlying pool before any investor tranche is reached has not transferred credit risk—it has created the appearance of risk transfer while retaining the economic substance of the first-loss position. The Proposal correctly identifies synthetic excess spread as a form of credit enhancement provided by the originating banking organization and requires retention of full capital against the underlying exposures.

Question 67 asks how the exposure amount of synthetic excess spread should be calculated if the agencies were to permit capital relief for such structures. Better Markets believes that the agencies should not permit capital relief for synthetic securitizations with synthetic excess spread, and should not develop a methodology for doing so. The question itself signals a willingness to revisit the prohibition in response to industry pressure, and Better Markets urges the agencies to resist that pressure in the final rule. Any methodology for calculating the exposure amount of synthetic excess spread would introduce exactly the complexity, subjectivity, and variability across banking organizations that the removal of internal models was designed to eliminate. The Proposal acknowledges that "the total amount of synthetic excess spread made available at inception to investors over the life of the transaction may not be known ex ante." A capital requirement calibrated to an unknown and unknowable quantity is not a capital requirement; it is a placeholder that sophisticated institutions will design around. The prohibition should be maintained without qualification.

vi. The Nth-to-Default Prohibition Should Be Extended

Better Markets supports the Proposal's prohibition on recognizing risk-mitigating benefit, from nth-to-default credit derivatives, but urges the agencies to go further. Nth-to-default credit derivatives are inherently correlation-sensitive instruments whose capital treatment under a standardized formula—which the agencies themselves acknowledge does not explicitly capture default correlation—is structurally unreliable. The SEC-SA incorporates correlation effects implicitly through the supervisory parameter p, which is a blunt proxy that cannot distinguish between reference portfolios with widely differing actual correlation structures. A banking organization that sells a second-to-default credit derivative on a basket of highly correlated credits faces a materially different risk than one that sells the same instrument on an uncorrelated basket—but the SEC-SA treats them identically. The agencies should require conservative capital treatment for nth-to-default instruments, whether purchased or sold, and should not allow the SEC-SA formula to be used to obscure correlation tail risk for any instruments in this category.

vii. The Clean-Up Call Expansion Is Unnecessary and Creates Moral Hazard

The Proposal would expand the definition of an eligible clean-up call to permit exercise upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure, or a tax event that significantly changes the tax treatment. Better Markets opposes this expansion.

The existing eligible clean-up call definition—exercisable only when 10 percent or less of the underlying pool remains outstanding—is calibrated to the prudential purpose of the rule: permitting originating banking organizations to collapse securitization structures that have become administratively burdensome when they no longer serve a meaningful economic function. That purpose is served by a balance-based trigger because it applies when the structure has substantially run off.

A regulatory event trigger is categorically different. It permits an originating banking organization to collapse a securitization (in effect bringing the underlying assets back onto its balance sheet under the applicable risk-weight treatment) whenever a regulatory change makes the securitization economically unattractive. That is precisely the scenario in which the risk transfer rationale for the securitization has evaporated (i.e., if the capital treatment changes such that holding the securitization is now more expensive than holding the underlying assets directly, the banking organization's incentive is to collapse the structure and re-originate in a form that benefits from the new treatment). Therefore, labeling this transfer a "clean-up call" does not properly describe the process. It is actually a capital optimization trigger. The agencies should not incorporate this expansion in any final rule.

viii. The Proposal's Securitization Framework Will Accelerate the Migration of Credit Risk to NBFIs—A Material Systemic Error for the Banking System

Taken as a whole, the Proposal's securitization framework makes a category error that the agencies do not acknowledge: it treats the question of how much capital banks should hold against securitization exposures as a question of bank-level risk sensitivity, while ignoring the system-wide consequences. Recent academic research has extensively documented that when the capital cost of holding securitization exposures falls relative to direct lending, large banking organizations expand securitization activity.[100] When they expand securitization activity, the credit-risk-bearing tranches must be held by someone. In a financial system where the NBFI sector—hedge funds, CLO managers, business development companies, insurance companies, and private credit vehicles—has grown to rival the regulated banking sector in total assets, the likely destination for those tranches is outside the regulatory perimeter, where no equivalent capital, liquidity, or supervisory framework applies.

The Financial Stability Board, the Bank for International Settlements, the International Monetary Fund, and the Financial Stability Oversight Council have each documented the systemic risks created by the migration of credit intermediation to NBFIs and the interconnections between NBFIs and regulated banks. Those interconnections mean that stress in the NBFI sector does not remain contained: bank lending to NBFIs, repo exposures to NBFI counterparties, step-in risk where banks support affiliated NBFI vehicles, and liquidity pressures that propagate through shared funding markets all transmit NBFI stress to the regulated banking system. Reducing securitization capital requirements at large banking organizations in this environment does not reduce systemic risk — it relocates it to entities with less capacity to absorb it and less regulatory visibility into how they are managing it.

The Basel III final standards, as implemented in the European Union, also include a 15 percent floor for senior securitization exposures consistent with the BCBS framework. However, the European Union implementation also occurs within a regulatory architecture that includes more comprehensive NBFI oversight—including AIFMD, the Money Market Fund Regulation, and proposed frameworks for private credit—than currently exists in the U.S. A 15 percent floor that is embedded in a comprehensive system of NBFI regulation in Europe is not the same instrument as a 15 percent floor embedded in a U.S. system where the NBFI sector is, by comparison, lightly regulated and rapidly expanding. The agencies cannot justify wholesale adoption of the Basel floor without acknowledging that difference and explaining why the same floor is appropriate in the materially different U.S. regulatory context.

Better Markets accordingly urges the agencies to maintain the minimum 20 percent floor for securitization exposures; reject the look-through approach as a capital reduction mechanism;

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[100] *See* Chernenko, Ialenti and Scharfstei. "Bank Capital and the Growth of Private Credit" (May 27, 2025). available at: "In part, this is because bank loans to BDCs and private credit funds (or, more precisely, SPVs established by them) are considered senior tranches of securitizations, allowing banks to use lower risk weights for these loans and thus relatively little capital." available at: https://www.hoover.org/sites/default/files/2025-04/Bank%20Capital%20and%20Private%20Credit%202.pdf.

decline to expand the overlapping exposure treatment across regulatory books; maintain and strengthen the synthetic excess spread prohibition; delete the regulatory event clean-up call trigger; and recognize explicitly in the preamble to the final rule that the securitization capital framework interacts with NBFI growth in ways that create systemic risks the Proposal does not adequately analyze or address.

ix. Better Markets' Specific APA, Process, and Definitional Demands on the Securitization Framework

The agencies must address each of the following before finalizing any rule governing securitization exposures. Failure to do so would render the final rule vulnerable to challenge as arbitrary and capricious under the APA.

1. **Empirical justification for the 15 percent floor.** The agencies must publish a data-grounded analysis —including historical loss data, stress scenario modeling, and a reasoned comparison of alternative calibrations—demonstrating why 15 percent rather than 20 percent is the appropriate minimum floor for securitization exposures. The analysis must assess the scenario identified above in which correlated stress simultaneously impairs the reference portfolios underlying SSFA-treated securitizations, the NBFI investors holding those tranches, and the NBFI borrowers whose obligations appear on the originating banks' loan books. A reference to Basel alignment is not sufficient under the APA. The current 20 percent floor must be maintained unless and until that analysis is completed and subjected to public comment.

2. Definition of "senior securitization exposure." The agencies must provide a precise, operationally complete definition of "senior securitization exposure" for purposes of the look-through approach, including how seniority is determined in multi-tranche structures where cash flow priority varies by performance state, how liquidity facilities and servicer advance facilities are treated when their priority is conditional, and how a banking organization determines seniority for ABCP conduit exposures. Institutions must not be permitted to self-certify seniority without supervisory review.

3. **Classification rule for credit-linked notes as CRM versus synthetic securitization**. The Proposal simultaneously introduces credit-linked notes as eligible prepaid credit protection arrangements under the CRM framework and revises the synthetic securitization definition to include prepaid credit protection arrangements. The agencies must publish a binding classification rule specifying the criteria that determine whether a given credit-linked note structure is treated as CRM or as a synthetic securitization, and must prohibit institutions from electing between the two treatments based on which produces the lower capital requirement.

