BETTER MARKETS, PHILLIP BASIL

Proposal and Comment Information

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June 18, 2026

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Re: Notice of Proposed Rulemaking—Regulatory Capital Rules: 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)

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 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.

1 Better Markets is a non-profit, non-partisan 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 Board of Governors of the Federal Reserve System, 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.

I. Executive Summary

As described in detail below, Better Markets has serious concerns about the legal sufficiency, empirical foundation, and procedural adequacy of this Proposal. Better Markets supports thoughtful, evidence-based refinement of the standardized approach capital framework to promote a safe and sound banking system that provides critical banking services to the American people. However, the Proposal does not meet those criteria. Additionally, and importantly, the Proposal fails to recognize the unique business models of community banks by making no distinction for them and failing to provide them with streamlined options. Of the 4,336 institutions that filed a Call Report in the first quarter of 2026, only nine are Category I and II institutions, meaning this Proposal applies to the other 4,327 institutions, 97 percent of which are community banks (using a threshold of $10 billion in assets).[3]

The Proposal should be significantly modified if the agencies choose to attempt to finalize this Proposal. We urge the agencies to take the following three actions before proceeding to any final rule:

First, the agencies should immediately finalize the accumulated other comprehensive income ("AOCI") recognition requirement for all banking organizations with total consolidated assets above $10 billion, with a two-year transition period from the effective date of any final rule.

This element of the Proposal addresses a genuine and demonstrated gap in the transparency of regulatory capital ratios that was exposed during the banking stress of 2023. Trade associations for large banks also supported the removal of the AOCI filter during the previous proposal process.[4] The AOCI recognition requirement does not increase or reduce capital in principle—it makes capital ratios more accurately reflect actual loss-absorbing capacity—and there is no principled basis for limiting its application to Category III and IV banking organizations when the same transparency concerns apply with equal force to institutions above $10 billion in assets. A two-year transition period is sufficient to allow banking organizations to adjust their balance sheet management and hedging strategies without creating undue market disruption. This element of the Proposal should proceed to finalization on an expedited basis, decoupled from the remainder of the rulemaking.

Second, the agencies should withdraw and repropose the revised risk weights for residential mortgages, corporate exposures, and other assets, the elimination of the mortgage servicing asset capital deduction, the revised credit conversion factors for off-balance sheet exposures, and the modifications to the securitization framework. In the reproposal, the agencies should thoroughly consider the costs to community banks of the increased complexity versus the limited benefits, if any at all, considering community banks generally maintain capital levels well above their capital

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3 Based on analysis of Q1 2026 Call Report data.

4 *See* Francisco Covas, Bank Policy Institute. "The industry supports the removal of the AOCI filter for all banks above $100 billion in assets. This change will require banks to increase their capital when unrealized losses on available-for-sale securities increase (and vice versa), addressing issues similar to those faced by Silicon Valley Bank in March of 2023." (September 20, 2024), available at: https://bpi.com/regulators-arent-enabling-risk-by-reproposing-basel-theyre-following-the-law/.

requirements.[5] The agencies should disclose to the public a holistic impact analysis that demonstrates, with institution-level granularity and across every affected exposure category, that the proposed capital requirements do not fall below the statutory floor established by the Collins Amendment as of July 21, 2010. That analysis must establish the capital requirements in effect for covered institutions on the date of the Dodd-Frank Act's enactment, the amount of the capital increase from the agencies' 2013 Basel III final rule on the banking organizations covered by this Proposal, and a net impact assessment demonstrating that the proposed reductions leave every affected institution above the statutory floor on every applicable capital measure. Without this analysis in the public record and subject to public comment before the close of any reproposal comment period, the agencies cannot lawfully finalize those elements of this rulemaking.

Third, and as a condition of any reproposal, the agencies should issue a formal data collection—through the supervisory process, through a voluntary survey, or through a notice and request under the Paperwork Reduction Act—that gathers the loan-level and portfolio-level information necessary to support a credible, institution-specific impact analysis for the proposed changes. The current Proposal rests on aggregated supervisory data that was never designed to support the granular, loan-to-value ("LTV")-sensitive, exposure-category-specific analysis that this rulemaking demands. Notably, the risk weights for lending fail to recognize the fact that historical loan charge-off rates for community banks are 60 percent lower than charge-off rates for non-community banks.[6]

A reproposal built on the same data foundation as the current Proposal will suffer the same analytical deficiencies and will be equally vulnerable to legal challenge. The agencies have the supervisory authority and have the institutional capacity to collect this data but have elected not to undertake such a collection. That abdication of responsibility is not acceptable when the stakes—for the banking organizations subject to these requirements, for the depositors whose funds depend on adequate capital, and for the systemic resilience of the financial system as a whole—are this high.

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5 *See e.g.,* comment letter from the Independent Community Bankers of America ("ICBA") signed by nearly 15,000 persons in response to the agencies' proposal of the first set of Basel III requirements, which would have included risk weights by loan-to-value bucket, that notes "Basel III will force community banks to hire new compliance staff, compute complex risk weights for residential mortgages, and limit their loan offerings to meet the requirements of arbitrary risk-weighted buckets—which will result in disastrous and unintended consequences to the communities they serve." (October 30, 2012), available at: https://www.federalreserve.gov/secrs/2013/january/20130110/r-1442/r-1442_103112_110322_388227869612_1.pdf.

6 Based on Better Markets' analysis of 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.

II. Background

The agencies' Proposal is not compelled by Congress or a clear statutory requirement. Further, apart from one material positive change, the Proposal constitutes a significant policy mistake by the agencies. Comptroller Gould testified before the House Financial Services Subcommittee on Financial Institutions and Monetary Policy in September 2024 that the Basel III endgame "lacks any direct and explicit congressional mandate" and that "this current rulemaking exercise is undertaken on the agencies' own initiative." [7] Gould's critique was directed at the agencies' July 2023 Basel III endgame proposal that would have applied to large banking organizations—a proposal that could at least claim to be related to the Basel Committee's 2017 international framework as a coherent policy rationale. On the other hand, this Proposal to update the standardized approach cannot even make that claim. **As the agencies acknowledge, the Basel Committee's framework was designed for internationally active banks**. The covered banking organizations subject to the standardized approach risk-weight revisions in the Proposal are not internationally active, were not the subject of the Basel Committee's calibration exercise, and are not required by any international commitment or domestic statute to adopt these changes. Indeed, as noted above, 97 percent of institutions to which the Proposal would apply are community banks.

If Comptroller Gould's "agency entrepreneurialism" critique applies to the Basel III endgame for large banks, it applies with considerably greater force to this Proposal that would reduce capital requirements for regional and mid-size institutions on the basis of no congressional directive, no binding international obligation, and—as detailed throughout this letter—no adequate empirical foundation.

At the most fundamental level, Better Markets opposes the risk-weight changes included in this Proposal as they are selectively applied to only reduce capital requirements and would, as a result, significantly reduce the loss-absorbing capacity of most banking organizations in the United States. As further detailed in this comment letter, the proposed risk-weight reductions for residential mortgages, corporate exposures, and other assets are inadequately supported by data, are calibrated in a manner that generally would lower capital requirements for most exposures, and raise serious questions about compliance with the Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[8] Further, they would reduce the capital held by precisely the size and type of banking organizations whose undercapitalization caused or contributed to the 2023 bank failures.[9] The proposed changes are unlikely to

7 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.

8 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 Section 171 (July 2010), available at: https://www.congress.gov/bill/111th-congress/house-bill/4173.

significantly increase lending to the real economy due to the incentives from the securitization framework being stronger than direct lending and the substantial reduction in capital requirements simultaneously being proposed for Category I and II institutions, which proportionally do much less lending to the real economy compared to smaller banks.[10]

We do support the AOCI recognition requirement, but recommend it be applied more broadly, including a haircut for held-to-maturity securities and apply it with a much shorter transition period. We also support certain other technical changes to the capital, including the updated definition of commitment, the treatment of commitments with no pre-set limit and off-balance sheet approaches.

III. Comments

A. The Proposal Fails to Reflect Lessons from the 2023 Banking Failures

The large failures of Silicon Valley Bank ("SVB"), Signature Bank, and First Republic Bank in 2023 all occurred at banking organizations with the asset size to be considered Category IV banking organizations.[11] Those are precisely the category of banking organizations to which this Proposal would provide the most significant capital relief.

As Governor Michael Barr wrote in his letter[12] after the failure of SVB, the underlying cause of the firm's failure was concerns about its loss-absorbing capital. The run that precipitated its failure was spurred by depositors' realization that the bank was, in fact, insolvent. This is

9 At the time of their respective failures, Silicon Valley Bank reported approximately $217 billion in total assets, Signature Bank reported approximately $110 billion in total assets, and First Republic Bank reported approximately $213 billion in total assets—making the three failures, in combination, the largest concentration of failed bank assets in a single year in the history of the United States. All three institutions fell within the $100 billion to $250 billion asset range associated with Category IV banking organizations under the agencies' tailoring framework. *See* Office of the Comptroller of the Currency, Federal Reserve Board and Federal Deposit Insurance Corporation. Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements. 84 FR 59230 (Nov. 1, 2019) (tailoring framework recognizing differences in size, complexity, and risk profile across banking organizations), available at: https://www.federalregister.gov/documents/2019/11/01/2019-23800/changes-to-applicability-thresholds-for-regulatory-capital-and-liquidity-requirements.

10 *See* Phillip Basil. Better Markets, "Community Banks Need More than the Crumbs from Big Banks' Cake to Thrive" (May 28, 2026), Better Markets, available at https://bettermarkets.org/analysis/community-banks-need-more-than-the-crumbs-from-big-banks-cake-to-thrive/.

11 Category III and IV banking organizations are defined by asset thresholds of $250–$700 billion and $100–$250 billion 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.

12 *Id*. Vice Chair for Supervision Michael S. Barr Letter pages 1-4.

consistent with nearly every major bank failure; capital adequacy is the primary factor, with accompanying other risks joining to cause a bank's failure.

The singular importance of bank capital is empirically demonstrated as the main determinant of whether banks survive periods of stress. A recent study[13] 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."

Similarly to the results of the study, SVB's failure was not primarily a failure of credit risk—it held a disproportionately concentrated large portfolio of government-backed securities that carried nominal 0-20 percent risk weights. It was a failure of interest rate risk management and liquidity risk management, compounded by a regulatory framework that allowed Category IV banks to present artificially strong capital ratios by excluding unrealized losses. The Federal Reserve's own post-mortem concluded that SVB's supervisors "failed to take forceful enough action" and that the tailoring rules "created the false impression" that SVB was adequately capitalized.

This Proposal would reduce risk-weighted assets for Category III and IV banking organizations by 6.1 percent before accounting for AOCI. For Category IV banks in particular—those with between $100 billion to $250 billion in assets, which is where SVB, Signature, and First Republic sat—the risk-weight reductions represent a straightforward reduction in minimum capital requirements.

The agencies assert that the AOCI recognition requirement partially offsets these reductions, producing a net 3.0 percent decrease in capital requirements. But this assumes that AOCI in the current environment represents a net capital increase. At the time of the 2023 failures, Category IV banks' AOCI was deeply negative—driven by unrealized losses on their bond portfolios in a rising-rate environment. A bank that experienced significant unrealized losses on its securities portfolio would not benefit from the AOCI recognition requirement; it would see capital decline.

