# INTERNATIONAL SECURITIES LENDING ASSOCIATION AMERICAS

## Proposal and Comment Information

**Title:** Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-weighted Assets, R-1888

**Comment ID:** FR-2026-0008-01-C192

## Submitter Information

**Organization Name:** International Securities Lending Association Americas

**Organization Type:** Organization

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Please see attached files.

ISLA AMERICAS

June 18, 2026

VIA ELECTRONIC SUBMISSION

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**Re: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations (FRB Docket No. R-1887, RIN 7100-AH20; FDIC RIN 3064-AF29; OCC Docket ID OCC-2026-0265, RIN 1557-AF52)**

**Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets (FRB Docket No. R-1888, RIN 7100-AH21; FDIC RIN 3064-AG23; OCC Docket ID OCC-2026-0034, RIN 1557-AF49)**

Ladies and Gentlemen:

The International Securities Lending Association Americas ("ISLA Americas")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC") and the Office of the Comptroller of the Currency (the "OCC," and collectively with the FRB and the FDIC, the "Agencies") on behalf of ISLA Americas' numerous members that participate in the industry, including some of the largest U.S. custody banks, asset managers and securities dealers. This letter addresses the

[1] ISLA Americas is the successor organization to the Risk Management Association's Securities Lending Council and represents securities lending firms in the Americas region. ISLA Americas is an affiliate of the International Securities Lending Association ("ISLA"), which represents securities financing market participants across Europe, Middle East and Africa. ISLA will be providing its comments by submitting an independent letter to the Agencies.

Agencies' proposals to revise their risk-based capital rules (the "Proposals"),[2] which follows the Agencies' 2023 proposals to implement the Basel Committee on Banking Supervision's ("BCBS") 2017 revisions to the Basel III framework (the "Basel Framework").

In 2024, the Securities Lending Council of the Risk Management Association[3] submitted a comment letter that offered targeted suggestions to improve the overall calibration of the 2023 proposal. We commend the Agencies for their constructive approach to revisiting the calibration of the regulatory capital framework. In this regard, we believe that the Proposals make significant progress in addressing the concerns we highlighted in 2024. Our members play an essential role in supporting liquidity in the securities markets, and an appropriately risk-sensitive regulatory capital framework helps to ensure our members can continue serving that critical function. We provide relevant background on our members' securities lending activities in Appendix A.

In this letter, we identify certain additional changes that would be consistent with the Agencies' objectives in revising its risk-based capital framework. In particular, we respectfully submit a series of technical recommendations and clarifications to improve consistency and facilitate effective implementation of the final rule, as well as several more substantive recommendations on specific elements of the Proposals. All recommendations are offered in the spirit of partnership and with the shared goal of ensuring that the final rule "achieves the objectives of the international accord while tailoring to the unique characteristics of the U.S. banking system."

Our core recommendations are as follows:

- We recommend that firms be permitted to apply the revised "collateral haircut approach" ("CHA") as soon as the Proposals are adopted, i.e., prior to any mandatory compliance date, so that the benefits of the Agencies' commendable reformulation of the CHA are not further delayed during the transition period.

- We recommend that the single counterparty credit limits ("SCCL") be revised to allow for models-based approaches for valuing securities financing transactions, including simple VaR to avoid any sudden significant increases in credit exposure amounts under the SCCL that could disrupt securities financing markets.

- We recommend the final rule explicitly provide that for repo-style transactions where collateral is held in a bankruptcy-remote manner from the secured party (the lender), thereby insulating the banking organization from the secured party's (the lender's) default, there is no counterparty credit risk and no counterparty credit risk ("CCR") charge should apply, consistent with the principles underlying the cleared transaction framework.

- We recommend targeted changes to the CHA to improve risk-sensitivity as follows:

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[2] 91 Fed. Reg. 14952 (Mar. 27, 2026) (the "ERBA Proposal"); 91 Fed. Reg. 15332 (Mar. 27, 2026) (the "Standardized Proposal").

[3] This council has been succeeded by the International Securities Lending Association Americas.

- We would propose that the 10% limitation be calculated on a risk-adjusted basis, by scaling the size of each position by the standardized market volatility haircut to which such position would be subject.

- In light of the significant technological, operational and regulatory advancements over the past 13 years, we recommend removing the 5,000 trade limit for all securities financing transactions.

- The final rule should adopt the Basel Framework's approach to short-term bank exposures. In addition, the final rule should separately apply a 20% risk weight for affiliated bank exposures.

- The final rule should broaden the scope of exposures subject to the "bank" framework to include financial institutions prudentially regulated as banks, including consolidated subsidiaries of a bank holding company.

** ** **

The technical recommendations and clarifications, which can be resolved with narrow, incremental changes in the final rule, are summarized below and discussed in greater detail in Appendix B to this comment letter:

- The final rule should clarify that "qualifying master netting agreements" and "qualifying cross-product netting agreements" need not be documented under a single master agreement.

- The Agencies should clarify, or the final rule should provide that, exposures to an index of securities, including exchange-traded funds ("ETFs"), should be treated as an exposure to the underlying securities, not the index as a whole, for the purposes of calculating the "N" parameter.

- The final rule should clarify that a "company" explicitly includes certain regulated entities regardless of legal form.