4. **Quantitative threshold for genuine risk transfer in SRT transactions**. The agencies must define, in the regulatory text, the criteria for "genuine, durable, and stress-resilient" risk transfer in synthetic risk transfer transactions, including minimum credit protection coverage ratios, minimum external investor funding requirements, prohibitions on implicit recourse commitments, and required supervisory pre-approval before any capital relief is recognized. Principles-based descriptions of genuine risk transfer are not enforceable standards.

5. **Basis for the look-through approach overriding the SEC-SA**. The agencies must explain why a banking organization should be permitted to apply the look-through approach—producing a lower capital charge—in cases where the SEC-SA formula would produce a higher result. If the SEC-SA is the primary risk measurement tool for securitization exposures, the look-through approach should operate as a cap on the SEC-SA output, not as an alternative that institutions may select when it reduces capital requirements.

6. **Definition of "regulatory event" in the clean-up call expansion**. The agencies must define with precision what constitutes a "regulatory event that significantly changes the risk-weighted asset amount" for purposes of the expanded eligible clean-up call definition, including whether a proposed rule, an advance notice of proposed rulemaking, or supervisory guidance qualifies, and how "significantly" is measured. Without a precise definition, this provision functions as an open-ended capital optimization trigger that institutions may invoke whenever a regulatory change makes a securitization structure economically unattractive.

7. **Explanation of the floor inversion relative to GSE exposures**. The agencies must explain, on first principles of credit risk, why the minimum capital requirement for a privately structured senior securitization tranche—15 percent risk weight—should be lower than the risk weight assigned to direct exposures to GSEs such as Fannie Mae and Freddie Mac—20 percent. An explanation by reference to Basel alignment would be insufficient; the agencies must provide a principled credit-risk rationale for assigning less minimum capital to an instrument that introduces waterfall risk, servicer risk, correlation risk, legal risk, and liquidity risk than to an instrument backed by the explicit or implicit support of the U.S. government.

8. **System-wide analysis of NBFI migration effects**. Before finalizing the securitization framework, the agencies must publish a system-wide analysis of the likely effects of reduced securitization capital requirements on the migration of credit risk from the regulated banking sector to non-bank financial institutions, including an assessment of whether existing NBFI oversight frameworks are adequate to prevent that migration from creating systemic risk. The APA requires agencies to consider all important aspects of a regulatory problem; the interaction between bank securitization capital requirements and NBFI growth is an important aspect of this problem that the Proposal does not address.

x. <u>Synthetic Risk Transfers Should be Subject to a Cap</u>

The Proposal also raises concerns regarding synthetic risk transfer ("SRT") transactions and other structures designed primarily to reduce RWAs. While banks frequently characterize these transactions as transferring risk to private investors, the financial crisis and subsequent market disruptions demonstrate that banks often retain substantial economic, reputational, operational, and contingent liquidity exposure even after nominal risk transfer occurs. In many cases, market participants expect large institutions to support sponsored or affiliated securitization structures during periods of stress regardless of contractual disclaimers. The agencies should therefore apply much more stringent standards and a concentration limit before recognizing purported capital relief from synthetic structures and should require banks to demonstrate genuine, durable, and stress-resilient transfer of risk.

The SRT market has grown substantially in the years since the global financial crisis. Protected assets across Canada, the Euro Area, the United States, and the United Kingdom are estimated at approximately $25 billion annually, doubling over the past five years.[101] Yet the regulatory framework has not kept pace with that growth, particularly in the U.S. Key supervisory concerns include ensuring that capital relief is commensurate with actual risk transferred and not simply recognizing capital benefits without genuine risk reduction, and monitoring the potential for high bank dependence on SRTs, which may increase procyclicality of credit provision and interconnectedness with non-bank financial intermediaries, especially if protection providers become unwilling or unable to offer coverage during downturns. The Basel Committee has acknowledged these concerns, publishing a report in February 2026 finding that while SRT markets have grown rapidly and become an important source of capital relief for corporate credit risk, the risks associated with SRT use merit continued monitoring by supervisors.[102]

Exposures from SRTs should not exceed three percent of a bank's common equity tier 1 capital without approval from a banking organization's primary federal supervisor

Better Markets urges the agencies to adopt a binding concentration limit, providing that retained or contingent exposures arising from SRT transactions shall not exceed three percent of a banking organization's CET1 capital without prior written approval from the banking organization's primary federal supervisor.

This limit is calibrated to serve two mutually reinforcing objectives: to preserve the ability of banking organizations to use SRT transactions in a responsible, safe, and sound manner and to establish a regulatory boundary on the potential downside risk to the institution and, by extension, to the financial system. The three percent CET1 threshold reflects the absence of a through-the-cycle loss dataset for SRT structures sufficient to validate risk-weight relief at higher concentration levels. Two-thirds of the $1.1 trillion in synthetically securitized assets since 2016 were in Europe, and it was not until fall 2023 that the Federal Reserve began approving favorable capital treatment for banks executing SRTs via credit-linked notes, with several regional institutions following only in the first half of 2024. The SRT market therefore lacks the seasoned loss history necessary to support actuarially grounded capital calibration at higher concentration levels, and prudential regulation demands a conservative default where that history is absent.

The three percent CET1 limit also provides a structural safeguard against the incentive problem inherent in SRT transactions: because capital relief from SRT reduces the cost of holding the reference portfolio, banking organizations face systematic pressure to maximize the volume of SRT transactions regardless of whether genuine risk transfer has occurred. The potential for high bank dependence on SRTs may increase procyclicality of credit provision, particularly if protection providers become unwilling or unable to offer coverage during downturns—precisely the moment at which the assumed risk transfer would be most needed and most likely to fail. A binding concentration limit disrupts that incentive by ensuring that the marginal capital benefit of

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101 *See* BNP Paribas. "From risk transfer to return engine: The Evolution of SRT" (January 22, 2026), available at: https://alts.axa-im.com/insights/alternative-credit/risk-transfer-return-engine-evolution-srt.

102 *See* Basel Committee on Banking Supervision. *Basel Committee publishes analysis for synthetic risk transfers.* (February 17, 2026), available at: https://www.bis.org/press/p260217.htm.

SRT activity diminishes as exposure approaches the threshold, thereby aligning the banking organization's incentive structure with the prudential objective of genuine risk reduction.

L. *Operational Risk*

Better Markets supports the Proposal's adoption of a standardized approach to operational risk capital as a replacement for the deeply flawed Advanced Measurement Approaches framework, which allowed GSIBs to model their own operational risk capital requirements with predictably self-serving results. The Business Indicator-based approach is a conceptually sound approach. It uses a bank's revenue and income profile as a proxy for its operational risk exposure and avoids the opacity and gaming potential of internal models. Better Markets also supports the inclusion of a floating Internal Loss Multiplier ("ILM") as part of the framework, specifically one that rises or falls based on a bank's actual ten-year operational loss history. The ILM is the risk-sensitive element of the Basel framework that ensures banks with demonstrated patterns of operational failures have capital commensurate with that historical evidence of actual losses. Therefore, the Proposal's decision to set the ILM at a fixed value of 1.0 for all institutions—in effect, eliminating its risk-sensitivity entirely—is the single most consequential and least defensible deviation from the Basel standard in the entire operational risk section, and Better Markets urges the agencies to include a floating ILM in the final rule.

Including a non-fixed, floating ILM is critical to ensuring the operational risk capital framework will practically actually work as intended for the institutions whose operational failures have been most severe, most costly, and most persistent. The evidence on that question is unambiguous and it comes from Better Markets' research of GSIBs fines and misconduct: the six largest U.S. banks—Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo—have collectively accumulated 490 major legal actions resulting in over $208 billion in fines and settlements over the past two decades. That is a record of widespread and consistent incidents.[103] It is a documented pattern of operational failure spanning fraud, market manipulation, money laundering, consumer abuse, recordkeeping violations, and criminal enterprise. Such a loss history is precisely why the floating ILM is designed to capture and price into operational-risk capital requirements. Setting the ILM to 1.0 for all institutions means that a bank with $40 billion in operational loss history over the past decade would not be penalized more on a relative basis than as a bank with $400 million in operational losses.

i. <u>The Fixed ILM of 1.0 Is a Material Deviation From Basel That Demands APA Justification</u>

The Proposal would not adjust operational risk capital requirements based on a firm's internal loss history, consistent with ILM equal to 1. The Proposal departs from the Basel III final reforms. The agencies' decision to fix the ILM at 1.0 is presented in the Proposal as a design choice, but it is not accompanied by the reasoned empirical explanation that the APA requires.