This means the Proposal's structure is procyclical in a future rising-rate environment. For example, if the Proposal had been in effect during 2022 and 2023, when interest-rate-sensitive Category IV banks were most vulnerable, the risk-weight reductions would have lowered minimum capital requirements while the AOCI recognition requirement would have reflected substantial unrealized losses in regulatory capital. The combined effect would have been to reduce

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[13] *See* Correia, Luck & 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.

capital resilience at precisely the moment when those institutions were experiencing the greatest stress.

Congress required enhanced prudential standards that "increase in stringency" based on the risk characteristics of covered companies.[14] A Proposal that reduces capital requirements for Category IV banks—without a rigorous showing that the new levels remain adequate through adverse interest rate and credit scenarios—is difficult to square with that mandate. Better Markets urges the agencies to conduct and publish scenario analysis showing that proposed capital levels are adequate under conditions similar to those that preceded the 2023 failures before finalizing the risk-weight reductions as part of a broader data collection and impact analysis.

B. *The Proposal's Direct Lending Claims Are Internally 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 Proposal and the proposal that would apply to Category I ("GSIBs") and Category II banking organizations ("Basel III proposal")[15] on the grounds that lower capital requirements will "free up" balance sheet capacity for direct lending to businesses and households.[16] Better Markets[17] has previously demonstrated that this claim is not supported by the behavioral evidence. After the capital proposals were released, not a single CEO of Category III or IV bank announced a major new lending 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.[18]

Furthermore, the argument that reducing (or "freed up") capital requirements would be used by banking organizations towards additional lending is a long-running fallacy that is

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[14] 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."

[15] *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,* 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.

[16] *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").

[17] *See* Better Markets, *Reducing Capital For Megabanks Will Hurt the Main Street Economy* (April 27, 2026), available at: https://bettermarkets.org/newsroom/reducing-capital-for-megabanks-will-hurt-the-main-street-economy/.

[18] *See* e.g., CFO of U.S. Bank, Q1 2026 Earnings Call Transcript (April 16, 2026). "We are very committed to long-term capital distribution targets of 70 percent to 75 percent, and we are keen to get back to those levels with share repurchases . . . [T]he framework as proposed supports our return to historical capital deployment ranges under both scenarios."), available at: https://ir.usbank.com/financials/quarterly-results/default.aspx.

nonetheless continually used by the industry—and now the agencies' principals—to promote the industry's agenda of lowering capital requirements for large banks. 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 common equity tier 1 ("CET1") requirement for institutions covered by the Proposal is 7 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 $35,000 of capital funding and $965,000 of deposit funding. If capital requirements were reduced such that only $20,000 of capital funding was required for the mortgage, the bank would need an additional $15,000 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 large banks engage in capital optimization, and so, to those institutions, risk weights define return-on-equity profitability. Therefore, risk weights 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.

Not only would the package of proposals not boost overall real economy lending by banking organizations as claimed (and in fact likely will decrease it), the two risk weight-related proposals (Basel III proposal and this Proposal) also would drive more of large bank lending towards the wealthy individuals, large corporations, and NBFIs as a direct result of the incentives they would create with the updated risk weight frameworks for mortgage lending, corporate lending, and securitizations. First, the risk weight-related proposals restructure mortgage risk weights in a way that, while improving risk sensitivity, would systematically favor wealthier borrowers at origination over first-time 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").

Third, the Basel III proposal would incentivize those institutions to allocate more lending to large corporations and investment funds than to small businesses. That is because that 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 Category I and II institutions would 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 use of the investment grade classification, but because those assessments would require additional time and resources, Category I and II institutions 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 and the Basel III proposal would push even more loan origination away from large banks and towards NBFIs, despite the claim by the agencies that the Proposal would do the opposite.[19] Bank loans to NBFI credit intermediaries are very profitable, which is why such lending increased over 45 percent last year.[20] That is because the current capital framework already provides a strong incentive for NBFI lending structured as securitizations by assigning a minimum 20 percent risk weight. The Proposal and Basel III proposal would lower that floor to 15 percent under the proposed securitization standardized approach ("SEC-SA") floor. Category III and IV banks 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.[21]

The consequence for the Proposal's stated lending objectives is therefore direct and self-defeating. A large regional bank facing a choice between holding a direct corporate loan at 95 percent risk weight and retaining a senior collateralized loan obligation ("CLO") tranche backed by similar corporate obligations at 15 percent does not experience the five-point reduction on the direct loan as a meaningful positive incentive. It experiences an 80-percentage point structural differential that makes the securitized alternative five times more capital-efficient for the same underlying corporate credit exposure.

C. The Proposal Likely Would Provide Little to No Benefit to Community Banks While Increasing Operational Complexity and Greatly Disadvantaging Community Banks Compared to Large Banks; the Agencies Must Reconsider the Capital Requirement Framework

As noted above, and as the agencies acknowledge, the Basel Committee's framework was designed for internationally active banks. The covered banking organizations subject to the standardized approach risk-weight revisions in the Proposal are not internationally active, were not the subject of the Basel Committee's calibration exercise and are not required by any international commitment or domestic statute to adopt these changes. Indeed, 97 percent of institutions to which the Proposal would apply are community banks.

Community banks have not advocated for the additional complexity that would be introduced by the Proposal. In fact, when an expanded set of mortgage risk weights associated with a range of LTV buckets was proposed by the agencies in 2012, community banks strongly

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19 *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

20 Based on data from the Call Report.

21 *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.

opposed the framework, citing operational complexity and burden as the reasons.[22] Additionally, the community bank leverage ratio was introduced to simplify community bank capital requirement compliance, and over 40 percent of community banks currently utilize it for that very reason.[23] Simply put, community banks prefer to minimize operational complexity and compliance costs.

That's because community banks largely maintain very straightforward, basic business models that involve taking deposits and making loans to the communities that they serve through so-called relationship lending. As part of serving their communities, community banks generally maintain capital levels well above their requirements so that they can easily absorb losses and continue to serve their communities even in bad times, which they have proven to do.[24] Unlike capital-optimizing large banks, the substantial capital cushions maintained by community banks make them less responsive to and less incentivized by more risk-sensitive capital requirements. That is, reducing capital is not their goal; lending to their communities is their goal.

The agencies continue to disadvantage community banks at every turn. First, the Proposal would apply a more complex risk weight framework to community banks, increasing their operational costs and complexity with little to no identifiable benefit. Second, neither the Proposal nor the Basel III proposal that applies to Category I and II institutions recognize in their risk weight calibrations the fact that community banks have historical loan charge-off rates that are 60 percent lower than charge-off rates for non-community banks.[25]

Third, and perhaps most importantly, both the Proposal and the proposals that apply to the GSIBs unfairly and structurally disadvantage community banks by putting in place capital requirements for non-community banks that are no greater than the requirements for community banks. It is nonsensical that large banks like SVB ($217 billion in total assets), whose failure caused the government to invoke the systemic risk exception to protect its uninsured depositors, have the same risk-based and leverage capital requirements as community banks, and half the leverage requirement as the community bank leverage ratio. Similarly, Better Markets estimates that the proposals that apply to the GSIBs would result in an effective 9 percent weighted average risk-based requirement, which ultimately would result in nearly the same amount of capital required by their egregiously low 3.9 percent weighted average leverage requirement.[26]

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22 *Supra* 5. *See also* individual community bank comment letters, such as the comment letter from Capital Bank of St. Paul, MN, available at https://www.federalreserve.gov/SECRS/2012/October/20121022/R-1442/R-1442_092812_108487_437746427424_1.pdf.

23 Based on data from the Call Report.

24 W. Scott Langford and Maryann P. Feldman, "We Miss You George Bailey: The Effect of Local Banking Conditions on the County-Level Timing of the Great Recession" (December 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3501746.

25 *Supra* 6.

26 Better Markets' analysis of GSIBs enhanced supplementary leverage ratio requirements from the FR Y-9C.

The largest institutions and those that engage in the riskiest activities must have capital requirements that are significantly higher than the requirements that apply to community banks. The upside-down capital framework of the agencies puts community banks at a tremendously unfair competitive disadvantage and allows large banks to continually earn outsized profits and use those to gain market share.

In light of these issues, the agencies must reconsider their entire approach to capital requirements in the context of community bank requirements, which should serve as the baseline benchmark for capital requirements that apply to the safest banks engaged in the most basic banking activities. Requirements for other institutions, therefore, must only increase from the community bank benchmark.

D. Rushed, Haphazard and Incomplete Impact Analysis

The agencies' impact analysis is underdeveloped, as the agencies did not collect the necessary data to support the estimates they are presenting. The agencies rely exclusively on existing supervisory reporting forms—Call Reports and FR Y-9C filings—which aggregate balance-sheet information at the institution level and, critically, do not capture the loan-level granularity that a redesigned LTV-based mortgage risk weight framework demands. No data collection was issued to covered banking organizations prior to this proposed rule. Further, the docket lists no supporting technical studies or working papers. The agencies acknowledge that LTV distributions, AOCI recognition requirement impact, and lending effects are estimated through modeling assumptions rather than measured through an actual data collection, as is customary for a rulemaking process. Therefore, the estimated impact—a 6.1 percent reduction in risk-weighted assets ("RWA") for Category III/IV firms, a 3.1 percent AOCI recognition requirement increase, a 7.8 percent common equity tier 1 ("CET1") reduction for smaller institutions—rest on a foundation of proxy data and model extrapolation, as opposed to a structured data collection from the banks whose behavior this rule is designed to shape. Due to these structural limitations, commenters like Better Markets would be in a position to challenge the agencies' empirical claims in this Proposal and to demand that any final rule be preceded by a data request that would allow the impact estimates to be validated and refined with actual loan-level and portfolio-level evidence. For example, the agencies do not justify applying the same loan risk weights to community banks and non-community banks when historical data show that loan charge-off rates for community banks are 60 percent lower than charge-off rates for non-community banks.[27]

From a practical standpoint, the changes in the Proposal to the risk weights are fundamentally misconceived in their scope. The standardized approach framework that the agencies are now proposing to modify—including the LTV-based mortgage risk weights, the revised credit conversion factors, and the securitization methodology changes—was architected as part of the Basel III international capital accords, a process designed over more than a decade specifically to address the risk profiles of large, internationally active banking organizations with

[27] *Supra* 6.

complex cross-border exposures, sophisticated trading books, and massive risk management infrastructure.

Conversely, community and regional banks—the institutions that will bear the operational and compliance burden of these changes under this Proposal—had no meaningful role in the Basel III debates, were never the intended subjects of the international framework, and face an entirely different risk landscape characterized by relationship lending, concentrated geographic exposures, and balance sheets that bear no resemblance to the institutions whose failure scenarios originally motivated the Basel capital process. Yet the agencies have ported over provisions of that rule that were calibrated for globally systemically important institutions, stripped out the sophistication and granularity that justified their complexity, and proposed to apply the residual mechanics to banks for which no empirical case has been made.[28] To make matters worse, this rushed and haphazard process was done on a comment timeline of 90 days, with no prior data collection and no standalone cost-benefit study tailored to the affected population of banking organizations.