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Below, we offer our substantive comments on the Proposals, organized by broad topic area.

## I. Timing and Transition Recommendations

### A. The final rule should permit firms to apply the revised CHA as soon as the Proposals are adopted.

The Agencies and the BCBS have long recognized the shortcomings of the current CHA – the BCBS adopted the revised CHA in its Basel Framework in 2017, and the Agencies proposed the revised CHA as part of the 2023 proposals. Throughout this period, the ability of our members to provide liquidity to the securities markets has been limited by the overstatement of credit exposure resulting from the current CHA.

If the final rule includes a transition period to (appropriately) provide firms additional time to adjust their systems, implementation of the revised CHA would be further delayed, perpetuating the overstatement of credit risk arising from securities financing transactions. It is critical that the benefits of the Agencies' commendable reformulation of the CHA not be delayed by continued application of a flawed methodology throughout the transition period.

**Recommendation**

We urge the Agencies to vote to adopt the final rule by the end of 2026 and set the related effective date as soon as practicable in accordance with the Administrative Procedure Act. We further recommend that firms be permitted to apply the revised CHA under the current standardized approach or advanced approaches, as applicable, as soon as the Proposals are adopted, i.e., prior to any mandatory compliance date.

Allowing firms to early adopt would be consistent with the FRB's approach in finalizing the standardized approach to counterparty credit risk for derivatives ("SA-CCR") in 2020, which "include[d] an effective date shortly after publication that permits any banking organization to elect to adopt SA-CCR prior to the mandatory compliance date."[4]

B. The final rule should retain the ability to use internal models-based approaches, including simple VaR, for purposes of the SCCL.

The Proposals would eliminate model-based approaches (except with regard to market risk). For agents that currently use internal models or simple VaR to calculate exposure amounts for securities financing transactions or derivatives, such elimination would significantly increase credit exposure amounts calculated for purposes of the SCCL.

Under current SCCL regulations, qualifying securities lending agents can use any FRB-permitted method, including internal models, to measure exposure to repo-style transactions.[5] However, as the Proposals would remove model-based approaches as a permitted option for measuring exposure to repo-style transactions, qualifying securities lending agents would no longer be able to use internal models for purposes of the SCCL exposure calculations (for repo-style transactions) without any transition period.[6] Forcing an immediate move to the CHA would result in a sharp and sudden upsurge in credit exposure amounts under the SCCL, even though there is no real change in economic risk. This could create a cliff effect requiring rapid collateral rebalancing or deleveraging that could disrupt securities financing markets.

In adopting the SCCL, FRB acknowledged that the standardized methodologies that would have applied to securities financing transactions "could have overstated exposure from some

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4 85 Fed. Reg. 4362, 4369 (Jan. 24, 2020).

5 12 CFR § 252.73(a)(4).

6 ERBA Proposal at 14958–59.

transactions."[7] This rationale continues to hold – although the revised CHA is far more risk sensitive than the current CHA, it still overstates credit exposure relative to internal models-based approaches.

**Recommendation**

We recommend that the SCCL be revised to allow for models-based approaches for valuing securities financing transactions, including simple VaR. As an alternative, the FRB could provide for a three- to five-year transition period whereby agents currently relying on internal models-based approaches could, at their option, recognize the difference between modeled SCCL and CHA-based SCCL, applying a haircut phase-in schedule that gradually moves from the modeled floor to the full CHA floor. The timing of the transition should follow the transition periods for Accumulated Other Comprehensive Income ("AOCI").

The Agencies provided a transition period for AOCI because they recognized that banking organizations need "sufficient time to adapt to the changes while minimizing any potential adverse impact."[8] We agree with the Agencies' analysis that such changes require a transition period but contend that the same concerns necessitate an optional transition period for the effects of the Proposals on SCCL. Lending agents may require sufficient time to adjust to the changes to credit exposure amounts under the SCCL to avoid the market dislocations that would inevitably occur if the changes were implemented at once.

## II. Recommendations Related to Pledged Collateral and CCR Capital Charge

The Proposals would replace the current CHA used to value exposures to repo-style transactions and eligible margin loans with a Basel-compliant revised version of the standardized CHA that would better capture the risk-mitigating benefits of diversification and netting. In addition, the Proposals would revise SA-CCR to recognize qualifying cross-product master netting agreements for non-cleared transactions and incorporate certain non-cleared (such as client-facing) repo-style transactions. In this Section II, we request that the Agencies clarify in the final rule that, consistent with the cleared transaction framework, no counterparty credit risk charges should apply to collateral that is held in a manner that is bankruptcy-remote from the counterparty.

In recent decades, market participants have increasingly entered into securities borrowing transactions pursuant to which they borrow securities and pledge collateral to the lender in a bankruptcy remote manner. Pursuant to such arrangements, the securities lender cannot rehypothecate the collateral and is required to hold the collateral in a segregated account that is insulated from the insolvency of the secured party (the lender).

The revised CHA raises a question as to whether such pledges of securities give rise to CCR because $E_s$ is defined to include the net position in a given instrument that a banking organization

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7 83 Fed. Reg. 38460, 38473 (Aug. 6, 2018).