The agencies spent years negotiating the international operational risk capital framework with the Basel Committee. That framework includes the ILM precisely because the Basel

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[103] *See, e.g.,* Better Markets (January 14, 2026), "The Better Markets Rap Sheet Report," available at https://bettermarkets.org/analysis/the-better-markets-rap-sheet-report/.

Committee determined—after extensive analysis—that a bank's historical loss experience is a meaningful predictor of future operational risk and should be reflected in its capital requirement. The agencies now propose to discard that element entirely, without providing data demonstrating that U.S. GSIB loss histories are not predictive, without explaining why the ILM-based differentiation that Basel requires is inappropriate for U.S. institutions, and without quantifying what capital the largest operational risk recidivists will avoid holding as a result of fixing the ILM at 1.0.

Under the APA, an agency must provide a rational connection between the facts it finds and the policy choices it makes.[104] The rulemaking record contains extensive documentation—including Better Markets' own filings and the penalty databases maintained by regulatory agencies—of the magnitude and persistence of GSIB operational losses. The agencies cannot simultaneously acknowledge that operational risk is a material category of capital risk for the largest banks while proposing to eliminate the one element of the Basel framework that differentiates capital requirements based on actual operational loss history. The agencies must either restore the floating ILM in the final rule or provide in the final rule a specific, empirically grounded explanation for why GSIB loss history is not predictive of future operational risk—an explanation that the rulemaking record as currently constituted does not support.

ii. The Income/Expense Netting Deviation Compounds the ILM and Business Line Reductions to Produce a Third Systematic Downward Departure from Basel

The Proposal would permit banking organizations to net income and expenses in the noninterest component of the Business Indicator ("BI") calculation. The Basel standard explicitly requires **gross treatment**—gross income and gross expenses must be included separately in the business indicator. The Basel Committee adopted gross treatment for a specific prudential reason: netting reduces the business indicator in ways that do not reflect the actual scale of a banking organization's operational risk exposure. A banking organization with $10 billion in fee income and $8 billion in fee expenses has gross exposure equal to the $10 billion income scale, not the $2 billion net figure. If the institution experiences an operational loss event (e.g., a systems failure, a rogue trading event, a regulatory or legal action) that loss event draws on the full $10 billion revenue base of the relevant business line, not the $2 billion net. Netting the BI to reflect net income rather than gross exposure systematically understates operational risk for institutions with large gross revenue and expense streams in their fee-generating businesses.

The agencies justify the netting approach on the grounds that U.S. GAAP presents certain revenue items on a net basis in financial statements. However, that accounting presentation argument does not answer and is generally not relevant to the prudential question. The BI is part of a capital framework, not a financial accounting measurement for complying with U.S. GAAP. Its purpose is to produce a reasonable proxy for a banking organization's operational risk exposure—a purpose that is not advanced by importing an accounting presentation that was designed for investor disclosure, not prudential capital measurement. The Basel Committee, including the U.S. representatives, were aware of different national GAAP presentations when it designed the standardized measurement approach ("SMA") framework and deliberately required

104 *Supra* 41.

gross treatment precisely because accounting netting conventions vary across jurisdictions and would otherwise produce inconsistent operational risk capital requirements for institutions with identical risk profiles.

iii. The 70 Percent Reduction for Investment Management, Investment Services, and Non-Lending Treasury Services Is Not Supported by the Rulemaking Record

The Proposal would apply a 70 percent reduction factor to the noninterest income and expense associated with investment management services, investment services, and non-lending treasury services for purposes of the operational risk calculation, after analyzing risk data reported by Category I and II bank holding companies that reflected lower historical operational losses resulting from these activities. Better Markets does not oppose recognizing that different business lines carry different operational risk profiles in principle. However, the Proposal's 70 percent reduction factor raises serious APA concerns that the agencies must address in the final rule.

First, the agencies have not published the underlying loss data or the analytical methodology that produced the 70 percent figure. Commenters cannot evaluate whether the data supports a 70 percent reduction, a 50 percent reduction, or no reduction at all without access to the analysis. The APA requires agencies to provide a reasoned explanation for their numerical choices—not just a description of the category of data consulted. The 70 percent figure is specific enough to demand a specific justification, and the Proposal does not supply one.

Second, custody and processing banks—specifically BNY Mellon and State Street—are the institutions that would benefit the most from this reduction, as these activities constitute the core of their business models. Yet these institutions have their own documented operational loss histories. BNY Mellon has been subject to multiple regulatory actions for operational failures in its custody and processing functions.[105] The agencies must demonstrate that the 70 percent reduction accurately reflects the loss experience of these specific institutions and business lines—not merely the average across a heterogeneous group of large banks that happen to report some revenue in these categories.

Third, the reduction factor creates a structural incentive for GSIBs to characterize revenue as investment management or treasury services to reduce their operational risk capital charge—precisely the kind of regulatory arbitrage that the elimination of internal models was supposed to prevent. The agencies have not analyzed this incentive effect or proposed any guardrails against it.

105 *See, e.g.,* "FCA fines The Bank of New York Mellon London branch and the Bank of New York Mellon Limited £126 million for failure to comply with the Custody Rules." (April 15, 2015), available at: https://www.fca.org.uk/news/press-releases/fca-fines-bank-new-york-mellon-london-branch-and-bank-new-york-mellon.

iv. The Proposal's Deviations From Basel Compound Each Other and Collectively Undermine the Framework's Credibility

The operational risk section of the Proposal contains multiple deviations from the Basel standard—fixed ILM at 1.0, the 70 percent business line reduction, and various netting adjustments — each of which reduces operational risk capital below what the internationally negotiated standard would require. Taken individually, each deviation might be defensible with adequate empirical support. Taken together, they represent a systematic pattern of downward deviation from Basel that the agencies have not justified in the aggregate. The agencies spent years at the Basel Committee negotiating a framework that reflects the collective analytical judgment of the world's leading prudential regulators about how to calibrate operational risk capital for the largest banks. They are now proposing to adopt that framework in name while discarding its most risk-sensitive elements in substance.

Better Markets urges the agencies to recognize that the credibility of the U.S. capital framework—internationally and domestically—depends on meaningful fidelity to the standards U.S. representatives helped negotiate. Governor Barr captured this concern precisely in his dissenting statement: adopting a framework that departs from Basel in ways that systematically reduce capital for the largest institutions risks triggering a race to the bottom among international regulators who will face pressure to match U.S. standards.[106] The operational risk section of the Proposal, as currently written, contributes directly to that risk.

v. Specific Requests On the Operational Risk Framework

The agencies must address the following in any final rule:

(1) Restore the floating ILM and apply it based on each institution's ten-year operational loss history, or provide a specific, data-supported explanation for why GSIB loss history—including Better Markets analysis on this specific issue of documented fines and settlements at the six largest banks[107]—is not predictive of future operational risk and therefore should not affect capital requirements.

(2) Publish the underlying loss data and analytical methodology supporting the 70 percent business line reduction factor, subject it to public comment, and explain why 70 percent rather than any alternative percentage accurately reflects the differential operational risk of investment management, investment services, and non-lending treasury services.

(3) Analyze and address the incentive effect created by the 70 percent reduction—specifically, whether covered banking organizations will restructure revenue characterization to minimize operational risk capital, and what guardrails exist to prevent that outcome.

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106 *See* Governor Michael Barr. Federal Reserve Board. "Deregulating in a Financial Boom: What Could Go Wrong?" (June 6, 2026), available at: https://www.federalreserve.gov/newsevents/speech/barr20260606a.htm.

107 *Supra* 103.

(4) Provide an aggregate analysis of the combined effect of all deviations from the Basel operational risk standard—ILM fixation, business line reduction, netting adjustments—and explain why the cumulative departure from the Basel III final reforms is consistent with the agencies' statutory obligation to maintain capital standards that promote safety and soundness at the most systemically important institutions in the U.S.

M. Equity Exposures

i. Any Final Rule Must Remove the 100 Percent Risk Weight for Non-Significant Equity Exposures

The Proposal would retain the current capital rule's treatment of non-significant equity exposures (i.e., equity exposures whose aggregate adjusted carrying value does not exceed 10 percent of the banking organization's total capital) at a 100 percent risk weight. Better Markets urges the agencies to adopt the alternative approach to remove the 100 percent non-significant bucket and require banking organizations to apply a risk weight based on the characteristics of each equity exposure.