Put simply, the Proposal is a selective application of internationally negotiated standards into domestic requirements for institutions those standards were never designed to govern, dressed up in the language of risk sensitivity but unsupported by any empirical evidence that the institutions now in scope present the risks that originally animated the framework. The Proposal provides little evidence that these recalibrations were selected because they improve the risk sensitivity of the capital framework. Instead, the record suggests that the changes were chosen primarily because they reduce capital requirements for the institutions subject to this Proposal, particularly given that nearly every significant recalibration moves in the same direction and that similarly situated institutions would otherwise receive materially smaller capital reductions than those contemplated under the agencies' separate Basel III proposal and GSIB surcharge proposal.[29] The agencies owe the public and the courts a far more rigorous justification than they have provided in the Proposal.

i. The Agencies Do Not Explain Why Every Major Change to the Calculation of Risk-Weighted Assets Produces Lower Capital Requirements

The agencies repeatedly justify the Proposal as an effort "to improve the risk sensitivity" of the standardized approach. However, credibly implemented, a more risk-sensitive capital framework should at times increase capital requirements on certain assets and sometimes decrease them, depending on the risk characteristics of the underlying exposure. Yet every material

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28 *Supra* 5. See for example comment letter from ICBA, available at: https://www.federalreserve.gov/secrs/2013/january/20130110/r-1442/r-1442_103112_110322_388227869612_1.pdf.

29 *See* Federal Reserve Board. 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.

calibration change included in this Proposal moves in only one direction: lower capital requirements.

The Proposal would reduce the effective risk weights for residential mortgages. It reduces risk weights for corporate exposures and "other assets" including retail exposures. It removes the mortgage servicing asset deduction. It lowers the securitization floor for senior tranches by 25 percent. The cumulative effect of these changes is a substantial reduction in risk-weighted assets and regulatory capital requirements across the banking organizations subject to the Proposal.

However, the agencies do not explain why every significant calibration change for the calculation of risk-weighted assets points toward less capital. The agencies do not identify a single major exposure category for which they concluded that existing capital requirements are too low. Instead, every significant recalibration produces the same result: lower capital requirements.

The Proposal's asymmetry raises a fundamental question. Were the agencies attempting to improve the risk sensitivity of the capital framework, or were they attempting to achieve a predetermined reduction in capital requirements and then selecting recalibrations that supported that objective?

The Proposal does not address this significant policy question. The agencies provide exposure-specific justifications for individual changes, but nowhere do they explain why the collective result of every major adjustment is lower capital requirements. Nor do they analyze whether the proposed calibrations remain appropriate in light of the 2023 regional bank failures, the growth of private credit markets, increased nonbank financial intermediation, commercial real estate stresses, or other developments that could reasonably support maintaining or increasing capital requirements in certain areas. The agencies never explain why the 2023 bank failures justify reducing capital requirements for the very population of institutions whose deficiencies required invocation of the systemic risk exception.

This omission is particularly significant because the agencies acknowledge that the Proposal is not required by statute and is not mandated by any international obligation. If the agencies are exercising discretionary authority to redesign the standardized approach, they must explain why every major exercise of that discretion results in less capital. The current record provides no such explanation.

The agencies should therefore identify every material calibration change contained in the Proposal, quantify its individual and cumulative effect on capital requirements, and explain why none of the changes result in higher capital requirements for any significant exposure category. Absent such an explanation, the Proposal appears less like a risk-sensitivity exercise and more like a capital-reduction exercise in which risk sensitivity serves as a post hoc justification.

ii. <u>The Proposal Fails to Consider Reasonable Regulatory Alternatives</u>

The agencies' impact analysis also fails to satisfy basic principles of federal regulatory analysis because it does not meaningfully consider a reasonable range of alternatives. Every significant regulatory alternative actually evaluated by the agencies moves in the same direction: lower capital requirements. The agencies present no alternative that would maintain current capital requirements, no alternative that would increase capital requirements for institutions whose risk profiles may warrant additional loss-absorbing capacity, and no alternative tailored specifically to community banks. The absence of such alternatives is particularly striking given the agencies' stated objective of improving the risk sensitivity of the standardized approach.

If the purpose of the Proposal is genuinely to improve risk sensitivity, then a complete analysis would evaluate calibrations that both increase and decrease capital requirements depending on the underlying risk characteristics of particular exposures. Yet the agencies do not appear to have considered any such possibility. Nearly every material recalibration would reduce effective capital requirements. The cumulative effect is a substantial reduction in capital requirements across the banking organizations subject to the Proposal.

This one-directional pattern creates the appearance that the agencies began with a predetermined policy objective of reducing capital requirements and then selected calibration changes consistent with that outcome. In fact, OMB Circular A-4[30]—while not currently binding on this rulemaking and which reflects widely recognized best practices for regulatory analysis—instructs agencies to evaluate a reasonable range of alternatives and compare regulatory options against an appropriate baseline, including alternatives that may better achieve the agency's stated objectives. It specifically warns against the Proposal's approach by directing agencies to evaluate a range of reasonable alternatives rather than constructing an analysis around a single preferred policy outcome. The agencies also fail to identify any alternative that would preserve current capital requirements while achieving the stated objective of increased risk sensitivity. The agencies' failure to evaluate alternatives that would maintain or increase capital requirements prevents commenters from assessing whether the Proposal represents the most reasonable approach available and deprives the public of the information necessary for meaningful notice-and-comment participation.

The omission is especially significant given the Proposal would apply directly to institutions of a similar size and profile to Silicon Valley Bank, Signature Bank, and First Republic Bank. A complete regulatory analysis would therefore evaluate whether some exposure categories warrant maintaining current capital requirements or increasing them in light of post-2023 evidence. The Proposal contains no such analysis.

The agencies should therefore withdraw and repropose the capital-reducing elements of the Proposal with a revised impact analysis that evaluates a reasonable range of alternatives, including: maintaining the current standardized approach; targeted increases in capital requirements where post-2023 evidence indicates greater risk; community-bank-specific alternatives designed to reduce operational complexity; and the agencies' preferred capital-reduction approach. Only after evaluating the costs, benefits, and tradeoffs of these alternatives can the agencies demonstrate that

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30 *See* Office of Management and Budget, Circular A-4, Regulatory Analysis (November 9, 2023), at 6–8, available at: https://bidenwhitehouse.archives.gov/wp-content/uploads/2023/11/CircularA-4.pdf. The Circular cautions against limiting analysis to a narrow set of options that predetermine the outcome of the rulemaking.

the Proposal represents a reasoned exercise of regulatory authority rather than a predetermined effort to reduce capital requirements.

E. The Proposal Should—but Does Not—Measure Implementation Costs on Community Banks

The Proposal repeatedly characterizes its changes as targeted refinements intended to improve calibration and reduce unnecessary burden. Yet the agencies have provided limited analysis regarding the operational costs institutions—particularly community and regional banking organizations—would incur to implement these changes. Material changes to regulatory capital frameworks require banking organizations to establish governance structures, modify internal systems, revise policies and procedures, update reporting processes, train personnel, devote compliance resources, and build controls capable of ensuring consistent implementation and validation. Vice Chair for Supervision Bowman has noted this critical issue in previous speeches, including with reference to community banks "they are struggling with the cost and burdens of regulatory compliance. Many bankers have said they consider this the most significant threat to their existence."[31] The Proposal assumes these operational transitions occur seamlessly and at minimal cost. That assumption is unsupported.

This omission is particularly significant because community and regional banking organizations generally operate with materially fewer compliance resources, smaller finance and treasury teams, more limited data infrastructure, and reduced model governance capabilities than the largest banking organizations.[32] Yet portions of the agencies' analytical foundation appear derived from calibration exercises developed primarily using information associated with large banking organizations while providing little analysis regarding implementation burdens for the institutions actually affected by this Proposal. Community banks do not maintain large quantitative risk teams. Many regional banking organizations similarly rely upon lean operational structures designed around traditional relationship banking models rather than continuously evolving prudential calibration frameworks. Those are exactly the issues raised by community banks in response to the 2012 Basel III proposal from the agencies, which similarly would have increased operational complexity for community banks if community banks had not strongly opposed the proposal. [33]

The Proposal nevertheless introduces changes requiring operational adjustments across mortgage underwriting systems, collateral tracking processes, internal capital reporting infrastructure, governance documentation, compliance controls, examiner coordination processes, audit functions, and implementation validation activities. History is repeating itself because the

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31 *See* Michelle Bowman. "Community Banks Rise to the Challenge" (September 30, 2020), available at: https://www.federalreserve.gov/newsevents/speech/bowman20200930a.htm.

32 *Supra* 2.

33 *Supra* 5.

agencies have failed to address concerns previously raised by community banks. Institutions may require vendor modifications, systems upgrades, policy rewrites, personnel training, board reporting changes, and additional internal review procedures to operationalize revised requirements consistently. The agencies provide no estimate of these costs. Nor do they analyze whether implementation burdens disproportionately affect smaller institutions relative to projected reductions in capital requirements.

This analytical omission is especially notable because the agencies elsewhere justify differentiated regulatory treatment based upon differences in institutional complexity, business model, and operational capacity.[34] The agencies cannot simultaneously argue community and regional banking organizations differ materially from the largest institutions for tailoring purposes while assuming implementation burdens scale proportionally across institution sizes. If community and regional institutions warrant distinct prudential treatment because of structural differences, those same differences must also inform implementation cost analysis.

The Proposal's failure to measure these burdens creates a significant gap in the agencies' impact analysis. Where agencies claim simplification, burden reduction, or calibration improvements, the Proposal should—but does not—include such an analysis. Before finalizing the Proposal, the agencies should publish institution-size-specific implementation cost estimates (particularly for community banks), supervisory burden estimates, vendor and systems modernization assumptions, and quantitative analysis demonstrating that claimed benefits exceed operational costs across affected institutions.

F. Lack of Empirical Support for Compliance with the Collins Amendment

i. <u>The Agencies Are Silent on Collins Amendment Compliance</u>

The agencies' Proposal is conspicuously silent on the agencies' statutory requirement to comply with Section 171 of the Dodd-Frank Act[35], commonly known as the Collins Amendment ("Collins Amendment"). Given the Proposal's one-directional proposed reductions to the requirements of the generally applicable approach, this absence puts into question the statutory validity of the entire rulemaking. The Collins Amendment was enacted precisely to prevent the agencies from reducing capital requirements for large banking organizations below the statutory floor through future regulatory actions (like this Proposal would do). The U.S. Congress, having observed the steady erosion of bank capital levels in the years preceding the 2008 financial crisis, drew a hard and binding floor under the risk-based capital requirements applicable to insured depository institutions and their holding companies, **prohibiting the agencies from setting those requirements below the capital levels that were in effect as of the date of enactment of the Dodd-Frank Act—July 21, 2010**. That floor is a statutory command, and it binds these agencies

34 The agencies should specifically disclose assumptions regarding technology modernization costs, reporting infrastructure changes, governance costs, and examiner implementation burden that would apply to banking organizations subject to this rulemaking (particularly community banks).