8 Standardized Proposal at 15335.

has "lent, sold subject to repurchase, or posted as collateral to the counterparty,"[9] even where the securities are held in a manner that is bankruptcy-remote from the secured party. This overinclusion would be inconsistent with the counterparty risk of the transaction, the treatment of cleared transactions and the Basel Framework.

First, we note that the CCR charge is designed to reflect the loss to which a banking organization is exposed upon a counterparty's default. Bankruptcy-remote pledge arrangements eliminate that loss by contractually separating the collateral from the counterparty's insolvency.

Second, we note that the inclusion of bankruptcy-remote pledges in the exposure calculation would be inconsistent with the Agencies' cleared transaction framework, which generally provides that "[n]otwithstanding any other requirement in this section, collateral posted by a [banking organization] that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section."[10]

Third, we note that the inclusion would be inconsistent with the Basel Framework. The Basel Framework (CRE 50.1) defines CCR to be "the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows." The framework goes on (CRE 51.4) to provide that "[b]anks must calculate a counterparty credit risk charge for all exposures that give rise to counterparty credit risk." Given that bankruptcy-remote pledges insulate the banking organization from the counterparty's default, such pledges do not give rise to counterparty credit risk and therefore should not be subject to CCR capital charges.

Absent such relief, U.S. institutions would be at a competitive disadvantage relative to their non-U.S. counterparts because non-U.S. institutions, operating under the Basel Framework, generally do not need to hold capital against collateral posted in a bankruptcy remote manner in connection with repo-style transactions. As a result, non-U.S. firms would be able to engage in the same activity with the same risk as U.S. institutions but with a lower cost of capital and thus threatens to unnecessarily reduce U.S. participation and strength in the securities lending market.

**Recommendation**

We recommend the final rule explicitly provide that for repo-style transactions, where collateral is held in a manner bankruptcy-remote from the counterparty, no CCR charge should apply, consistent with the principles underlying the cleared transaction framework.

## III. Recommendations Related to Collateral Haircut Approach

While we commend the Agencies for their continued efforts to improve the risk sensitivity of the regulatory capital framework, in this Section III, we provide two additional recommendations

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9 ERBA Proposal at 14980.

10 12 CFR 217.35(b)(4)(i).

regarding application of the revised CHA that would help to further improve its risk-sensitivity and reflect evolving market practice.

A. <u>The final rule should adjust the limitation of "N" based on the market volatility of the relevant positions, e.g., by excluding sovereign positions.</u>

The revised CHA is designed to account for the risk-mitigating benefits of both netting and portfolio diversification.[11] However, as designed, the limitation on "N" based on the largest $E_s$ in a netting set is not properly calibrated for portfolios with large quantities of government securities because, without exception, the instruments that may be included in "N" are limited to 10% of the largest absolute value of a net position in a given instrument or in gold in the netting set.

$$E^* = max\left\{0; \left(\sum_i E_i - \sum_i C_i\right) + \left(0.4 \times net_{exposure}\right) + \left(0.6 \times \frac{gross_{exposure}}{\sqrt{N}}\right) + \left(\sum_{fx}\left(E_{fx} \times H_{fx}\right)\right)\right\}$$

The securities lending and repurchase market for government securities is characterized by high volumes and low margins, interest and fees. The typical transaction size in this market is far higher than in the market for equity securities. As a result, the largest individual $E_s$ in a particular netting set that includes government securities is likely to be skewed by certain CUSIPs of government securities. Consequently, banking organizations that have portfolios with a diverse range of equity securities in addition to government securities would not be able to recognize much of the benefit of diversification within that asset class, notwithstanding the significant diversification benefit that those equities provide.

This is because the mathematical benefit of diversification is not based solely on the size of a given position, as the N-factor definition would suggest, but also on its volatility. *Ceteris paribus*, lower volatility assets simply do not contribute to the overall volatility of the portfolio in the same way as higher volatility assets. To illustrate this, we note that the total variance of a portfolio of assets can be modeled simply as follows:

$$\sigma_p^2 = \sum_{i=1}^{n} w_i^2 \sigma_i^2 + \sum_{i=1}^{n} \sum_{j=1, j \neq i}^{n} w_i w_j \sigma_{ij}$$

Where:

$w_i$ and $w_j$ are the portfolio weights of asset *i* and asset *j*;

$\sigma_i^2$ is the variance of asset *i*; and

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[11] ERBA Proposal at 14980-81; Standardized Proposal at 15347-48.

$\sigma_{ij}$ is the covariance between asset $i$ and asset $j$.

Thus, a large position of U.S. Treasury bills may have a large portfolio weight, but a low variance (as reflected by the Proposals' relatively lower market volatility haircuts), and therefore not contribute meaningfully to the variance of the portfolio. Similarly, cash positions may have a large portfolio weight but are not volatile (and hence are appropriate excluded from calculation of the N-factor).

**Recommendation**

We would propose that, in order to make the "N" parameter meaningful for government securities lending portfolios, we recommend that the limit exclude net positions in 0% risk-weighted sovereign securities (i.e., apply the 10% limitation based on the largest non-sovereign exposure in the netting set). This would preserve the prudential intent of filtering immaterial positions while recognizing that market risk diversification, not notional size, determines whether a position should count towards the "N" parameter.