The agencies' stated rationale for retaining the 100 percent non-significant treatment is that the cost of replacing it "may be higher than the improvement in risk sensitivity associated with the alternative approach," given that the proposed equity framework already covers a more limited set of exposures than the current rule because a significant portion of publicly traded equity exposures will fall under the market risk framework for banking organizations with significant trading activity. This reasoning is unpersuasive and inconsistent with the stated goals of the Proposal.

Operational burden is not a valid basis for retaining a capital treatment that demonstrably misrepresents risk (as the agencies admitted in their 2023 proposal). The 100 percent non-significant bucket is an aggregate threshold-based exemption that has no grounding in the actual credit characteristics of the underlying exposures. An equity exposure to a highly speculative, illiquid, privately held company qualifies for the 100 percent risk weight on exactly the same basis as an equity exposure to a highly rated, publicly traded corporation—simply because both fall below the 10 percent of total capital threshold. The current and proposed approach is a blunt exemption that allows banking organizations to accumulate excessive equity risk below a portfolio-level threshold without any differentiated capital requirement.

The agencies acknowledge that the alternative approach "would increase risk sensitivity by requiring banking organizations to apply a risk weight based on the characteristics of each equity exposure, rather than only for those in excess of 10 percent of the banking organization's total capital." **That is precisely the objective the Proposal states as its central purpose.** Having eliminated internal models for credit and operational risk on grounds of inconsistency and inadequate risk sensitivity, the agencies cannot credibly retain a portfolio-threshold exemption for equity exposures on grounds of administrative convenience. The same logic that requires a risk-sensitive treatment for corporate exposures, real estate exposures, and retail exposures applies with equal force to equity exposures below 10 percent of total capital.

The operational burden argument also exaggerates the difficulty of complying. Covered banking organizations are already required to track and classify equity exposures for accounting, reporting, and risk management purposes. Applying a risk weight based on whether an exposure is publicly traded, privately held, or falls into another defined category does not require new data infrastructure. It simply requires applying existing exposure data to a risk weight table that the Proposal already publishes. The agencies offer no empirical analysis of what the actual incremental compliance cost would be. Better Markets does not accept the unsupported assertion that it exceeds the prudential benefit of risk-sensitive capital treatment for a category of exposures that can present material loss risk.

ii. Any Final Rule Must Not Apply the Maturity-Differentiated Conversion Factor for Conditional Equity Commitments

In response to Question 80, Better Markets does not support retaining a treatment for conditional equity commitments that differentiates credit conversion factors based on maturity (i.e., applying 20 percent to commitments with an original maturity of one year or less and 50 percent to those with an original maturity of more than one year). The Proposal's adoption of a uniform 40 percent conversion factor for all conditional commitments to acquire equity exposures is the correct approach and we support that in other areas of the capital rule. A maturity-differentiated structure creates a straightforward structuring incentive: banking organizations and their counterparties have every reason to document conditional equity commitments as having original maturities of one year or less in order to attract the lower 20 percent conversion factor, irrespective of the economic substance of the commitment. The Proposal's uniform 40 percent approach eliminates that arbitrage, promotes consistency, and aligns with the Basel standards. The agencies should retain it in the final rule without reintroducing maturity differentiation.

iii. Any Final Rule Should Apply a 100 Percent Risk Weight to Tax Equity Exposures

In response to Question 83, Better Markets urges the agencies to adopt a specific, affirmative 100 percent risk weight for tax equity financing transactions. Any final rule should do so as a standalone classification, not through the non-significant equity bucket that Better Markets recommends removing.

Tax equity financing transactions occupy a distinct and important place in the equity exposure landscape. In a typical tax equity structure, a banking organization makes an equity investment in a project—most commonly a tax-advantaged project—and receives in return a share of the project's tax credits and depreciation benefits rather than, or primarily rather than, a share of its economic returns. The risk profile of a tax equity exposure is materially different from that of a straightforward equity investment in several respects that are directly relevant to capital treatment.

First, the return on a tax equity investment is substantially dependent on the investing banking organization maintaining sufficient tax liability to absorb the allocated credits and deductions. A banking organization that experiences a significant decline in taxable income—including precisely the kind of income decline that accompanies a credit or economic stress scenario—may find that the tax benefits it expected to receive are deferred, reduced, or lost, impairing the economics of the investment at the moment when capital adequacy is most critical. This procyclical vulnerability is not characteristic of most equity investments, which decline in value during stress but do not have their return mechanism structurally impaired by the stress itself.

Second, the credit support underlying many tax equity investments is the creditworthiness of the project's offtake or production tax credit structure rather than the equity value of the project entity. If the project fails to perform — due to construction delays, equipment failures, resource variability, or regulatory changes—the tax equity investor may lose both its projected tax benefits and its invested capital, with limited recourse to project assets whose value depends on continued operation. That double exposure—loss of return mechanism and loss of principal—is a distinctive risk characteristic that warrants explicit recognition in capital treatment.

Third, tax equity transactions are frequently structured through layered special purpose vehicles, partnership flip arrangements, and other structures that complicate the assessment of the banking organization's actual economic exposure and recovery prospects. The opacity of these structures increases the difficulty of supervisory assessment and reinforces the case for a capital treatment that does not rely on case-by-case examiner judgment.

For all of these reasons, the risk profile of tax equity exposures differs materially from that of general equity exposures in ways that make the non-significant 100 percent treatment (to the extent it is retained at all) an inadequate basis for capital adequacy. A banking organization that holds tax equity investments below 10 percent of total capital would, under the Proposal, apply a 100 percent risk weight to those exposures through the non-significant bucket regardless of the structural risks described above. However, that would be the correct approach for the wrong reason as the 100 percent risk weight for tax equity should be an affirmative classification based on the risk characteristics of the exposure, not a residual catch that disappears if the agencies adopt Better Markets' recommendation to remove the non-significant bucket.

The agencies should therefore adopt a specific 100 percent risk weight for tax equity financing transactions as a defined category in the SRWA table, applicable regardless of whether the non-significant equity bucket is retained or removed, and should define that category clearly in the regulatory text to capture investments in which the banking organization's expected return is substantially dependent on tax credits, accelerated depreciation, or other tax benefits allocated through a partnership or similar pass-through structure. That treatment is consistent with the alternative approach the agencies themselves considered and described, and Better Markets urges the agencies to adopt it in the final rule.

N. Indexing of Thresholds Should Require Affirmative Decisions by the Agencies

The Proposal would index certain dollar-based regulatory thresholds to inflation as measured by CPI-W to preserve their intended application in real terms over time. The agencies are correct to recognize that static dollar thresholds can become less accurate over time as inflation and economic conditions evolve. However, automatic indexing tied solely to inflation risks weakening prudential safeguards through a mechanical process disconnected from actual financial stability risks.

The Proposal implicitly asserts—but does not attempt to show—that banking system vulnerability moves in lockstep with inflation. A larger nominal economy, higher prices, or inflation-driven balance sheet growth do not necessarily make banking organizations less risky, less interconnected, or less capable of transmitting stress throughout the financial system. The experience of both the global financial crisis and the 2023 regional banking failures demonstrates that systemic vulnerabilities can emerge and intensify even during periods of economic growth and expanding nominal balance sheets.

Rather than adopting the Proposal's automatic adjustments, the agencies should establish a structured supervisory recalibration framework requiring periodic public review—such as every three years—of dollar-based thresholds and calibration metrics. As part of that process, the agencies should publish an analysis evaluating inflation, nominal GDP growth, banking sector concentration, interconnectedness, funding vulnerabilities, changes in market structure, technological developments, and supervisory experience, followed by a formal public vote on whether thresholds should remain unchanged, increase, decrease, or otherwise be recalibrated.

Such an approach would preserve flexibility for the agencies while ensuring prudential standards evolve deliberately, transparently, and based on actual financial stability considerations rather than automatic deregulation by formula. This framework would also strengthen accountability by requiring the agencies to periodically "show their work" and explain why regulatory thresholds remain appropriate in light of evolving risks and conditions. The agencies already conduct extensive supervisory and quantitative analyses to calibrate capital requirements; periodic threshold review would appropriately extend that discipline to threshold-setting itself.