35 *Supra* 8.

regardless of how they characterize the policy objectives of a given rulemaking or attempt to pursue other objectives within the capital framework.

ii. What the Collins Amendment Requires and Why It Was Written

The Collins Amendment was a deliberate congressional response to a specific and hard-earned lesson: the tendency of banking regulators (as exemplified by this Proposal), under pressure from elected officials and the institutions they are supposed to supervise, to selectively reduce capital standards in ways that appeared technically justified but that cumulatively hollowed out the prudential framework. To avoid that outcome, the law requires that the minimum risk-based and leverage capital requirements applicable to insured depository institutions and their holding companies be no less than the generally applicable requirements in effect for insured depository institutions under the prompt corrective action framework as of July 21, 2010. Congress did not give the agencies discretion to define their way around this floor, to recharacterize a reduction as a recalibration, or to net reductions in some requirements against increases in others without rigorous, transparent, institution-by-institution demonstration that the floor is respected. The Collins Amendment means what it says: capital cannot be reduced below the statutory floor (the 2010 baseline), and the burden of demonstrating compliance rests with the agencies, not with commenters.

iii. The 2013 Basel III Final Rule Created an Undisclosed Baseline

One fundamental empirical problem with this Proposal—and a critical reason the Collins Amendment compliance question cannot be waved away—is that the agencies have never publicly established, for the population of institutions now subject to this Proposal, what the capital increase actually was when the Basel III standardized approach was finalized in 2013.[36] When the agencies adopted the Basel III capital framework for U.S. banking organizations, including for the banking organizations below the $700 billion threshold that are the primary subjects of this Proposal, they projected aggregate capital impacts across the affected population. Critically, those projections were not disaggregated, were not published at a level of granularity that permits meaningful institution-by-institution Collins Amendment floor analysis, and were never presented as a formal Collins Amendment compliance baseline for the sub-$700 billion in assets population of banking organizations. The result is an analytical gap that creates significant legal uncertainty for any reduction in capital requirements for the covered banking organizations. On the one hand, the 2013 final rule increased capital requirements for these institutions relative to the pre-Basel III

[36] *See* Federal Reserve Board, Office of the Comptroller of the Currency. 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. The agencies did not provide a dollar estimate for "non-advanced approaches banks", nor at the granular level to community banks as defined by asset size, or regional banks.

framework, while on the other, there is no publicly available agency document on how much, for which institutions, and across which exposure categories.

Therefore, without that baseline, it is impossible to determine quantitatively whether the reductions included in the Proposal—reductions in RWA-based requirements across residential mortgage, corporate, and other asset categories—bring any institution's effective capital requirement below the July 21, 2010, statutory floor.

iv. The Agencies' Proposal Does Not Show Their Work (If it Exists)

The Proposal projects a 7.8 percent reduction in CET1 capital requirements for smaller holding companies and an 8.0 percent reduction for their depository institution subsidiaries. These reductions represent material, one-directional reductions in capital requirements. The Proposal does not present a Collins Amendment compliance analysis. No table or chart shows the pre-Dodd-Frank Act capital requirements by institution category, a comparison of the July 21, 2010, effective requirements against the post-2013 Basel III requirements, nor a demonstration that the proposed reductions, layered on top of any prior reductions, leave the affected institutions above the statutory Collins Amendment floor. The agencies have simply assumed compliance without demonstrating it and have published a Proposal that invites commenters to evaluate capital reductions against a baseline that the agencies themselves have never publicly established. This is the type of analytical opacity that the Collins Amendment was designed to prevent. It is also an example of the gap that can render a rulemaking arbitrary and capricious under the Administrative Procedure Act ("APA").[37]

v. 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. A comment period that proceeds without this foundational information is not meaningful notice-and-comment rulemaking; it 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 burying 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 better 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.

vi. Beyond The Basic Level Analysis the Agencies Have Not Demonstrated Exposure-Level Compliance with the Collins Amendment

37 *Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

Even assuming that the agencies are eventually able to demonstrate aggregate compliance with the Collins Amendment, the Proposal provides no basis to determine whether the reductions within specific exposure categories independently create Collins Amendment concerns. The agencies appear to imply that increases in some requirements may offset decreases in others, producing an acceptable net result across the affected institution population. However, the Collins Amendment contains no language authorizing the agencies to rely on broad averaging, aggregate netting, or portfolio-level balancing exercises to demonstrate compliance with statutory capital floors. As noted above, Congress enacted the Collins Amendment floor specifically to prevent prudential standards from being incrementally weakened through technical recalibration exercises that, viewed individually, may appear modest but collectively reduce resilience within the banking system.

That concern is particularly acute here, where the Proposal would reduce risk weights across multiple exposure classes (as discussed in further detail below), including residential mortgages, corporate exposures, and other assets, while providing **no institution-level or exposure-level analysis** demonstrating that these reductions remain above applicable statutory floors. The agencies have not disclosed whether Collins Amendment compliance was assessed institution-by-institution, exposure-by-exposure, through aggregate portfolio impacts, or through some alternative methodology entirely. Nor have the agencies disclosed whether reductions in one exposure category were effectively offset against increases elsewhere to produce aggregate compliance estimates. Without that information, commenters cannot meaningfully evaluate whether the Proposal complies with the Collins Amendment or instead accomplishes indirectly what Congress prohibited directly: a net reduction in prudential capital standards below statutory minimum requirements.

At a minimum, the agencies should demonstrate that the aggregate reductions produced by the proposed exposure-category changes do not reduce effective capital requirements below the Collins Amendment floor.

vii. Any Final Rule Without the Required Analysis to Prove Collins Compliance Should Be Rescinded

The agencies' path forward is clear, and the consequence of failing to follow it is equally clear. In a re-proposal, the agencies must publish, in the public record and with sufficient granularity to permit meaningful review, a complete Collins Amendment compliance analysis for the affected institution population. That analysis must establish: (i) the capital requirements that were in effect for covered institutions as of July 21, 2010; (ii) the capital requirements that were established by the 2013 Basel III final rule for those same institutions; (iii) the net impact of this proposal on the effective capital requirements of those institutions; and (iv) a demonstration, institution-category by institution-category, that the proposed requirements do not fall below the statutory floor on any measure for which the floor applies.

Failure to address these issues would create significant litigation risk and raise substantial questions under the APA and the Dodd-Frank Act. In light of the Supreme Court's recent decision in *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*,[38] such a challenge may be brought within six years of the date of injury—not merely six years from the rule's promulgation—expanding the universe of potential challengers and the temporal window of legal exposure for any unlawfully promulgated final rule. Further, given the Supreme Court's concurrent elimination of Chevron deference in *Loper Bright Enterprises v. Raimondo*[39], courts are asked to exercise independent judgment on questions of statutory interpretation rather than deferring to the Board's construction of its own authority.

If the agencies proceed to finalize this rule without publishing that analysis, any resulting final rule would face significant litigation risk under the Dodd-Frank Act and the APA. The Proposal appears to violate the explicit statutory command enacted by Congress for the express purpose of preventing unilateral, one-direction capital reductions that would result in capital requirements being below the statutory floor. Affected parties in federal court and future agency principals will have strong grounds to seek to vacate or rescind any such final rule.[40] 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.

A future administration, future agency leadership, or future Congress may reasonably conclude that a final rule adopted without a publicly disclosed Collins Amendment compliance analysis, institution-level impact analysis, and adequate explanation of the Proposal's capital reductions cannot be defended as a lawful exercise of the agencies' authority. Rules built upon incomplete analysis and unsupported assumptions are inherently vulnerable, not only to challenge in court, but also to reconsideration and rescission by future policymakers.

The agencies should therefore view these as risks to the durability and credibility of the final rule itself. A rulemaking that cannot demonstrate compliance with the Dodd-Frank Act and cannot explain the basis for its capital reductions is unlikely to provide the stable and durable regulatory framework that banking organizations, markets, and the public deserve.

G. Considerations for Domestic Systemically Important Banks

Large regional banking organizations (including many Category III and IV banks) continue to benefit from a critical weakness in the U.S. capital framework: the absence of a credible domestic systemically important bank ("DSIB") regime consistent with international standards.[41] The Basel Committee explicitly developed a framework for domestic systemically important banks because systemic risk does not begin and end only with globally active institutions. Large, complex regional banks can create extraordinary risks to financial stability, payment systems, credit

[38] 603 U.S. 799 (2024).

[39] 603 U.S. 369 (2024).

[40] *See, e.g., Chamber of Commerce v. SEC*, 412 F.3d 133, 141 (D.C. Cir. 2005) (finding rule violated APA where agency failed to engage in analysis mandated by statute).

[41] *See* Basel Committee on Banking Supervision, *A Framework for Dealing with Domestic Systemically Important Banks* (October 2012), at 1–5, available at: https://www.bis.org/publ/bcbs233.htm.

intermediation, and market confidence even where they fall below the GSIB threshold. Yet the United States has effectively declined to identify meaningful additional DSIBs beyond existing GSIB designations despite the size, interconnectedness, and economic significance of major regional banking organizations.

The glaring weakness of that approach was exposed during the 2023 banking crisis. The failures of large Category IV institutions demonstrated that systemic importance in practice extends well beyond designated GSIBs. When stress emerged, policymakers did not permit disorderly failures and market discipline to operate. Instead, federal authorities invoked the systemic risk exception to protect uninsured depositors at failed institutions, while extraordinary actions across the federal government—including direct engagement by the President of the United States—were deployed to stabilize confidence and prevent contagion.[42] Institutions regulators implicitly treated as outside the perimeter of systemic importance nevertheless required extraordinary intervention because their failures threatened broader financial stability. That experience reveals a basic regulatory truth: if an institution is large enough that public authorities determine its failure cannot be permitted to destabilize the financial system, it is large enough to face stronger ex ante capital requirements.

The Basel Committee's Regulatory Consistency Assessment Programme ("RCAP") identified the weakness years before the crisis. In its assessment of U.S. implementation of Basel standards, the Basel Committee noted that Federal Reserve staff indicated the U.S. DSIB framework effectively mirrored the GSIB framework and therefore "the US currently does not identify any additional DSIBs beyond those already designated as GSIBs."[43] The 2023 banking crisis demonstrated why that approach is no longer defensible. Large regional institutions generated risks significant enough to require emergency government support, demonstrating that America's systemic banking perimeter extends materially beyond formally designated GSIBs. The banking agencies should therefore develop a robust DSIB framework consistent with Basel standards that imposes additional loss absorbency requirements on large regional institutions whose distress could threaten financial stability, spread contagion, or require extraordinary public intervention. Capital is a public good. Either banks maintain sufficient resilience before a crisis to absorb losses themselves, or taxpayers and the broader economy bear those costs afterward.

For an example of how distorted the capital requirement framework has become, consider the current risk-based capital requirements for PNC Bank (a bank with $560 billion in total assets) versus a hypothetical community bank with $5 billion in total assets (that is not subject to the

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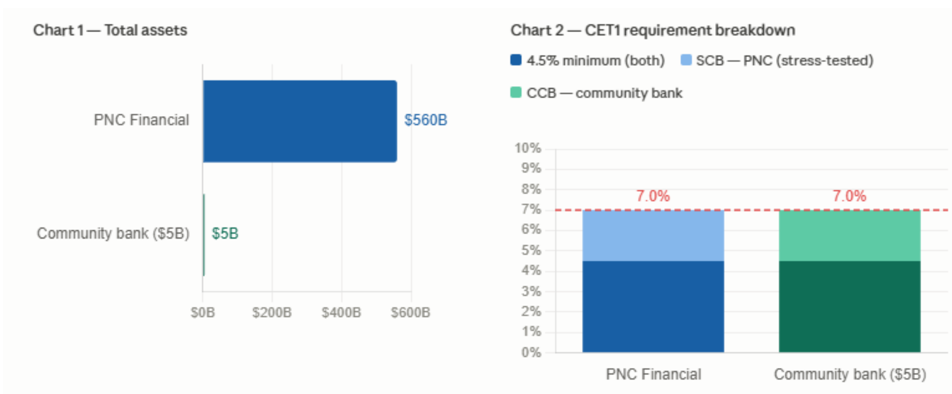
42 Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC, "Joint Statement by Treasury, Federal Reserve, and FDIC" (March 12, 2023), available at: https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312b.htm; *see* also Remarks by President Joseph R. Biden Jr. on Maintaining a Resilient Banking System and Protecting Historic Economic Recovery (March 13, 2023), available at: https://bidenwhitehouse.archives.gov/briefing-room/speeches-remarks/2023/03/13/remarks-by-president-biden-on-maintaining-a-resilient-banking-system-and-protecting-our-historic-economic-recovery/.