As an alternative, we propose that the 10% limitation be calculated on a risk-adjusted basis, based on the absolute value of the market price volatility haircut for each position (i.e., $H_s$) rather than the absolute value of the net position of each position ($E_s$), because the haircuts more accurately and directly reflect the diversification benefit of each position and the relative contribution to overall portfolio variance. Under this approach, a \$20,000 position in U.S. Treasury bills would be the same risk-adjusted size as a \$500 position in main index equity securities (both equal to \$100). Thus, a netting set where the largest $H_s$ is a \$20,000 position in U.S. Treasury bills would exclude any instruments with $H_s$ lower than \$10 (10% of \$100) for purposes of calculating the N parameter.

B. The Agencies should remove the 5,000 trade limit to reflect technological advancements and banks' proven track record of close-out.

Consistent with the current rule, the Proposals would require banking organizations to increase the standard supervisory haircuts for transactions with large netting sets. In adopting these upward haircuts in 2013, the Agencies noted that "during the recent financial crisis, many financial institutions experienced significant delays in settling or closing-out collateralized transactions, such as repo-style transactions and collateralized OTC derivatives."[12] As a result, the Agencies elaborated, "[t]he assumed holding period for collateral in the collateral haircut approach under Basel II proved to be inadequate for certain transactions and netting sets and did not reflect the difficulties and delays that institutions had when settling or liquidating collateral during a period of financial stress."[13]

Securities financing transactions tend to be characterized by larger netting sets, but simpler close-out (since close-out typically only requires sale of securities in the secondary market and often does not necessitate more complex valuations). Since the financial crisis, banking organizations have

[12] 78 Fed. Reg. 62018, 62108 (Oct. 11, 2013).

[13] *Id.* at 62108–09.

made significant technological and operational advances that have allowed them to manage close-outs for securities financing transactions even more accurately and expeditiously. Together with regulatory and marketplace advances (e.g., T+1 securities settlement), these advances have demonstrably decreased the time it takes to close out large netting sets of securities financing transactions. Moreover, in 2023, the U.S. Securities and Exchange Commission ("SEC") adopted rules that would require the direct participants of SEC-registered central clearing counterparties to submit all "eligible secondary market transactions" in U.S. Treasury securities for central clearing and settlement. The SEC has set the effective dates as December 31, 2026, for eligible cash transactions and June 30, 2027, for eligible repo transactions. Mandatory central clearing will reduce risk and increase efficiency in the U.S. Treasury market, making the 5,000 trade limitation inappropriate for eligible cash and repo transactions.

While the 5,000 trade limit may have been relevant in 2013, this threshold no longer accurately marks any meaningful boundary between simpler, easy-to-liquidate netting sets of securities financing transactions and complex, harder-to-liquidate netting sets. The Agencies already have recognized the need to recalibrate thresholds to reflect changes in market conditions over time and thus include in the proposed revisions to the capital surcharge for the U.S. global systemically important banks ("GSIBs")[14] certain modifications to account for economic growth and inflation. Over a decade of developments have similarly rendered the 5,000 trade limit outdated and inconsistent with the rationale provided by the Agencies in 2013 and warrants adjustment.

**Recommendation**

In light of the significant technological, operational and regulatory advancements over the past 13 years, we recommend removing the 5,000 trade limit for all securities financing transactions.

## IV. Recommendations Related to General Credit Risk

### A. The final rule should adopt the Basel Framework's approach to short-term bank exposures. In addition, the final rule should separately apply a 20% risk weight for affiliated bank exposures.

The ERBA Proposal retains the 2023 proposal's treatment of short-term bank exposures, which may impede liquidity in the securities markets and monetary policy transmission. For short-term bank exposures, which the Basel Framework defines as on- and off-balance sheet, "[e]xposures to banks with an original maturity of three months or less, as well as exposures to banks that arise from the movement of goods across national borders with an original maturity of six months or less," the Basel Framework provides lower risk weights for Grade A and B bank exposures, specifically: 20% for Grade A bank exposures and 50% for Grade B bank exposures.[15] Short-term Grade C bank exposures are assigned the base 150% risk weight.[16] For countries that permit the use of external

[14] Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15), 91 Fed. Reg. 14908 (Mar. 27, 2026).

[15] Basel Framework at CRE 20.19.

[16] Basel Framework at 20.21.

ratings, short-term exposures to banks graded BBB- and up receive a 20% risk weight, and exposures to banks graded B- and up receive a 50% risk weight.[17]

Instead of implementing the Basel Framework's approach to short-term bank exposures, the ERBA Proposal would limit the favorable 20% and 50% risk weights to a foreign Grade A or B bank exposure that "is a self-liquidating, trade-related contingent item that arises from the movement of goods and that has a maturity of three months or less."[18]

Among other reasons, a stated purpose of the lower risk weights for short-term bank exposures "is to avoid interference with monetary policy channels and to prevent any negative impact on market liquidity in interbank markets."[19] As we describe in detail in Section I of Appendix A, a significant portion of the securities finance market, particularly outside of the United States, is interbank. Like the 2023 proposal, the ERBA Proposal does not address the rationale for limiting the short-term bank exposure framework in this manner and does not address the potentially significant negative consequences on market liquidity in interbank markets or on monetary policy transmission that would result from the difference between the ERBA Proposal and the Basel Framework and international implementations (proposed and final) of the Basel Framework.