O. The Proposal's Impact Analysis Is Inadequate and Does Not Account for Dynamic Bank Responses

The agencies faced a challenging task to fully evaluate the economic impact of a Proposal so vast that it would recalibrate the capital requirements for over $20 trillion of banks' assets and exposures. Estimating the effects of such comprehensive revision to the regulatory capital framework requires substantial judgment, imperfect information, and assumptions about future market behavior. Notwithstanding the difficulty of the agencies' assignment, the APA still applies in full to this Proposal and thereby requires more than broad assertions that a Proposal will improve efficiency, reduce burden, or better align capital requirements with risk. It requires the agencies to provide the public with sufficient information to evaluate the Proposal's consequences and meaningfully comment on the rule.

This Proposal would materially reduce capital requirements (but some estimates over $200 billion in combination with recent deregulatory efforts[108]) for many of the largest and most systemically important banking organizations in the United States. Yet, the agencies repeatedly acknowledge that the data used to evaluate the Proposal were collected for a previous, now

[108] *See* Bloomberg. "The Fed's $200 billion bank stimulus poses a big risk" (March 17, 2026), available at: https://www.bloomberg.com/opinion/articles/2026-03-17/capital-rules-the-fed-s-200-billion-bank-stimulus-poses-a-big-risk.

rescinded proposal, contain known limitations, require extensive approximations, rely on industry estimates, omit key behavioral responses, and in several areas simply do not exist.

Rather than collecting updated information reflecting the banking system of 2026, the agencies rely on a patchwork of stale data, assumptions, proxies, and estimates. The result is an impact analysis that does not provide the public with the information necessary to evaluate whether the Proposal's capital reductions are justified or consistent with safety and soundness.

Indeed, the agencies effectively concede this point when they acknowledge that the 2023 special data collection was designed to evaluate a different proposal and that "the differences between the current Proposal and the proposal on which the special data collection was intended to inform are broad and material." The agencies further admit that many of the adjustments used to estimate the impact of the current Proposal are "only approximations" and "may not account for all material differences."[109]

As previously mentioned in Section III.C, those admissions should have led the agencies to collect updated data and publish a revised quantitative impact study. Instead, they proceeded with a proposal that would reduce capital requirements based on analysis they acknowledge may not capture the effects of the Proposal itself. That is not reasoned decision-making.

A concerning issue is that the agencies explicitly acknowledge that the methods used to estimate the effects of the Proposal may fail to capture material aspects of the Proposal itself.

Indeed, throughout the impact analysis the agencies repeatedly rely on simplifying assumptions rather than direct measurement. For example:

• To estimate the effects of removing the Spearman correlation test under the market risk framework, the agencies assume a 20 percentage point increase in model approvals.

• To estimate the effects of moving certain positions from the standardized approach into internal models, the agencies assume a 50 percent reduction in capital requirements for those positions.

• To estimate the impact of multiple market-risk changes, the agencies rely on broad scaling assumptions rather than institution-specific data.

These assumptions are inputs that directly determine the magnitude of the Proposal's estimated capital reductions. Yet the agencies provide little to no evidence demonstrating that these assumptions accurately reflect how banking organizations would actually be affected. If the agencies believe these assumptions are reasonable, they should disclose the empirical basis for each assumption, provide sensitivity analyses using alternative assumptions, and quantify the extent to which different assumptions would change the Proposal's estimated impact. Absent that information, the public cannot determine whether the reported capital reductions are robust findings or simply artifacts of the agencies' modeling choices.

109 *Supra* 2 at 15109.

i. <u>The Proposal's Industrial-Policy Rationale for Capital Reduction Is Internally Contradictory and Should be Removed</u>

The Proposal's economic analysis advances a remarkable and telling argument from the agencies: more Category I and Category II banking organizations "could constitute a safer and more competitive financial landscape."[110] This assertion is akin to an industrial policy argument in claiming that the current capital framework has removed the incentives for firms to become larger, noting the U.S. GSIBs have remained the same since 2012. These concerns are not within the agencies' statutory authority and, from a policy perspective, contradict the entire basis of the post-crisis framework.

The agencies' capital-setting authority derives from their safety-and-soundness mandates, section 165 of the Dodd-Frank Act, and the prudential capital requirements frameworks established by Congress. None of those statutory authorities empower the agencies to calibrate capital requirements to encourage industry consolidation or larger, more systemically important banks. In fact, Congress established a separate framework via bank merger review for evaluating the competitive and systemic effects of consolidation among large banking organizations, and that framework involves a different legal standard, different reviewing agencies, and different procedural protections. Using the capital framework as a surrogate consolidation policy instrument bypasses those procedural protections and substitutes the agencies' preferred market structure outcome for the statutory requirements that govern merger review.

The argument is also internally contradictory on its own terms. The GSIB surcharge framework—which is being concurrently addressed through the separate GSIB surcharge proposal exists precisely because larger banking organizations are more systemically dangerous and can cause negative externalities in failure (unlike smaller banks, particularly community banks).[111] The entire theoretical and empirical basis for the GSIB surcharge is that the probability-of-failure-adjusted systemic cost of a GSIB's failure is higher than that of a non-GSIB, and that GSIBs must therefore hold additional capital commensurate with that elevated expected social cost. If the agencies' consolidation argument is correct—if more Category I and II institutions constitute a "safer financial landscape"—then the GSIB surcharge itself is conceptually wrong, because it penalizes the very outcome the agencies now claim could improve the safety of the U.S. financial system. The agencies cannot simultaneously argue that GSIBs should pay a capital surcharge because their systemic importance makes them more dangerous and that encouraging more banks to become GSIBs would make the financial system safer. Those positions are irreconcilable.

The agencies must withdraw the consolidation rationale from the economic analysis and replace it with a safety-and-soundness analysis grounded in the statutory purposes of the capital framework.

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[110] *Supra* 2 at 15147.

[111] *See* Better Markets Comment Letter to the GSIB Surcharge Proposal (*Section III.A*) on the reference bank methodology.

ii. The Analysis Uses Nonverified Estimates Provided by Trade Associations

A recurring and troubling feature of the Proposal's impact analysis is the agencies' apparent reliance, in certain areas, on estimates and quantitative analyses supplied by industry participants and trade associations without adequately explaining how those estimates were independently validated. For example, in discussing the impact of the proposed treatment of agency mortgage-backed securities, cross-product netting arrangements, and changes to the CVA framework, the agencies reference estimates submitted by industry commenters, including SIFMA and ISDA. Yet the Proposal provides little information regarding how those estimates were evaluated, whether they were independently replicated, what alternative methodologies were considered, or how sensitive the resulting impact estimates are to changes in the underlying assumptions.

To be clear, Better Markets does not suggest that industry data should be ignored. Industry participants may possess information that regulators do not readily possess or cannot easily obtain. However, when industry-supplied estimates are used to support changes that would reduce regulatory capital requirements, the agencies bear a heightened obligation to independently validate those estimates and disclose the basis for relying upon them. The Proposal does not provide sufficient information for commenters to assess whether that validation occurred.

The omission is particularly concerning because the organizations supplying these estimates represent firms that stand to benefit directly from lower capital requirements. As a result, commenters cannot determine whether the projected reductions in risk-weighted assets reflect objective supervisory analysis, industry assumptions that were accepted without sufficient scrutiny, or some combination of the two.

The agencies should identify each aspect of the impact analysis that relies upon estimates supplied by industry participants or trade associations, disclose the methodologies used to evaluate those estimates, explain whether they were independently replicated or verified, and provide sensitivity analyses showing how the projected aggregate capital effects would change under alternative assumptions. Without that information, the public cannot meaningfully evaluate the reliability of the Proposal's projected capital impacts.