43 *See* Basel Committee on Banking Supervision, *Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III Regulations — United States* (December 2014), at 24, footnote 28 ("the US currently does not identify any additional D-SIBs beyond those already designated as G-SIBs"), available at: https://www.bis.org/bcbs/publ/d300.htm.

community bank leverage ratio framework). PNC Bank's total assets are 112 times more than the $5 billion bank (see Chart 1), but they are subject to the exact same risk-based capital requirement of 7 percent (minimum of 4.5 percent plus the 2.5 percent capital conservation buffer) as shown in Chart 2. That lack of tiering of requirements is because the stress capital buffer requirement (that applies to Category III and IV bank holding companies) **does not assess a bank's systemic risk**, and measures only its losses under the Board's supervisory stress test. Therefore, a bank's balance sheet can appear "safer" under the (significantly weakened) supervisory stress test, but its risk-based capital requirements do not internalize at all its systemic risk. This is precisely why the agencies must immediately address this blatant lack of systemic important risk sensitivity in the framework by creating a DSIB surcharge framework. This Proposal would exacerbate this inequitable treatment for smaller banks.



H. The Agencies Should Apply the AOCI Recognition Requirement More Broadly and Much More Quickly

i. <u>The AOCI Recognition Requirement Should Apply to All Banks with Over $10 Billion in Assets</u>

Better Markets strongly supports the requirement to recognize AOCI in regulatory capital for Category III and IV banking organizations. The 2023 bank failures demonstrated in the starkest possible terms that agencies know what happens when banks are permitted to carry large unrealized losses off their regulatory capital ratios: investors and depositors lose confidence when those losses become visible, triggering runs that regulators cannot contain. Therefore, the Proposal's AOCI recognition (at long last) for Category III and IV banks is the single most important change included in this Proposal.

The agencies are correct that "Category III and IV banking organizations have the tools and access to capital markets to manage the volatility of regulatory capital that recognition of AOCI in capital may cause." This is particularly true of banking organizations with over $100 billion in assets, which are sophisticated institutions with active treasury functions that routinely manage duration, interest-rate hedging, and portfolio composition.

Better Markets recommends that the agencies apply the AOCI recognition requirement to all banking organizations with more than $10 billion.[44] The sound logic the agencies included for the AOCI recognition requirement for banks with $100 billion or more in assets applies equally to banks below that threshold. An insured bank with $20 billion or $50 billion in assets that holds a concentrated portfolio of long-duration available-for-sale ("AFS") securities will face exactly the same run dynamics as SVB if those securities fall sharply in value and depositors observe the divergence between market value and book value.

The agencies' own reasoning supports this conclusion. They note that AOCI recognition reflects "actual loss-absorbing capacity at a specific point in time" and that "adverse trends in a banking organization's balance sheet equity can result in negative market perception and have liquidity implications." These dynamics apply regardless of asset size. A bank need not be a Category IV institution to experience a confidence-driven run triggered by visible unrealized losses.

The March 2023 banking turmoil demonstrated that confidence-driven deposit outflows triggered by visible unrealized losses are not confined to institutions of Category IV scale. Western Alliance[45], a mid-sized bank with approximately $65 billion in total assets at the time, experienced acute deposit outflows concentrated in the weeks immediately following the closures of SVB and Signature Bank, losing approximately $6 billion in deposits during the first quarter of 2023 and seeing its share price decline by as much as 17 percent in a single trading session as investors scrutinized its unrealized loss position.

Another example during that period was PacWest Bancorp (approximately $28 billion in total assets at the time).[46] The bank experienced deposit outflows of approximately 17 percent during the first quarter and an additional 9.5 percent during the week of May 5, 2023, following media reports about the bank's strategic options—outflows that drove its share price down more than 50 percent within a single month. Academic analysis of the contagion episode confirms that unrealized losses in held-to-maturity securities were the most economically significant predictor

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44 A $10 billion threshold would appropriately balance regulatory burden considerations for community banks while ensuring that larger and more complex regional institutions accurately reflect economically significant unrealized losses in regulatory capital. Nevertheless, the agencies could consider also applying the AOCI treatment to community banks, particularly those with a high percentage of securities holdings; however, additional considerations and outreach should be undertaken in order to ensure the costs outweigh the benefits for those smaller institutions. Given that most of those organizations are less likely to have significant securities portfolios due to their traditional banking activities, the recognition of AOCI may not provide sufficient additional benefit.

45 *See* Western Alliance Bancorporation, Form 8-K (April 4, 2023) (disclosing quarter-end total deposits of $47.6 billion, down from $53.6 billion at December 31, 2022, and acknowledging "elevated net deposit outflows surrounding the announcements of the Silicon Valley Bank and Signature Bank closures"), available at: https://www.sec.gov/Archives/edgar/data/0001212545/000121254523000113/selectedunauditedfinancial.htm.

46 *See* PacWest Bancorp, Form 8-K (May 11, 2023), available at: https://www.sec.gov/Archives/edgar/data/0001102112/000110465923055748/tm2314675d1_8k.htm.

of post-SVB stock price declines across the banking sector, that mid-sized banks in the $50 billion to $250 billion asset range experienced heightened stress immediately after the SVB failure, and that better-quality assets or holdings of liquid securities did not mitigate negative spillovers — only cash holdings were effective.[47] The agencies' post-mortems on the 2023 turmoil similarly identified "substantial unrealized losses" as one of five key attributes that caused depositors and investors to reassess the financial soundness of institutions well below the Category IV threshold.[48] Accurately reflecting AOCI is a system-wide concern, particularly given the lessons of the 2023 banking turmoil.

The potential objection that smaller banks cannot manage AOCI volatility is not sufficiently persuasive. A bank that cannot manage interest-rate risk on its portfolio—either through hedging, portfolio composition, or liability management—is taking on risk that should be reflected in its regulatory capital. Capital requirements that allow smaller banks to hide that risk from their regulatory ratios do not eliminate the risk; in fact, they only temporarily obscure it until it materializes through a depositor run. The market already prices interest rate risk for institutions that disclose it honestly. Capital regulation should reinforce market discipline, not substitute for it.

ii. Held-to-Maturity Securities Should be Included in the AOCI Recognition Requirement

The Proposal's AOCI recognition requirement, even as extended by Better Markets' recommendation to banking organizations with above $10 billion in total assets, will fail to achieve its stated purpose unless the agencies simultaneously address the treatment of unrealized losses on banking organizations' held-to-maturity ("HTM") securities. Under current GAAP, HTM securities are carried at amortized cost, and unrealized gains and losses do not flow through other comprehensive income. A bank subject to AOCI recognition under this Proposal can therefore eliminate its AOCI exposure entirely by reclassifying AFS securities to HTM—converting visible regulatory capital losses into invisible ones without changing its economic position by a dollar. This is the strategy SVB executed in early 2022, shifting $16 billion in AFS securities to HTM as rates rose, effectively concealing from its regulatory capital ratios the unrealized losses that ultimately rendered it insolvent. A reform designed to prevent a recurrence of that dynamic cannot be finalized without closing the reclassification channel that made it possible.

Better Markets recommends that the agencies require, for regulatory capital purposes, that all banking organizations subject to AOCI recognition calculate and include in their AOCI adjustment the difference between the fair value and amortized cost of their HTM portfolios. This look-through treatment does not require any change to GAAP accounting—it applies only for regulatory capital calculation — and it does not impose a new data collection burden, because Schedule RC-B of the Call Report already requires disclosure of HTM fair values alongside amortized cost. The approach would be consistent with the stated rationale for the AOCI recognition requirement, which is that regulatory capital should reflect actual loss-absorbing

47 *See* Choi, Goldsmith-Pinkham and Yorulmazer. *Contagion Effects of the Silicon Valley Bank Run*, NBER Working Paper No. 31772, at 1–3 (October 2023), available at: https://doi.org/10.3386/w31772.

48 *See* Federal Deposit Insurance Corporation. *Recent Bank Failures and the Federal Regulatory Response* (March 27, 2023), available at: https://www.fdic.gov/news/speeches/2023/spmar2723.html.

capacity at a point in time. The intent of a banking organization as classified by HTM did not preclude SVB's depositors from initiating a run, as they rationally assessed the bank's actual loss-absorbing capacity (which does not vary based on accounting classification). Additionally, during any transition period, the agencies should impose an immediate, non-phased regulatory capital deduction equal to the full unrealized loss on any AFS securities reclassified to HTM after the effective date of a final rule, to prevent institutions from using the transition period itself to migrate losses into the unrecognized HTM category before full recognition applies.

As an alternative, the agencies could consider requiring banks to deduct a specified percentage—e.g., 50 percent—of net unrealized losses on HTM securities from common equity tier 1 capital. This is less conservative than the full look-through treatment recommended above but captures the tail risk of large, concentrated HTM portfolios without requiring full mark-to-market treatment for capital purposes. This approach would mirror the logic of the existing haircut framework for deferred tax assets and other items where full deduction is considered too blunt but zero recognition is plainly wrong.

iii. Significantly Shorter Transition to Incorporate the AOCI Recognition Requirement

The Proposal would provide a five-year phase-in for Category III and IV banks to recognize AOCI in their regulatory capital requirements. Better Markets recommends the agencies significantly shorten this period to two years as the proposed transition is unnecessarily long. Five years is sufficient time for an entire economic cycle to pass, during which banks operating with elevated unrealized losses would continue to report capital ratios that overstate their loss-absorbing capacity. In fact, for context, five years ago, the target range of the Federal Funds Rate was between zero and 25 basis points, 500 basis points lower from its highest level less than three years later.[49]

SVB's unrealized losses had been accumulating and visible for well over a year before the bank's failure.[50] A five-year transition would have provided no benefit in that scenario. Therefore, Better Markets recommends a two-year transition with a requirement that covered banks disclose their AOCI-adjusted capital ratios from the effective date of any final rule, regardless of where they are in the phase-in. Transparency during the transition period is essential to market discipline.

I. The Proposal's Selective Changes to Risk Weights

The agencies describe this Proposal as improving the "risk sensitivity" of capital requirements, suggesting the changes better align capital with actual risk. However, risk-sensitivity done correctly goes in both directions – but every material changes to risk weights in this Proposal reduces capital requirements. Not one proposed risk-weight revision would increase the capital requirement for any exposure category. A framework that is selectively "more sensitive" only when sensitivity reduces capital represents a capital-reducing exercise with risk-sensitivity as a post hoc justification.