Aligning the exemption scope to the Basel Framework preserves prudential conservatism and the risk-sensitivity rationale that justifies ERBA itself. If liquidity contagion concerns are the rationale for limiting the short-term bank exposure framework, we would welcome clarification on whether those should be addressed instead through liquidity coverage and/or stable funding rules rather than through a risk-based capital exemption.

In addition, the ERBA Proposal does not provide a distinct risk weight for an intermediate holding company's ("IHC") exposures to its foreign bank affiliates. As currently proposed, those exposures would be treated like any other bank exposure and therefore generally would receive a risk weight ranging from 30% to 150%, unless the exposure qualifies as short-term. This fails to account for the significant exposures IHCs maintain to foreign bank affiliates as part of ordinary intra-group risk management and liquidity management practices, as well as the intermediary role IHCs often perform in facilitating access to U.S. financial markets. As with interbank exposures discussed above, applying standard bank exposure risk weights to these affiliated exposures would impose unduly high capital requirements on IHCs without accounting for the underlying economic relationship and consolidated risk profile of affiliated banking organizations and potential negative consequences on market liquidity.

**Recommendation**

We recommend that, consistent with international implementation, the final rule should adopt the Basel Framework's approach to the scope of short-term bank exposures eligible for lower risk

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17 *Id.* at CRE 20.18.

18 ERBA Proposal at 14966.

19 BCBS, "Revisions to the Standardized Approach for credit risk," Second Consultative Document at 6 (Dec. 10, 2015), *available at* https://www.bis.org/bcbs/publ/d347.pdf.

weights (20% for Grade A bank exposures and 50% for Grade B bank exposures), provided they are on demand or overnight and unconditionally cancelable (the types of maturities most commonly associated with the transmission of monetary policy and interbank markets).

In addition, the final rule should provide a separate 20% risk weight for an IHC's exposures to its foreign bank affiliates. Providing a tailored risk weight for these affiliated exposures would better reflect the operational and economic realities of intra-group funding, liquidity and risk management arrangements and would avoid imposing unnecessarily punitive capital requirements on IHCs that play an important intermediary role in U.S. financial markets.

B. The final rule should broaden the scope of exposures subject to the "bank" framework to include financial institutions prudentially regulated as banks, including consolidated subsidiaries of a bank holding company.

The Basel Framework for bank exposures extends to securities firms and other financial institutions subject to prudential standards and supervision equivalent to banks in recognition of the fact that in many major jurisdictions, there is no bright line between commercial and investment banking as in the United States.[20] Consistent with the Basel Framework, the EU and UK propose to apply risk weights for bank exposures to "institutions," which include both deposit-taking "credit institutions" and "investment firms" such as broker-dealers.[21]

The ERBA Proposal's definition of "bank exposure" is narrow: "an exposure to a depository institution, foreign bank, or credit union."[22] Such a narrow definition restricts favorable bank exposure risk weights to depository institutions, excluding non-bank financial institutions that may be prudentially regulated as depository institutions in other jurisdictions. This would include, for example, foreign broker-dealers subject to prudential requirements.

The rationale for applying favorable risk weights to bank exposures is based on the idea that banks are required to maintain a specified level of capital and liquidity, making them a lower credit risk. If mandatory capital compliance reduces credit risk, then favorable risk weight should apply to all Basel-regulated institutions, which are recognized as being subject to prudential and supervisory standards similar to banks, regardless of legal form or charter. In carrying forward the narrow definition from the 2023 proposal, the Agencies project artificial U.S. statutory and regulatory distinctions onto the rest of the world in a manner inconsistent with broad international consensus. Excluding, for example swap dealers or investment firms that are Basel-regulated institutions, is

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20 Basel Framework at CRE 20.16 ("For the purposes of calculating capital requirements, a bank exposure is defined as a claim (including loans and senior debt instruments, unless considered as subordinated debt for the purposes of CRE 20.60) on any financial institution that is licensed to take deposits from the public and is subject to appropriate prudential standards and level of supervision.").

21 European Banking Authority ("EBA") Capital Requirements Regulation ("CRR"), Article 121(1) (applying to "institutions"); EBA CRR, Article 4(1)(3) ("'institution' means a credit institution or an investment firm").

22 ERBA Proposal § __.101.

contrary to the purpose of exemption in the first place as legal form, rather than actual credit risk, would determine the applied risk weight.

The currently proposed definition of "bank exposure" would thus significantly limit our members' ability to competitively lend securities to non-U.S. borrowers, particularly in the EU and UK, where many borrowers are securities firms that are subject to bank prudential regulations. Further, while not subject to prudential regulation directly, the rule also would exclude consolidated subsidiaries of a bank holding company within the scope of those "prudentially regulated."