These deficiencies also raise concerns under the APA. An agency may not rely on quantitative estimates that materially affect its policy choices without providing sufficient information for the public to evaluate the basis for those estimates and the agency's reasons for relying upon them. To the extent the agencies relied on estimates submitted by ISDA, SIFMA, or other interested parties in developing the Proposal's impact analysis, they must explain how those estimates were tested, verified, and incorporated into the agencies' conclusions. Absent that explanation, the Proposal fails to provide the transparency necessary for meaningful notice and comment.

iii. The Impact Analysis Does Not Attempt to Dynamically Assess the Impact of the Proposal

The agencies acknowledge that their estimates have not accounted for "potential longer-term changes in banking organizations' behavior or changes in market conditions." That limitation is particularly significant for a rulemaking of such significance and whose contents will fundamentally change the incentives of the largest banking organizations in the U.S. It is also particularly problematic in this Proposal because the agencies repeatedly suggest that the Proposal will improve market functioning, support financial intermediation, reduce unnecessary burden, improve hedging, increase market-making capacity, and better align capital requirements with risk. Each of those purported benefits is a significant claim but also critically, depends on the behavioral responses of banking organizations to the Proposal.

An additional issue with the lack of a dynamic analysis is that the Proposal mainly affects risk-weighted assets. A large body of academic literature and supervisory experience shows that banks respond dynamically to changes in the capital rules for risk-weighted assets through balance sheet optimization, risk shifting, and model adjustments. For example, research by the Bank for International Settlements has shown that sophisticated banks take affirmative steps to reduce risk-weighted assets materially through internal model adjustments and portfolio reallocation—often by amounts exceeding 10 percent over time.[112]

A change in the calculation of capital requirements can only generate purported benefits if banks alter their behavior. If institutions do not expand lending, market-making, derivatives intermediation, securities financing activity, or other activities identified by the agencies, then many of the Proposal's asserted benefits may never materialize. Yet, at the same time, the agencies claim these benefits they explicitly exclude estimating those behavioral effects from their quantitative analysis.

This affirmative choice creates a one-sided analytical framework. The agencies exclude the possibility that lower capital requirements could increase leverage, reduce loss-absorbing capacity, amplify procyclicality, increase interconnectedness, or encourage greater concentrations of risk. At the same time, they implicitly assume that lower capital requirements will generate desirable economic outcomes.

The result is an analysis that omits both the potential costs and the potential benefits associated with behavioral change. If the agencies believe behavioral responses are too uncertain to model, then they should not rely on those same behavioral responses as a justification for the changes in the Proposal that would reduce capital requirements. Conversely, if behavioral responses are central to the rationale for the Proposal, then the agencies should attempt to quantify those effects and provide sensitivity analyses reflecting a range of possible outcomes.

Taken together, the agencies cannot simultaneously claim that behavioral responses justify the Proposal while excluding those same behavioral responses from the analysis used to support it.

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112 *See* Basel Committee on Banking Supervision. *Variability in risk-weighted assets: what does the market think?* BIS Working Papers. (February 25, 2020), available at: https://www.bis.org/publ/work844.htm. *See also* Basel Committee on Banking Supervision. *RCAP Analysis of risk-weighted assets for credit risk in the banking book* (July 2013), available at: https://www.bis.org/publ/bcbs256.pdf.

iv. The Impact Analysis Repeatedly Acknowledges the Agencies Did Not Have the Necessary Data

One striking feature of the Proposal's impact analysis is the frequency with which the agencies acknowledge that they do not possess the information necessary to directly evaluate important aspects of the Proposal. For example, when discussing adjustments to the operational risk capital framework associated with Treasury services activities, the agencies acknowledge that the relevant data necessary to estimate the effect of the Proposal are not available.

Rather than collecting the necessary information or developing an alternative analytical framework, the agencies chose to proceed using assumptions and approximations. This pattern appears throughout the Proposal and reinforces that it was a rushed process.

In multiple areas, the agencies rely on proxy measures rather than reported values from banking organizations. In others, they substitute institution-level estimates for transaction-level information. Elsewhere, they extrapolate from incomplete data or apply broad scaling assumptions because the necessary information was not collected. The cumulative significance of these limitations is significant and undercuts the credibility of the impact analysis.

The Proposal would reduce capital requirements for systemically important institutions, yet the agencies repeatedly acknowledge that they lack important information regarding how specific provisions will affect regulated institutions. That haphazard approach raises a straightforward question: if the agencies do not possess the information necessary to estimate the effects of a proposal, how can the public be expected to evaluate those effects during the notice-and-comment process?

The appropriate response to missing information is to simply collect the information necessary to evaluate the Proposal before finalizing a rule. At a minimum, the agencies should identify every instance in which data were unavailable, explain how the resulting uncertainty affects the reliability of the analysis, provide confidence intervals or sensitivity analyses where possible, and explain why the Proposal should proceed despite those acknowledged limitations.

v. The 50 Percent IMA Reduction Assumption is Not Explained

The agencies' estimate of the capital impact of the Proposal's RFET liberalization, Spearman test removal, and IMA eligibility expansions rests on a single, undisclosed assumption that positions gaining IMA eligibility under the loosened standards will have their capital requirements reduced by approximately 50 percent relative to the standardized approach.

This assumption directly determines the magnitude of the estimated market risk capital reduction attributable to the Proposal's model-liberalization provisions. A 40 percent assumption would produce materially different aggregate capital estimates; conversely, a 60 percent assumption would produce materially different estimates in the other direction. The agencies do not disclose the empirical basis for the 50 percent figure, do not identify the data source from which it was derived, and do not provide any sensitivity analysis showing how the aggregate market risk capital estimates would change if the assumption is varied.

The agencies' 2023 QIS collected desk-level data from covered banking organizations that included both standardized approach and IMA capital estimates for positions where both could be calculated. That data would support a direct empirical estimate of the ratio of IMA capital to SA capital across the universe of desks that would gain IMA eligibility under the Proposal's loosened standards. The agencies chose not to disclose that desk-level comparison data. In its absence, the 50 percent assumption is a modeling input whose selection is not explained and whose effect on the aggregate estimates is not disclosed.

The agencies must publish the empirical basis for the 50 percent assumption, the desk-level SA versus IMA capital comparison data from which it was derived or estimated, and sensitivity analyses at 30 percent, 50 percent, and 70 percent reduction assumptions. The public, including Better Markets, cannot evaluate the accuracy of the agencies' market risk impact estimates without access to this information, and the agencies cannot satisfy their obligation under the APA to make a reasoned judgment without disclosing the factual basis for this critical assumption.

vi. <u>The Agencies Reference an Unexplained and Unproposed 5 Percent Credit Conversion Factor Without Including Corresponding Preamble Language, Regulatory Text or Impact Analysis</u>

The Proposal contains an apparent internal inconsistency that further illustrates the inadequacy of the agencies' impact analysis and raises significant notice-and-comment concerns under the APA.

In the Proposal's *Section X. Related Proposals and Proposed Amendments to Related Rules*, the agencies state that in the Board's GSIB surcharge proposal certain low-utilization retail commitments would receive a 5 percent CCF which is consistent with the Proposal's Section IV.A.3.[113] Yet the Proposal in the relevant purported preamble section does not discuss a 5 percent CCF, does not identify any affected exposures, does not appear to provide a quantitative assessment of the impact of this unknown treatment, and, most importantly, do not appear to include corresponding amendments to the regulatory text implementing such a requirement in either the Proposal or the GSIB surcharge proposal.

The significance of this omission is material for commenters to this Proposal and the Board's GSIB surcharge proposal. Credit conversion factors directly determine the amount of off-balance-sheet exposure incorporated into risk-weighted assets and total exposures under the SLR. Modest adjustments to CCFs can have material consequences for capital requirements when applied across large portfolios of retail commitments, particularly to the GSIBs. Accordingly, if the agencies are intending to create a new 5 percent CCF category, the agencies must inform the public in a reproposal:

- which exposures qualify for the treatment;
- the aggregate and institution-specific capital effects of the treatment;

[113] *Supra* 2 at 15150. "The proposal would also introduce a 5 percent credit conversion for certain low-utilization retail exposures and a treatment for retail commitments with no pre-set limit."

- the empirical basis supporting the 5 percent CCF calibration;
- how the treatment compares with the Basel framework, which does not include a 5 percent CCF[114];
- if the agencies would apply the 5 percent CCF to the standardized approach and why; and
- how the agencies incorporated the treatment into their quantitative impact analysis;

The Proposal provided none of this information and has created significant uncertainty among interested parties given the significance of a new, unknown, and unexplained CCF.

Even more troubling, commenters reviewing the proposed regulatory text have been unable to identify the operative provisions necessary to implement the treatment described in the preamble. If the agencies intended to establish a new 5 percent CCF category but failed to include conforming amendments to the regulatory text, the public has been deprived of meaningful notice regarding a substantive aspect of the Proposal. Conversely, if the agencies did not intend to establish such a category, then the preamble is materially inaccurate and may have affected public understanding of the Proposal's capital impact.