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49 *See* Federal Reserve Bank of New York. Effective Federal Funds Rate, available at https://www.newyorkfed.org/markets/reference-rates/effr.

50 *Supra* 11.

The agencies present no evidence that any current standardized risk weight is set too low, 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 operating with inadequate capital before and during the 2008 financial crisis and the 2023 regional bank failures.

Better Markets is particularly concerned that the agencies seem to be reverse-engineering the risk weights to achieve a particular capital outcome—reductions in the range of 3 to 8 percent—and then constructing a risk-sensitivity rationale around them. This is the inverse of sound rulemaking. The appropriate method is to analyze historical loss experience, stress outcomes, and through-the-cycle capital needs, and then derive the appropriate risk weight. The record does not show the agencies followed that path here. Better Markets included specific comments about each element of the risk-weighting 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 organization. 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 2008 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 exposures surged across the financial system.[51] 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[52], the agencies explained that MSAs "may not be available to absorb losses" during periods of stress and therefore warranted deduction thresholds and limitations within CET1 capital. 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[53] on the effect of capital rules on MSAs, the Federal Reserve, FDIC, OCC, and NCUA 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 2008 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

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

52 *Supra* 2 at 62073 ("The agencies believe that these items should be subject to limitations because they may not be available to absorb losses in all circumstances.").

53 *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.

fourfold increase in the annual cost of servicing nonperforming loans between 2008 and 2015.[54] 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 overstates 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 monetary policy 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.[55] Regulators, including the Financial Stability Oversight Council ("FSOC"), 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 in material part by interest rate exposures that were 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.

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54 *Id*.

55 *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.

It is confounding that the agencies are proposing to simultaneously require Category III and IV banks to recognize AOCI in their regulatory capital requirements (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 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. <u>Off Balance Sheet Exposures</u>

1) <u>*Definition of Commitment*</u>

Better Markets supports the Proposal's revisions and clarifications to the definition of "commitment," 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 nonbank financial institutions 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) <u>*Credit Conversion Factors*</u>

Better Markets supports the proposed change to a uniform 40 percent credit conversion factor ("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.

3) *Unconditionally cancelable commitments*

Better Markets urges the agencies to apply the 10 percent credit conversion factor for unconditionally cancellable commitments ("UCC") proposed under the expanded risk-based approach[56] uniformly to all covered banking organizations under the standardized approach. The agencies' decision to retain the 0 percent CCF for UCCs in the standardized approach creates an incoherent, structural inconsistency that cannot be justified on prudential grounds. As the agencies have themselves acknowledged by proposing a non-zero CCF for UCCs in the expanded risk-based framework, unconditionally cancellable commitments are not genuinely risk-free, and the longstanding 0 percent CCF treatment significantly understates actual exposure. That acknowledgment does not become less true for smaller institutions for products of wide issuance like credit cards.

The rationale for a non-zero UCC CCF is stronger for community and regional banks, whose charge card and revolving credit programs are proportionally larger relative to their capital bases and whose ability to absorb unexpected drawdown losses is more limited than that of the global systemically important banks ("GSIBs") for whom the expanded risk-based approach was designed. Retaining no capital requirement for smaller banks' off-balance sheet UCC exposures while moving larger banks to 10 percent would produce the perverse outcome that the institutions least able to absorb surprise drawdowns are also the ones held to the least demanding CCF standard. The agencies offer no empirical or policy rationale for this asymmetry. Further, it is inconsistent with the proposed application of commitments with no pre-set limit (see below).

A uniform 10 percent CCF for UCCs across both frameworks—consistent with the Basel III final standards adopted by the EU and other major jurisdictions—would close the charge card arbitrage that the no pre-set limit provision in Section III.B.3 attempts but fails to address, and would do so in a way that is simple, transparent, and equally applicable regardless of institution size.

4) *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 escape capital requirements for decades. However, it must be done with a 10 percent UCC CCF, or this section of the Proposal would be moot as a practical matter.

Under the existing rule, commitments with no pre-set limit are not treated as an off-balance sheet exposure. 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

56 *Supra* 15 at 14977.

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 buffer. 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.

However, the agencies' Proposal to maintain a zero percent CCF for UCC while proposing a treatment to rectify the commitments with no pre-set limit is challenging to understand as a policy matter. The practical effect for off-balance sheet charge card exposures would continue to be holding no capital against the off-balance sheet exposure of a charge card. This disparate treatment versus traditional credit cards should be rectified, and the agencies must explain their reasoning.

iii. Mortgage Risk Weights

The agencies assert that the proposed residential mortgage risk weights, calibrated on LTV ratios, represent an appropriate reflection of credit risk. However, the empirical foundation for the proposed calibration is inadequate in several respects.

First, the agencies rely heavily on analysis developed in connection with the expanded risk-based approach ("ERBA") and import those conclusions to this Proposal. However, the ERBA is designed and calibrated for the most complex and internationally active banking organizations, which have sophisticated risk management infrastructure, diversified global portfolios, and capital buffers that exceed minimums by substantial margins. The banking organizations subject to this Proposal—midsize and smaller institutions—were not subject to the lengthy quantitative and policy process that resulted in this approach. Applying risk-weight calibrations derived from the largest banks' loss experience to smaller banks with concentrated regional portfolios is methodologically suspect, especially since the historical charge-off rate for community banks is 60 percent lower than the charge-off rate for non-community banks.[57]

Second, the proposed risk weights omit private mortgage insurance ("PMI") from the LTV calculation. The agencies acknowledge this but provide no empirical analysis of what the appropriate risk-weight calibration would be if PMI were recognized. PMI materially affects expected loss on mortgage exposures. A capital framework that expressly ignores it and nonetheless claims to be appropriately calibrated is incomplete.

Third, the proposed LTV-based structure relies on origination-date LTVs that are only updated for amortization, with property values generally held at origination. In periods of declining property values — precisely the periods when mortgage credit risk is highest — this approach will systematically understate LTV and therefore produce risk weights that are too low. The 2008

57 *Supra* 6.

mortgage crisis is precisely a case in which origination-based valuations dramatically understated actual risk. A framework that enshrines this methodology invites the same error.

iv. Corporate Risk Weight

The Proposal would apply a 95 percent risk weight for corporate exposures, a reduction from the current risk weights by 5 percentage points from the current 100 percent risk weight. The agencies offer only the most general justification for this reduction, noting that "analysis undertaken by the agencies in connection with the expanded risk-based proposal" informed these changes. This is grossly insufficient for a change to a risk weight of such significance for banking organizations.

The agencies' own economic analysis section, at Section VI.E in the Proposal, discusses effects on safety and soundness in only the most general terms, without showing that actual historical losses on corporate exposures are better reflected by a 95 percent risk weight than a 100 percent risk weight. The agencies' proposed reduction is based on a methodological foundation that is explicitly borrowed from a different regulatory change that applies to an entirely different type of financial institution.

The preamble states that "analysis undertaken by the agencies in connection with the expanded risk-based proposal included evaluating the appropriateness of the risk weights applicable to exposures at the business-line level" and that this analysis "informs the changes in this proposal." The expanded risk-based approach was designed for Category I and II banking organizations—GSIBs and institutions with at least $700 billion in consolidated assets or $75 billion in cross-jurisdictional activity.[58] The agencies cannot simultaneously maintain that institution size, complexity, and business model justify separate prudential frameworks while importing calibration outputs derived primarily from institutions operating under fundamentally different business models. The Proposal attempts to rely upon institutional differences when imposing requirements and ignores them when reducing them.

The corporate portfolios of those institutions consist predominantly of rated, publicly reporting, investment-grade obligors with ready access to capital markets as an alternative to bank financing. Community and regional bank corporate books are structurally distinct: borrowers are overwhelmingly unrated and privately held, underwriting relies on relationship-based credit judgment rather than market signals, and portfolios carry geographic and industry concentrations that large, nationally diversified institutions do not face. Deriving a universal risk weight from large-bank internal model outputs and applying it to institutions whose borrower universe looks nothing like the calibration sample is a category error embedded at the foundation of the Proposal.

The Proposal's false precision of the 95 percent figure compounds the concern rather than alleviating it. A five-percentage point reduction from the existing standard implies that the agencies have determined, through rigorous empirical measurement, that corporate exposures carry exactly 95 percent of previously assumed risk—not, for example, 83 percent or 97 percent. However, no community or regional bank specific loss data is cited in support of this figure. The

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58 *Supra* 15 at 14957.

most plausible reconstruction is that the expanded risk-based analysis revealed a gap between standardized approach outputs and IRB-equivalent model results for large-bank portfolios, and the 95 percent risk weight was reverse-engineered to close that gap.[59] If so, the calibration period almost certainly reflects the unusually benign credit conditions of 2013–2024, a period marked by historically low corporate default rates and extraordinary government support that backstopped commercial borrowers who would otherwise have defaulted.[60] A risk weight calibrated on a favorable decade using large-bank data and then applied universally is a point-in-time estimate from near the top of the credit cycle, dressed in the language of permanent recalibration.

The structural consequence is that the institutions most affected by the change—smaller banking organizations that will use the standardized approach almost universally, given the compliance infrastructure required to apply the expanded risk-based approach alternative—are precisely the institutions least represented in the underlying data. The agencies' own categorical framework acknowledges that risk profile, complexity, and business model differ materially across institution sizes, which is the stated justification for maintaining separate regulatory frameworks in the first place. It is logically inconsistent to invoke those differences as the reason large banks need a more sophisticated framework while simultaneously importing that framework's analytical outputs as the basis for recalibrating capital requirements for smaller institutions. The agencies should be required, before finalizing any reduction, to produce stratified empirical analysis of corporate credit loss rates by institution size category, covering at least one full credit cycle, with explicit disclosure of the data sources, time periods, and confidence intervals that support the 95 percent figure specifically for the institutions to which it will apply.

v. Other Assets Risk Weight

The reduction of the residual "other assets" category from 100 percent to 90 percent is the least empirically grounded element of the entire Proposal. This category is, by construction, a catch-all classification for assets that do not fit into other defined exposure buckets—notably, retail exposures, deferred tax assets, bank premises, other real estate owned ("OREO"), miscellaneous receivables, and similar items. Therefore, other assets are deliberately incoherent exposure classes whose risk characteristics cannot be measured, averaged, or modeled in the way that a corporate loan book could be. Yet the agencies cite the same large-bank business-line analysis that informed the corporate exposure change as the basis for this reduction too. Applying methodology derived from large-bank portfolio analysis to a residual miscellaneous category is a deeply flawed methodology. In effect, the agencies are proposing to extend a number they computed for one purpose into a domain where it has no analytical foundation.

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59 This reverse-engineering dynamic is consistent with the Basel Committee's own documentation of the IRB shortfall relative to standardized outputs. *See* Basel Committee on Banking Supervision, *Reducing Variation in Credit Risk-Weighted Assets—Constraints on the Use of Internal Model Approaches*, BCBS 362 (March 2016).

60 *See* Federal Reserve Bank of New York, *Corporate Default Rates: Historical Trends*, Staff Reports (2024) (documenting below-average default rates in the post-2013 period); *see also* Congressional Budget Office, *Federal Support for Businesses During the COVID-19 Pandemic* (2021) (estimating scale of Paycheck Protection Program and related interventions that reduced commercial credit losses during 2020–2021).