This is particularly relevant to our members that lend to securities affiliates of GSIBs. As each securities affiliate is prudentially regulated, any subsidiary of the GSIB is consolidated and would be regulated by virtue of being a subsidiary. In addition, their capital would contribute to the GSIB's overall capital requirement, and they would be subject to similar activity limits. Moreover, many of these GSIBs are subject to special resolution regimes that are substantially similar to the regimes applicable to insured depository institutions. A GSIB affiliate subject to a special resolution regime, such as the U.S. Orderly Liquidation Authority ("OLA"), is much less likely to default given the "bail in" and recapitalization mechanisms in place. Applying the bank exposure framework would appropriately reflect the reduced credit risk associated with such institutions. Importantly, the FRB's SCCL would still effectively cap any intra-GSIB exposure to 15% of the creditor firm's Tier 1 capital, thus mitigating any concerns regarding interconnectedness.

**Recommendation**

We recommend that the final rule should expand the bank exposure framework to include all financial institutions directly subject to Basel Framework capital requirements, including CRD IV/CRR credit institutions and Part 23 swap dealers, or if they are subject to a "special resolution regime" that is substantially similar to OLA.

Thank you for considering these comments. Please feel free to contact Francis Garritt (Fran.Garritt@ISLAAmericas.org) with any questions.

Respectfully submitted,

Francis Garritt
CEO and President
ISLA Americas

# Appendix A

*Background on Securities Lending*

## I. Agency Securities Lending

Agency securities lending is a well-established, safe and sound activity that supports global capital markets activities and facilitates trade settlement. By effectively increasing the supply of securities available for these and other market activities, securities lending improves market liquidity and enhances price discovery.[23] Securities lenders largely consist of buy-side entities, such as public and private pension funds, mutual funds, Employee Retirement Income Security Act ("ERISA") plans, endowment funds of not-for-profit institutions, insurance companies, investment funds and other similar entities or funds into which such entities invest. Borrowers in securities lending transactions largely consist of broker-dealers, banks and other financial institutions.

Agents act as intermediaries in securities lending programs by facilitating loans on behalf of beneficial owners to qualified borrowers. Securities are generally lent pursuant to a (i) securities lending authorization agreement between the beneficial owners and the agents, and (ii) securities borrowing agreement between the borrower and the agents (acting in an agency capacity on behalf of the beneficial owners as principal). Under these agreements, the borrower provides initial collateral to the beneficial owners (generally, via its agent) in excess of the value of the loaned securities, usually by 2% to 5% depending upon the characteristics of the loaned securities and the collateral. The loaned securities and collateral are then marked-to-market daily to ensure that the collateral consistently meets the requisite value. The margins for securities lending transactions are typically low. Because agency lending typically involves an agent guaranty against borrower credit risk, agency lending by capital-regulated banks is also somewhat capital intensive. Accordingly, securities lending generally requires economies of scale to be profitable, and even marginal increases in cost may drive supply-side liquidity out of the market unless it can be offset with increased fees.

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23 Beneficial owners use agency securities lending services from lending agents in order to obtain additional incremental revenues. Agency securities lending activities developed initially as an outgrowth of agents' custody and related activities, and have long been regulated, examined and treated by regulators as traditional banking services. *See, e.g.*, OCC, "Banking Issuance," BC-196 (May 7, 1985), *available at* https://www.occ.gov/static/news-issuances/bulletins/pre-1994/banking-circulars/bc-1985-196.pdf ("The policy is directed toward national banks that are lending securities from their own investment or trading accounts or from safekeeping, trust or pension accounts of their customers"); Letter from J. Virgil Mattingly, General Counsel, FRB, William F. Kroener, General Counsel, FDIC, and Julie L. Williams, General Counsel, OCC, "Re: File No. S7-41-02-Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 ('Proposed Rules')" (Dec. 10, 2002), *available at* https://www.sec.gov/rules/proposed/s74102/jvmattingly1.htm (indicating that interagency guidelines "ensure that banks conduct their securities lending activities in a safe and sound manner and consistent with sound business practices, investor protection considerations and applicable law"); Council Directive 2004/39/EC, 2004 O.J. (L 145/1), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:145:0001:0044:EN:PDF.

As of year-end 2025, S&P Global Market Intelligence data showed approximately $48.5 trillion of lendable securities globally ($37.8 trillion in global equities and $10.7 trillion in global fixed income), consisting of $29.4 trillion of U.S. lendable assets ($26.4 trillion in U.S. equities and $3 trillion in U.S. treasuries) and $19.1 trillion of non-U.S. lendable assets ($9.5 trillion in global equities (ex-US) and $9.6 trillion in global fixed income (ex-US)) in the securities lending market. Of those assets, over $1.36 trillion of U.S. securities ($358.6 billion U.S. government bonds and $515.6 billion U.S. equities) and $483.4 billion of non-U.S. securities were on loan against cash collateral. The total average value of securities on loan in December 2025 was $3.4 trillion ($1.55 trillion in equity and $1.85 trillion in global fixed income).