Either possibility reveals a serious defect in the administrative record of the Proposal and the GSIB surcharge proposal. The agencies cannot simultaneously rely upon a purported 5 percent CCF treatment in describing the Proposal while failing to provide the public with the legal text necessary to evaluate it.

Accordingly, the agencies should identify every reference to a 5 percent CCF in the Proposal, explain whether the treatment is actually being proposed, publish the operative regulatory text necessary to implement it, quantify the institution-level and aggregate capital effects of the treatment, and reopen the comment period to permit meaningful public review of that information.

More broadly, the appearance of a substantive capital calibration in the preamble of the Proposal that does not appear in the regulatory text raises significant, broader concerns regarding the agencies' quality-control process. Given the breadth and complexity of the Proposal, commenters cannot independently determine whether other aspects of the impact analysis rely on assumptions, calibrations, or exposure treatments that have not been fully reflected in the proposed regulatory text. This uncertainty further undermines the agencies' claim that the public has been provided sufficient information to evaluate the Proposal.

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[114] *See* Basel Committee on Banking Supervision. *The Basel Framework.* Available at: https://www.bis.org/baselframework/BaselFramework.pdf.

P. Conclusion

Better Markets has provided extensive comments on this Proposal because the stakes are high. The institutions subject to the ERBA are the same institutions whose undercapitalization, opacity, and interconnectedness produced the worst financial crisis since the Great Depression, triggered the worst bank failures since 2008, and imposed hundreds of billions of dollars in losses on the Deposit Insurance Fund, American taxpayers, and the broader economy.[115] The post-crisis capital reforms that followed were the minimum price of a financial system that could withstand severe stress without requiring extraordinary government intervention. This Proposal, in combination with the GSIB surcharge proposal, would reverse significant portions of that price for the largest banks without a credible justification for doing so.

Our comments identify specific, concrete deficiencies across nearly every major component of the framework: an investment-grade corporate risk weight that allows institutions to effectively self-certify their way to a 35 percentage point capital reduction; an equity exposure framework that retains a non-risk sensitive threshold exemption with no grounding in the credit characteristics of the underlying positions; a credit risk mitigation framework that permits maturity-mismatched collateral recognition; and a securitization framework that lowers the minimum capital floor for the exposure class at the center of the global financial crisis to a level below what the agencies require for exposures to government-sponsored enterprises. These and a myriad of other examples are proposed by the agencies without an empirical analysis that would satisfy the most basic legal and procedural requirements under the APA.

As identified in this comment letter, those deficiencies are structural and widespread throughout the entire Proposal. They also share a common direction: nearly every significant judgment call in this Proposal would lead toward lower capital, looser and vaguer definitions, expanded optionality for institutions, and reduced supervisory constraint. It is thus a series of serious policy mistakes that Better Markets believes is wrong as a matter of prudential policy, unsupported as a matter of empirical analysis, and in significant respects legally vulnerable to challenge or rescission.

Better Markets accordingly restates its core demands for the administrative record with full clarity. The agencies must withdraw and formally repropose the entire Proposal. In particular, the reproposal must demonstrate the basis for the proposed risk-weight reductions beyond stating that those reductions align with an international framework that has no domestic legal basis. Any reproposal must be accompanied by a complete, publicly available APA compliance analysis demonstrating the empirical basis for each calibration, a Collins Amendment compliance analysis establishing with institution-category-level granularity that no covered institution is brought below the statutory floor on any applicable capital measure and a formal data collection that gathers the loan-level and portfolio-level information necessary to support a credible impact analysis for each proposed change. The data relied upon in this Proposal was collected for a different rulemaking (that is now rescinded), were supplied on a voluntary basis, were not validated for the quality

115 *See* Better Markets. *Cost of the Crisis Report:$20 Trillion and Counting.* (February 2017), available at: https://bettermarkets.org/newsroom/20-trillion-cost-financial-crisis-3/.

demanded by the agencies' minimum regulatory reporting standards, and cannot support the quantitative claims the agencies have made.

Therefore, the agencies must issue, as a condition of any reproposal, a mandatory data collection through a Paperwork Reduction Act notice that gathers institution-specific, loan-level data sufficient to support calibration of risk weights across the full range of institutions subject to the final rule. A reproposal built on the same data foundation as this Proposal will fail for the same reasons and should not be published until that foundation has been replaced.

The history of financial regulation teaches consistently that frameworks calibrated to accommodate industry preferences rather than empirical risk measurement produce precisely the crises they are designed to prevent. The savings and loan crisis, the global financial crisis, and the 2023 banking crisis all resulted in part from capital frameworks that understated risk at scale, relied on institutional self-assessment in place of objective standards, and assigned supervisory discretion to tasks that required strong, binding rules. This Proposal repeats each of those errors. The agencies have been placed on notice of these deficiencies through the public comment process. If they proceed to finalize any element of this Proposal without addressing them, they will do so with full knowledge that the administrative record is insufficient, that the statutory floor has not been demonstrated to be respected, and that the calibration methodology rests on a data foundation that commenters have shown to be unfit for the purpose to which it has been put.

Better Markets will continue to monitor this rulemaking closely and will pursue all available avenues—including judicial review—to ensure that the final capital framework for the nation's largest banking organizations is lawful, empirically grounded, and adequate to protect the depositors, the Deposit Insurance Fund, and the broader financial system that strong capital requirements exist to safeguard.

Sincerely,

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Appendix: Better Markets' Assumptions for Estimated Capital Requirements Reduction

As noted above, Better Markets has estimated that the impact of the proposals, combined with changes made to weaken the supervisory stress test and corresponding SCB requirement, would be an additional ten percentage point reduction in the CET1 capital required for the GSIBs relative to the Proposal's estimated combined impact. The ten percentage point figure beyond the agencies' estimated approximately five percent rests on the continued minimization of SCBs (especially considering recent changes being made to the stress testing framework) and on three key pillars related to RWA: (1) corporate loan reclassification/securitization arbitrage, (2) cross-product netting benefits (particularly for GSIBs with large matched-book repo), (3) the issues identified in *Section I* of this commenter letter on the market risk framework.

As discussed above in *Section III.A.i*, in 2020 the Board transitioned away from conducting the CCAR exercise and replaced it with the SCB, and in the process also weakened key, prudent assumptions of the effective capital requirements from the previous CCAR exercise (e.g., eliminating the assumed growth of a bank's balance sheet and reducing the number of quarters of pre-planned capital actions included in the stress test requirement from 9 to 4 quarters). The average GSIB SCB requirement has declined significantly since then to just 3 percent last year, and SCBs were at the 2.5 percent minimum for five of the eight GSIBs. Most recently, the Board has published full details of the stress test model methodology and scenarios, which will allow stress tested banks to fully optimize their balance sheets for the supervisory stress test.[116] As such, Better Markets analysis assumes that going forward, the SCBs will be floored for 6 of the GSIBs and will be at a value of 3 percent for Goldman Sachs and Morgan Stanley, whose substantial market operations likely will prevent them from reaching the 2.5 percent minimum. Better Markets estimates this would result in about a 1 percent reduction in capital required across the GSIBs.

As for RWA reduction, fundamentally, as noted in *Section O.iii* of this comment letter, the agencies' impact analysis does not account for the behavioral response that the proposals structurally incentivize, specifically the active portfolio optimization by GSIB treasury and risk management functions to minimize RWA under the ERBA. The agencies themselves acknowledge that their impact analysis "assumes no change in banking organization behavior" in response to the proposed rules. That assumption is implausible as GSIBs employ hundreds of capital efficiency professionals whose explicit function is to minimize required capital against a given economic exposure.

When the rules, as under this Proposal, change the relative cost of one asset class versus another by tens of percentage points, behavior changes. The agencies have designed a framework that creates large and predictable optimization opportunities and then analyzed its impact as though those opportunities will go uncaptured.

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116 *See* Better Markets comment letter regarding "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 FR 51856" (November 18, 2025), available at: https://bettermarkets.org/wp-content/uploads/2026/02/BetterMarkets_Comment_Letter_Fed_Stress_Test_Model.pdf.