The 10-percentage-point reduction is also conspicuously larger than the 5-point reduction applied to corporate exposures, which, as mentioned above, are at least a defined and relatively homogeneous asset class. The agencies provide no explanation for why the less-defined, more heterogeneous category receives a more aggressive haircut than the better-understood one. The most plausible interpretation is that the 90 percent figure was not derived from any specific analysis of "other asset" loss rates at all but was instead set as a round number slightly more conservative than the corporate weight, which itself was borrowed from large-bank data. This approach is interpolation by intuition.

The practical risk for safety and soundness is that community banks—which hold proportionally more of their balance sheets in items like retail exposures, bank premises, OREO from workout situations, and deferred tax positions—will now capitalize these assets against a weight that was never validated against their actual loss experience on such holdings. Unlike a large bank that can absorb a write-down on miscellaneous assets through diversified earnings streams, a community bank with concentrated exposure in this residual category faces real capital adequacy risk if the 90 percent risk weight proves insufficient. The agencies must provide commenters with a specific, independent empirical basis for the 90 percent risk weight—not an assertion that large-bank business-line analysis supports it—or they should retain the 100 percent floor for this category pending data that actually justifies a reduction.

As an alternative specifically for retail, the agencies could incorporate the transactor and retail exposure category from the ERBA, but only if the ten percent CCF for UCC is also applied (as recommended above). Those two changes are contingent on each other to work in parallel. It is unclear why the agencies did not simply use the ERBA approach for retail exposures, which is more risk sensitive, instead of the catch all "other assets" approach, which lacks coherence and does not differentiate sufficiently between exposure types. This is another example of the rushed, incomplete and haphazard rulemaking process that calls into question this entire Proposal's legitimacy.

vi. 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 2008 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 agencies’ cuts to staffing and 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 for loss absorption, especially in a stressed 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.

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.

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.

vii. 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 2008 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 regional banking turmoil—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 nonbank financial institutions, 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.

Finally, Better Markets supports the Proposal's ban on recognizing risk mitigation from nth-to-default credit derivatives, but goes further. These instruments are inherently correlation-sensitive and can leave banks exposed to first losses, later losses, or clustered defaults. The agencies should treat them conservatively, whether purchased or sold, and should not allow SEC-SA outputs to obscure correlation tail risk.

1) <u>*The Agencies Should Not Finalize any Cross-product netting Under SA-CCR*</u>

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 the standardized approach for counterparty credit risk ("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 should fully quantify the resulting reduction in RWAs 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 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 simply makes 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 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.

The agencies have never assessed whether covered banking organizations subject to the standardized approach possess these capabilities, and they provide no such assessment here. Extending cross-product netting to these institutions in the name of consistency with larger banks is the application of a framework element designed for sophisticated institutions to institutions for whom it has never been validated, justified on the grounds that the sophisticated institutions will be using it too.

Further, the absence of any updated impact analysis for this change is disqualifying on its own terms. The Proposal's impact analysis in Section V 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. A capital reduction that is structured as a voluntary election is still a capital reduction; its optionality does not exempt it from the statutory floor analysis. The agencies have placed on notice in this comment letter that the cross-product netting provision generates an unquantified, unanalyzed, and unvalidated capital reduction for covered banking organizations—one that is available to any institution that elects SA-CCR, that the agencies have acknowledged they have not modeled, and that they cannot demonstrate is consistent with the Collins Amendment floor. Therefore, proceeding to finalize this provision without demonstrating the analysis (and its compliance with the Collins Amendment) would not be a defensible posture under the statute or under the APA.

viii. Credit Valuation Adjustment Capital Requirements

1) *The Agencies Have Not Justified the Capital Relief Embedded in the Revised CVA Framework*

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. The Basel Committee identified CVA risk as a primary source of losses during the 2008 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.[61] 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.[62]

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

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61 *See* Basel Committee on Banking Supervision. "Capital treatment for bilateral counterparty credit risk finalized 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.

62 *See* Basel Committee on Banking Supervision. "High-Level Summary of Basel III Reforms" 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" (December 2017), available at: https://www.bis.org/bcbs/publ/d424_hlsummary.pdf.

remain adequate to absorb losses of the type and magnitude observed during the 2008 financial crisis.

2) *The BA-CVA Eligibility Criteria Are Not Calibrated for the Institutions Subject to This Proposal*

The Proposal permits covered banking organizations to use the BA-CVA approach as an alternative to the full SA-CVA methodology. The BA-CVA was designed as a simplified fallback for institutions with limited CVA hedging activity and straightforward derivative books. However, the eligibility criteria as proposed are not anchored to any empirical demonstration that covered banking organizations using BA-CVA hold derivative books that are genuinely simpler, less correlated, or less exposed to CVA tail risk than those requiring SA-CVA treatment at larger institutions.

The calibration of the BA-CVA framework was developed primarily through quantitative impact studies conducted on the portfolios of large and internationally active banks (primarily, Category I and II banking organizations). The covered banking organizations subject to this Proposal—regional, mid-size institutions, and community banks—were not represented in those studies because the CVA framework was never designed for such institutions. Their derivative books differ structurally from the calibration sample: counterparty concentrations are higher relative to capital, hedging programs are less sophisticated, and the legal and operational infrastructure for rapid close-out and collateral liquidation is materially less developed. A BA-CVA formula calibrated on GSIB derivative portfolios does not produce capital requirements that are appropriate for institutions whose CVA exposure profile was never evaluated during the calibration process. The agencies offer no institution-size-specific validation of the BA-CVA outputs for the covered population and provide no analysis demonstrating that BA-CVA capital levels would have been sufficient for mid-size institutions during the 2008 CVA stress event or the March 2020 market disruption[63].

The practical consequence is that covered banking organizations will elect BA-CVA—the simpler and more capital-efficient option—not because it is the most accurate reflection of their CVA risk, but because it produces the most favorable capital outcome. That is not risk sensitivity. That is regulatory arbitrage enabled by the agencies' failure to validate the approach for the institutions using it.

3) *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

[63] *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.

inconsistent with the empirical record and with the agencies' own stated commitment to ensuring that capital requirements reflect actual risk.

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 2008 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.

4) *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 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 2008 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 2008 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.

5) *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 2008 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.[64] 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.

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

[64] *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.

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.[65] 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.

6) *The Collins Amendment Analysis Must Include CVA Capital Reductions*

As described elsewhere in this letter, the agencies have not demonstrated compliance with Section 171 of the Dodd-Frank Act for any element of this Proposal. 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) 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.

Thereby, 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.

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

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

netting, margin collection, and mutualized default management.[66] 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, 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.[67] 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 acknowledged uncertainty surrounding CCP resilience under severe but plausible stress, and must publish scenario analysis demonstrating that covered banking organizations' capital against CCP

[66] *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; see also https://g20.org/wp-content/uploads/2024/10/G20_EUA_2009_communique-1.pdf.

[67] *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.

exposures remains adequate if default fund contributions are partially or fully depleted in a major clearing member default scenario.[68]

ii. Securitizations

Better Markets strongly opposes any material weakening of capital requirements applicable to securitization exposures. Securitization markets were at the center of the 2008 financial crisis, transmitting losses throughout the global financial system through highly leveraged, opaque, and excessively interconnected structures that proved far riskier than reflected in prevailing regulatory capital requirements. The Proposal risks repeating several of the same conceptual errors that contributed to the crisis by continuing to rely heavily on formulaic assumptions, tranche mechanics, diversification assumptions, and highly technical modeling inputs that can materially understate tail risk.

Although the Proposal would replace existing methodologies with the SEC-SA and make various technical adjustments to attachment points, detachment points, supervisory parameters, and risk-weight floors, these changes do not eliminate the fundamental vulnerability inherent in securitization capital frameworks: they remain highly sensitive to assumptions that tend to fail during systemic stress events. In practice, small changes in supervisory inputs or tranche structures can produce large reductions in measured RWAs even when the underlying economic risk remains substantial.

Better Markets is particularly concerned by aspects of the Proposal that would lower capital requirements for certain senior securitization exposures or otherwise permit more favorable treatment for highly structured products to a 15 percent risk weight. History repeatedly demonstrates that purportedly "super senior" exposures can become highly vulnerable during periods of correlated stress, especially when markets experience simultaneous liquidity deterioration, collateral impairment, and uncertainty regarding valuation. During the financial crisis, institutions suffered severe losses on positions previously considered remote-risk and highly rated, including exposures backed by residential mortgages and complex resecuritizations.

Better Markets strongly opposes the proposed 15 percent floor for securitization exposures. A 15 percent floor is far too low for complex structured exposures that introduce waterfall risk, servicer risk, liquidity risk, correlation risk, model risk, and legal risk beyond the underlying assets. The Proposal itself acknowledges securitization adds risks not present in directly holding the underlying exposures, but then sets a floor that may be far too permissive for senior tranches.

The agencies should maintain the lowest possible risk weight for securitization exposures at 20 percent, which is equivalent to an exposure to a government-sponsored enterprise. The agencies must explain how a privately structured securitization tranche—an instrument that

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68 *See* Gadgil, Lumsdaine and Paddrik. "The Impact of CCP Liquidity and Capital Demands on Clearing Members Under Stress" Office of Financial Research Working Paper (July 1, 2025). 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" Available at: https://www.financialresearch.gov/working-papers/2025/07/01/the-impact-of-ccp-liquidity-demands-on-clearing-members-under-stress/.

introduces waterfall risk, servicer risk, liquidity risk, legal risk, and correlation risk on top of the underlying credit exposures — can be assigned a 15 percent risk weight that is lower than or equivalent to the risk weight assigned to exposures to government-sponsored enterprises such as Fannie Mae and Freddie Mac (which carry the explicit or implicit backing of the United States government and whose obligations have never defaulted).[69] A capital framework that assigns less required capital to a privately structured CLO senior tranche than to a government-sponsored enterprise backed exposure has its risk hierarchy inverted, and the agencies must provide a principled explanation based on credit risk (not simple alignment with international standards) of how that outcome is consistent with any coherent theory of credit risk.

The agencies are right to prohibit capital relief for synthetic securitizations with synthetic excess spread. Synthetic excess spread is retained first-loss support by another name. If the originating bank continues to absorb losses before investors do, the bank has not achieved clean, durable risk transfer. The agencies should not create an alternative calculation that permits recognition of capital relief for these structures.

The agencies should also reject expansion of overlapping exposure treatment across securitization and market-risk frameworks. Allowing banks to hold capital only for the greater of the securitization or market-risk charge risks ignoring basis risk, timing differences, liquidity risk, and operational uncertainty across books. The agencies should require capital for each exposure unless the bank can demonstrate perfect legal, economic, and temporal overlap under stress.

The agencies should therefore maintain conservative capital floors for all securitization exposures and reject pressure to weaken treatment for senior tranches, synthetic securitizations, or exposures benefiting from thin forms of credit enhancement. Better Markets also urges the agencies to apply especially conservative treatment to resecuritizations and synthetic structures, which historically have exhibited heightened complexity, opacity, model risk, and correlation risk. Complexity should increase capital requirements, not reduce them.