## II. Borrower Default Indemnification

As a matter of standard market practice developed over the past several decades, agents provide securities replacement guarantees or indemnification for borrower default to the substantial majority of their lending clients pursuant to their securities lending authorization agreements. This practice is commonly referred to as "borrower default indemnification." The vast majority of lending clients (both U.S. and international) focus on risk avoidance and see the securities replacement guarantee as providing both protection to their programs and a validation of the strength of their agents' risk management systems. Moreover, many lending clients (e.g., U.S. clients subject to ERISA) are required under U.S. law to receive borrower default indemnification by an agent in their securities lending program under defined circumstances.[24] Certain U.S. states and municipalities also require indemnification from the agent, either by statute or by policy, as a condition to their funds' participation in securities lending.[25]

## III. Overview of Standard Master Agreements

The standard agreement used for U.S. securities lending transactions is the Master Securities Loan Agreement ("MSLA"), published and maintained by the Securities Industry and Financial Markets Association ("SIFMA"). To support the MSLA and related market documentation, SIFMA obtains

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[24] *See* Prohibited Transaction Exemption (PTE) 2006-16, Class Exemption To Permit Certain Loans of Securities by Employee Benefit Plans, 71 Fed. Reg. 63786 (Oct. 31, 2006) (requiring in the case of securities lending transactions involving (i) certain types of foreign banks or broker-dealers as borrowers or (ii) certain types of collateral, including U.S. and non-U.S. securities, defined in the exemption as "Foreign Collateral," that a U.S. bank or broker-dealer "Lending Fiduciary" indemnify the lending plan for borrower default).

[25] *See, e.g.*, Texas Government Code § 815.303(b)(3) (stating that in order for a bank to be eligible to lend securities on behalf of a Texas Public Fund, the bank must "execute an indemnification agreement satisfactory in form and content to the retirement system fully indemnifying the retirement system against loss resulting from borrower default."); New York State Teachers' Retirement System, "Investment Policy Manual," Securities Lending at 4 (Oct. 2023), *available at* https://www.nystrs.org/NYSTRS/media/PDF/IPM.pdf (requiring that the agent lender indemnify the System for losses resulting from a default by the borrower); New Jersey Department of the Treasury, Department of Investment, "Request for Proposals for Securities Lending Services" at 6-7, *available at* https://www.nj.gov/treasury/doinvest/pdf/Rfp/SecLendingFinal.pdf ("For securities lending services the Contractor shall satisfy and maintain the following minimum qualifications and requirements for the duration of the contract: . . . Be willing to accept responsibility for DOI's securities lending program on an agency basis as a fully indemnified program specific to operational risk and borrower default").

legal opinions on behalf of its members that address netting and enforceability under U.S. law. To the extent that market participants do not use the SIFMA form, many rely on master agreements that are substantially similar to the SIFMA form and obtain opinions that address netting and enforceability under applicable law.

For over 30 years, the International Securities Lending Association ("ISLA") has been the custodian and architect of the internationally recognised industry standard master agreements, including the Global Master Securities Lending Agreement ("GMSLA") Title Transfer document. In 2018, ISLA developed the GMSLA Security Interest over Collateral variant, commonly referred to as the ISLA Pledge GMSLA. The ISLA GMSLAs are the most widely used agreements outside of the United States.

ISLA obtains, supports and maintains legal netting opinions across 71 jurisdictions globally. ISLA also provides opinions to support the Pledge documentation suite. The opinions obtained cover the bankruptcy remoteness of the collateral manager and additional FCAR opinions confirm that the arrangement is considered a Financial Collateral Arrangement in the relevant jurisdiction.

## Appendix B

*Additional Technical Recommendations*

### I. Clarifications Related to Collateral Haircut Approach

In this Section, we provide technical recommendations regarding application of the revised CHA that would help to further improve its risk-sensitivity and reflect evolving market practice.

A. The final rule should clarify that "qualifying master netting agreement" and "qualifying cross-product netting agreement" can consist of a set of agreements and that such arrangements need not be documented under a single master agreement.

The revised CHA provides an exposure quantification methodology for "netting sets" of repo-style transactions. The term "netting set" is defined as "a group of transactions with a single counterparty that are subject to a qualifying master netting agreement." The term "qualifying master netting agreement" is in turn defined as "a written, legally enforceable agreement" that meets certain additional criteria, while a "qualifying cross-product master netting agreement" is defined as a "qualifying master netting agreement" that meets certain additional criteria. In each case, the relevant definitions refer to an "agreement" in the singular form, which could be interpreted to require that all termination and close-out netting provisions be contained within a single contract.

Typically, parties enter into multiple bilateral securities lending and repurchase agreements. To the extent that parties have entered into multiple bilateral agreements, the parties may amend these existing agreements or enter into new netting or securities agreements that provide for termination and close-out netting across these multiple bilateral agreements.

Often, however, the mechanics for close-out across these agreements may not exist in a single agreement, e.g., because the agreements may require close-out netting to be completed under the bilateral agreement before those amounts are subsequently netted under a different agreement. Notwithstanding the lack of a single "contract," the legal effectiveness of such netting arrangements is the same; firms are able to terminate and close-out all transactions subject to such agreements on a net basis in a manner consistent with the requirements of the rule.

**Recommendation**

Although the relevant definitions refer to an agreement in the singular form, the definitions of "netting set," "qualifying master netting agreement" and "qualifying cross-product master netting agreement" should not be defined to require a single *contract* that meets all the relevant criteria. In particular, the final rule should clarify that multiple sets of contracts may constitute a single "agreement" that can collectively meet the relevant definitions (and operational criteria). Such a clarification would better reflect current market practice and be fully consistent with the Agencies' objectives in recognizing such netting arrangements. Otherwise, market participants may be required to re-paper longstanding arrangements under single contracts without meaningfully changing the legal effect (or risk mitigation benefits) of those arrangements.