First, the most significant mechanisms for RWA reduction in lending are the strong incentives created by the proposed lowering of the 20 percent floor for senior CLO tranches to a 15 percent floor and the proposed lowering of the risk weight for investment-grade corporate loan exposures from 100 percent to 65 percent. Over time, considering the significant RWA advantages, institutions would adjust their exposures to maximize RWA benefits under both structures.

Starting with the securitization risk weight for lending, the current 20 percent floor already has created strong incentives for the GSIBs to engage in securitized lending (as discussed in *Section III.k.i*). That is why GSIB lending to NBFIs as a share of total lending has increased from 8 percent at the end of 2019 to 21 percent at the end of last year. More specifically related to securitization-based lending, GSIB lending to nonbank credit intermediaries—virtually all of which likely falls under the advantageous securitization structure—grew by 40 percent between 2024 (the first year the breakout was available on the Call Report) and the end of last year. GSIB loans to nonbank credit intermediaries, which is about two-thirds of all GSIB NBFI lending, now represents 12 percent of total loans, up from 10 percent in 2024. Such growth in lending to NBFI credit intermediaries surely would be exacerbated by the additional 5 percentage points of RWA benefit relative to the mortgage or corporate loan risk weights. Better Markets estimates that the growth in GSIB lending to NBFI credit intermediaries as a share of total lending just between 2019 and 2025 has resulted in a 3 percent reduction in total RWA[117] and that a 3 percent further reduction could be achieved easily going forward with the lower risk-weight floor.

Additionally for lending, GSIB institutions would benefit from ERBA's risk weights for residential real estate and corporate loans. As discussed in *Section III.B*, the GSIBs make proportionally more mortgages to lower-LTV borrowers and make more corporate loans to larger corporations and NBFIs, which all have much lower risk weights under the new framework. Additionally, as discussed in *Section III.F.2.8*, the highly subjective nature of the investment grade determination for corporate loans would result in institutions classifying a material proportion of corporate loans as investment grade to benefit from the 35 percentage point reduction in RWA.

Starting with mortgages, based on origination data from the Home Mortgage Disclosure Act dataset, Better Markets mapped the LTV bucket risk weights from the Proposal to the proportions by LTV bucket of mortgage originations by the three largest GSIBs in the residential mortgage business between 2022 and 2024. That exercise suggests that the Proposal's calibration would produce weighted average risk weights materially below the current 50 percent mortgage risk weight for prudently underwritten mortgages.[118] In particular, the Proposal's structure creates

[117] Better Markets' analysis assumes the same growth in GSIB lending to NBFI credit intermediaries as total NBFI lending and that the share of total NBFI lending that is lending to NBFI credit intermediaries has remained at a constant 60 percent (i.e., the share of total lending that is lending to NBFI credit intermediaries increasing from 5 to 12 percent); analysis also assumes the proportion of residential real estate loans to corporate loans is the same as reported in the 2023 special collection, with current risk weights allocated accordingly. Calculations performed on Q4 2025 RWA data from FR Y-9C.

[118] Better Markets' analysis found an estimated weighted average risk weight of 30 percent for non-cash flow dependent mortgages and 45 percent for cash flow dependent mortgages. Using the proportions from the 2023 special collection between non-cash flow dependent mortgages and cash flow dependent mortgages and applying those proportions to those the respective estimated risk weights resulted in a total weighted average mortgage risk weight of 30 percent.

incentives for banks to originate and retain mortgages with lower reported LTVs, which Better Markets anticipates would further reduce average mortgage risk weights. Using the proportions of non-cash flow dependent and cash flow dependent mortgages reported in the 2023 special collection, Better Markets anticipates that the resulting weighted average mortgage risk weight could be approximately 30 percent, implying a reduction of roughly 20 percentage points relative to the current framework. Applying that reduction to total mortgage exposures reported in the 2023 special collection suggests that the Proposal's mortgage provisions could reduce aggregate RWA by approximately 3 percent.

For corporate exposures, 19 percent of corporate exposures reported in the 2023 special collection were assigned to a risk weight of 65 percent or lower. Better Markets assumed those proportions also apply to the GSIBs and that GSIBs would be able to classify one third of the remaining 81 percent of corporate exposures as investment grade through the highly subjective classification process (this number could increase further depending on the assertiveness or lack thereof of supervision for this key risk management process). That would result in about half of GSIB corporate exposures being classified as investment grade, resulting in an average corporate risk weight of 83 percent, or a reduction of 17 percentage points from the current 100 percent risk weight. Applying that 17 percentage point reduction to the total corporate exposure reported in the 2023 special collection and dividing that amount by the total RWA from the 2023 special collection yields an estimated 5 percent RWA reduction for corporate exposures.

The estimates above collectively result in a 12 percent reduction to required GSIB capital from current levels. That already is well above the roughly 5 percent estimated reduction in the Proposal. However, Better Markets notes that there would be even further material reductions from other aspects of the proposal, discussed below. These reductions are much more difficult to estimate, but they nonetheless would likely result at least an additional 3 percent reduction that would bring the total estimated reduction in required capital for the GSIBs to the Better Markets' estimate of a 15 percent reduction. If the data were available to complete the estimate (which Betters Markets recommends the agencies to do in a reproposal), the final result would likely be higher than the 15 percent. Better Markets views the 15 percent reduction as a conservative estimate.

The cross-product netting benefit as described in *Section H.ii* of this comment letter, available under the ERBA would add materially to the RWA reduction for GSIBs, particularly those large matched-book prime brokerage and repo operations. The 2023 proposal contained no recognition of cross-product netting arrangements between derivatives and repo-style transactions under SA-CCR. However, this Proposal would permit a banking organization to recognize cross-product netting arrangements across repo-style transactions and non-cleared derivatives under a qualifying master netting agreement, treating repo-style transactions as forward derivative contracts for SA-CCR exposure calculation purposes. The significance of that change is illustrated by the ISDA/SIFMA quantitative impact study on the 2023 proposal, which estimated that the absence of cross-product netting recognition was responsible for approximately 94 percent of total securities financing transaction counterparty credit risk ERBA RWA.[119] While the Proposal would not apply the full benefit, partial cross-product netting recognition would produce a material CCR RWA reduction for GSIBs with large SFT books.[120] Applied to the SFT and derivatives counterparty credit risk component of GSIB RWA, which represent in the aggregate approximately 8 percent of total RWA for the GSIBs, partial cross-product netting recognition alone could contribute an additional 2 to 4 percentage points of total RWA reduction beyond the agencies' static estimate.[121]

In addition, as noted previously in this comment letter, the agencies' 5 percent baseline reduction is derived from a voluntary QIS submitted by the institutions with the largest financial incentive. The QIS on which the agencies relied was conducted while the 2023 proposal was pending, under conditions that gave the participating institutions a direct monetary incentive to overstate the capital burden of that proposal in order to achieve regulatory relief.

The agencies lacked an independent enforcement mechanism to verify the voluntary QIS submissions with the same regulatory authority as they have for other regulatory reporting forms like the FR Y-9C or FFIEC 101. The agencies are therefore calibrating a capital reduction against a self-reported baseline produced under conditions of structural incentive conflict, without the typical independent verification processes. While it is challenging to estimate the impact of this overstatement, nonetheless it is another factor that would further reduce the agencies' RWA estimate in the Proposal.

Finally, although it is difficult to project the impact of RWA optimization for market risk, CVA, and certain derivatives exposures, Better Markets believes that optimization would unquestionably result in at least a 3 percent reduction in RWA due to the material changes described in *Section I*, which alone when combined with the reductions above yields Better Markets' total estimated 15 percent reduction in required capital.

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119 *See* ISDA and SIFMA. Response to US Basel III NPR, at Appendix 8, Quantitative Impact Study Results. (January 16, 2024), available at: https://www.federalreserve.gov/SECRS/2024/February/20240220/R-1813/R-1813_011724_156753_496678267479_1.pdf.

120 *See* ISDA. "Higher Collateral Puts Focus on Cross-product Netting" (April 29, 2026), available at: https://www.isda.org/2026/04/29/higher-collateral-puts-focus-on-cross-product-netting. The Proposal "allows only limited recognition of offsets across products under a master netting agreement and falls short on producing a genuinely risk-sensitive outcome" and that "capital requirements remain materially overstated relative to the risk of an economically hedged portfolio".

121 *Supra* 2. "Special Collection Aggregate Release data files."