B. <u>The Agencies should clarify, or the final rule should provide, that exposures to an index of securities, including ETFs, should be treated as an exposure to the underlying securities, not the index as a whole, for the purposes of calculating the "N" parameter.</u>

As described in Section III.A. of our letter, the objective of the "N" parameter is to recognize the risk-mitigating benefits of portfolio diversification. An indexed exposure to a basket of securities, including ETFs, is a cost-effective way to diversify exposure (without having to incur transaction costs associated with buying and selling individual securities).

If an indexed exposure is considered at the index-level instead of the individual security level, it disregards the diversification the index provides, inconsistent with the purpose of the "N" parameter and might result in any small equity exposures in the netting set being excluded as well if they constitute less than 10% of the indexed exposure's cumulative value. Further, it would open up the rule to potential evasion, as a lender could increase its "N" parameter without increasing diversification by simply splitting a number of identical securities under different indexes.

**<u>Recommendation</u>**

The Agencies should clarify, or expressly provide, in the final rule that exposures to an index of securities in a netting set will be treated as an exposure to the underlying securities, subject to the same *de minimis* limits (calculated based on the pro rata ownership of each underlying security). This would avoid a meaningless distinction between indices and their underlying securities and better carry out the objective of the "N" parameter.

For the avoidance of doubt, the final rule should also clarify that a transaction involving an ETF should be a single trade for purposes of the 5,000-trade threshold. The 5,000-trade threshold gates netting set eligibility based on operational complexity and actual counterparty granularity, not constituent granularity. An index position is operationally a single trade even if it economically represents hundreds of underlying holdings, so counting an ETF as multiple trades for threshold purposes creates a mismatch between the rule's intent and its application. Permitting index positions to count as a single trade preserves the threshold's prudential purpose, which is to prevent operationally unmanageable netting sets, while preventing the rule from inadvertently disqualifying genuinely manageable netting sets simply because index constituents push the trade count over the limit.

C. <u>The final rule should clarify that a "company" explicitly includes certain regulated entities regardless of legal form.</u>

Consistent with the current rule, the Proposals define "corporate exposure" by exclusion as any "company" that does not fall into any of several enumerated categories. The term "company" is defined to mean "a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization." Despite the expansive definition, there remains residual ambiguity as to whether certain regulated entities that may not have independent legal existence for corporate law or tax purposes may nonetheless qualify as "companies" for purposes of this exposure category.

In particular, entities registered with the SEC under the Investment Company Act of 1940 (or foreign equivalents thereof) (collectively, "RICs"), pension plans and quasi-sovereign entities may not have a legal form independent of their regulatory status.

Notwithstanding their lack of separate legal status for purposes of corporate or tax purposes, many of these companies are subject to separate regulatory regimes and may enter into contracts as if they are separate entities. For example, RICs must meet detailed transparency, asset valuation and investor disclosure requirements, including the issuance of fund prospectuses, regular reporting of audited and unaudited financial statements and the daily calculation of net asset values. In addition, RICs are subject to regulations concerning their structures, policies and procedures, including specific leverage and liability requirements and detailed asset quality, coverage and diversification mandates.[26] These additional layers of prudential regulation and oversight reduce their credit risk compared to public companies.

As with RICs, pension funds[27] (i) are subject to stringent statutory and regulatory disclosure requirements and extensive disclosure and supervision regimes, in line with or beyond those of public companies and (ii) are subject to regulations concerning their structures, policies and procedures rather than solely the accuracy of their disclosures.

Banking organizations are able to assess the creditworthiness of these entities using standard internal risk rating systems applied to other corporate obligors. Failing to explicitly include these entities creates ambiguity, which would penalize some of the safest and most transparent counterparties in the securities finance market, even though the Agencies already treat the same entities as low-risk financial entities that warrant favorable treatment elsewhere within the rules.[28]

**Recommendation**

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26 Regarding leverage, RICs are not permitted to incur indebtedness that exceeds 33% of their assets. Similarly, Retail Undertakings for the Collective Investment in Transferable Securities ("UCITS") are prohibited from borrowing more than 10% of the value of their assets; borrowing by other types of UCITS generally does not exceed 25% to 40% of their assets.

Regarding liquidity, U.S. mutual funds (a type of RIC) cannot invest more than 15% of their net asset value in illiquid assets, with illiquid assets defined as investments that cannot be sold within seven calendar days without significantly changing the market value of the investment.

Regarding diversification, open-ended mutual funds must generally limit their exposure to any single issuer to no more than 5% of their net asset value and also cannot own more than 10% of the outstanding securities of any one issuer.

27 For these purposes, a "pension fund" is "an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of ERISA, a 'governmental plan' (as defined in 29 U.S.C. 1002(32)) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction."

28 *See, e.g.*, 12 CFR 217.2 (exclusions from the definition of "financial institution").

The Agencies should explicitly confirm that, consistent with the treatment of such entities as prudentially regulated financial entities, counterparty credit exposures to RICs and pension funds should be regarded as exposures to "companies" and therefore "corporate exposures" eligible for the 65% investment grade risk weight if the counterparty meets the relevant investment grade criteria.