1) *Synthetic Risk Transfers*

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

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[69] Under the current capital rule, exposures to Fannie Mae and Freddie Mac while in conservatorship receive a 20 percent risk weight under the standardized approach for credit risk. *See* 12 CFR 3.32(e) (OCC); 12 CFR 217.32(e) (Board); 12 CFR 324.32(e) (FDIC). Neither the ERBA or this Proposal would modify this treatment. A 15 percent risk weight floor for senior securitization tranches would therefore assign less required capital to privately structured, unguaranteed credit exposures than to obligations of institutions operating under explicit federal conservatorship. The agencies do not acknowledge and do not explain this incoherent outcome or deemed incentive.

purported capital relief from synthetic structures and should require banks to demonstrate genuine, durable, and stress-resilient transfer of risk.

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

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

The agencies are correct to recognize that static dollar thresholds can become less accurate over time as inflation and economic conditions evolve. 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. 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.

K. Disclosure Requirements Should Apply to All Non-Community Banks

The agencies should extend the Proposal's disclosure requirements to all banking organizations above the $10 billion in total assets community bank threshold—rather than limiting enhanced transparency obligations to only the largest banking organizations. Market discipline can only function effectively when investors, counterparties, depositors, and supervisors have timely and decision-useful information regarding a banking organization's risk profile, capital position, funding vulnerabilities, and exposure concentrations. That principle becomes even more important because the Proposal would substantially reduce capital requirements across much of the banking system, especially for firms between $10 billion and $100 billion. If firms are permitted to operate with thinner capital cushions and greater loss sensitivity, the case for enhanced public transparency becomes stronger. Reduced capital requirements increase the importance of external monitoring because smaller equity buffers leave less room for losses before stress can spread through the financial system.

As noted above, the 2023 banking failures demonstrated that institutions outside the global systemically important bank framework can nevertheless create material financial stability risks and require extraordinary government intervention when market participants lack confidence in a firm's resilience. Institutions below the largest categories are often highly concentrated, regionally significant, operationally interconnected, or reliant on potentially unstable funding structures. Applying enhanced disclosure requirements only to the very largest institutions risks creating informational blind spots precisely where emerging vulnerabilities may accumulate. The failure of multiple Category IV institutions revealed that risks can build rapidly outside the traditional perimeter of heightened prudential requirements.

Moreover, extending disclosure obligations more broadly would improve comparability across institutions and strengthen market discipline at a time when the Proposal would otherwise move in the opposite direction by materially reducing capital requirements for many firms. The agencies should, at minimum, require more comprehensive disclosure so market participants can independently assess whether those judgments prove accurate. Greater risk-taking and lower capital buffers should be paired with greater transparency—not less. Doing so would better align the Proposal with the longstanding Basel objective that market discipline serves as a critical complement to minimum capital requirements and supervisory oversight.

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

The agencies' impact analysis projects capital requirement reductions of 3.0 percent for Category III and IV holding companies and 7.8 percent for smaller institutions. However, these static projections only use current asset portfolios and apply new risk weights. The impact analysis should attempt to model how banks will respond to the Proposal's lower capital requirements by increasing exposure to the affected asset classes, substituting between asset categories, or engaging in the portfolio optimization behavior that is well-documented in the academic literature and in our previous comments to these agencies. Instead, the agencies rushed to issue this Proposal and did not apply best practices.

As Better Markets has documented extensively, and as confirmed in the empirical literature, banks systematically respond to capital requirement changes by optimizing their portfolios rather than passively holding capital above minimums. Research examining Norwegian bank behavior found that the majority of capital ratio improvements following regulatory changes came from reducing reported risk-weighted assets rather than from raising actual capital or reducing assets.[70] Studies of European banks documented that regulatory arbitrage via risk-weight manipulation was present and stronger at banks using more advanced internal models.[71]

For banking organizations subject to the standardized approach—which relies on fixed regulatory weights rather than internal models—the optimization mechanism is different but equally real: banks will shift their portfolios toward lower-weighted exposures. If the corporate risk weight falls to 95 percent and the mortgage risk weight falls to 25-40 percent for well-collateralized loans, banks face incentives to expand those exposures, concentrating credit in the asset classes where capital is cheapest. The agencies' impact analysis does not model this behavioral response and therefore likely understates the capital reduction from the Proposal.

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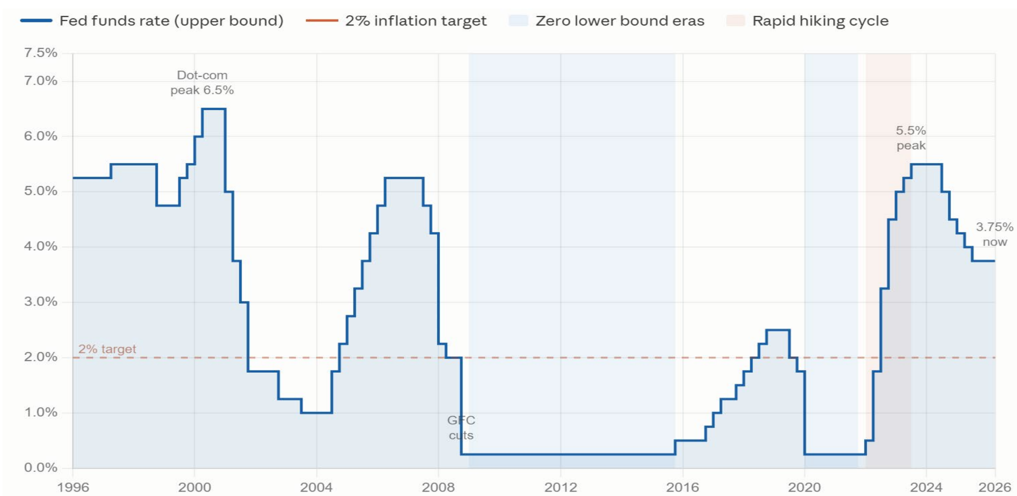
70 *See* Juelsrud, and Wold. "Risk-weighted capital requirements and portfolio rebalancing." Journal of Financial Intermediation. (February 2020), available at: https://doi.org/10.1016/j.jfi.2018.10.002.

71 *See* Ferri, Giovanni & Pesic. "Bank regulatory arbitrage via risk weighted assets dispersion," Journal of Financial Stability, pages 331-345. (2017), available at: https://ideas.repec.org/a/eee/finsta/v33y2017icp331-345.html.

i. Impact Analysis on AOCI Includes Unsupportable Assumptions

The impact analysis on the AOCI uses FR Y-9C data from the 1996 start date. This critical decision that undergirds the impact for nearly all banks affected by the Proposal is unexplained and untested. The agencies must disclose why 1996 was selected rather than an earlier or later date, and publish a sensitivity analysis showing the long-run average AOCI impact factor under windows beginning in 1985, 1990, 2000, 2005, and 2010 in order to show all relevant periods of rate changes and the AOCI recognition impact. If the –81.1 bp estimate is robust across these windows, that would strengthen the analysis. If it is sensitive to the start date, that is material information for the public comment process.

Specifically, the 1996–2025 period includes an unusually long secular rate decline (see chart below). The agencies should provide forward-looking scenario analysis (for example, the agencies should have considered the AOCI recognition impact under a rate environment comparable to 1994–2000 or the 1970s–1980s). Given that the stated policy rationale is that Category III and IV banks can "manage" AOCI recognition volatility, the analysis should demonstrate what that volatility looks like in adverse scenarios, not just on a 30-year average, with a secular decrease in interest rates.



Source: Federal Reserve (FOMC statements and H.15 releases). Upper bound of target range shown; pre-2008 data reflects the single target rate. Quarterly end-of-period values.

The interaction with the stress capital buffer requirements for Category III and IV banks and transition provisions is explicitly acknowledged but not quantified. The document states clearly that the AOCI recognition estimates "do not account for interactions with the stress capital buffer requirement or the five-year transition provisions." This is a material omission—the stress capital buffer is calculated based on stress test results that already include mark-to-market dynamics, and the interaction between the AOCI recognition requirement and stress capital buffer requirement sizing could produce pro-cyclical capital dynamics that are more severe than the –81.1 bp average implies. This effect should be modeled and not disclaimed.

ii. *The Agencies Have Not Demonstrated the Proposal Performs Adequately Across Economic Conditions*

The agencies provide point estimates regarding the Proposal's effects on capital requirements and risk-weighted assets but provide no analysis demonstrating whether the revised framework remains appropriately calibrated across differing economic environments. Prudential capital requirements are designed specifically to ensure resilience during periods of financial stress—not only during periods of stable growth and unusually favorable credit conditions. Yet much of the empirical foundation underlying the Proposal appears calibrated using a period characterized by historically low default rates, substantial fiscal and monetary support to financial markets and borrowers, and unusually benign credit performance. A prudential framework calibrated disproportionately to one of the most supportive credit environments in modern banking history risks systematically understating loss potential during periods when capital actually matters the most.

This concern is particularly acute because portions of the Proposal appear informed by analyses associated with large-bank supervisory and regulatory exercises conducted during a period that included extraordinary pandemic-era government interventions, prolonged periods of exceptionally low interest rates, and credit conditions materially more favorable than long-run historical averages.[72] Commercial borrower defaults during substantial portions of the calibration period remained below historical norms, while unprecedented government support programs reduced realized losses that otherwise may have occurred.[73] A framework calibrated to unusually favorable outcomes risks embedding temporary conditions into permanent prudential standards.

The agencies also provide insufficient analysis demonstrating that the Proposal remains appropriately calibrated under alternative economic scenarios reasonably foreseeable over the life of the framework. The economic analysis provides little discussion regarding performance under conditions involving higher interest rates, rising unemployment, commercial real estate stress, normalization of corporate default rates, regional banking funding pressures, or material declines in residential property values. Nor do the agencies disclose sensitivity testing demonstrating how revised capital requirements would perform under parallel shifts in interest rates or more adverse credit environments. Without such analysis, commenters cannot meaningfully evaluate whether

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72 *See* S&P Global Ratings, *2022 Annual Global Corporate Default and Rating Transition Study* (April 2023). The report noted there was global speculative-grade default rate of 1.9 percent in 2022, "just the ninth time in the 42 years covered in this study that the default rate was below 2 percent"), available at: https://www.spglobal.com/ratings/en/research/articles/230425-default-transition-and-recovery-2022-annual-global-corporate-default-and-rating-transition-study-12702145.

73 The Federal Reserve Bank of Minneapolis explicitly acknowledged this dynamic in its stress test modeling documentation, noting that during the pandemic period "there was no corresponding increase in loan losses given the very unusual nature of the shock to the economy and the massive government response," and that the Federal Reserve was required to introduce dummy variables into its loan loss models to exclude 2020 data points and "preserve the pre-existing historical relationship" between unemployment and loan losses. This was a concession that pandemic-era loss experience was too anomalous to serve as a reliable calibration input. *See* Federal Reserve Bank of Minneapolis. *Large Bank Stress Test Tool: Methodology and Technical Notes*, available at: https://www.minneapolisfed.org/banking/financial-studies-and-community-banking/run-your-own-stress-test-on-large-banks.

reductions in risk weights reflect durable improvements in risk measurement or merely favorable point-in-time observations near the top of the credit cycle.

This omission is particularly notable given recent banking stress events demonstrating how rapidly changing economic conditions can expose weaknesses in capital frameworks calibrated to assumptions that proved insufficiently resilient. Prudential regulation necessarily requires calibration across economic cycles rather than calibration to unusually supportive periods.[74]

Before finalizing the Proposal, the agencies must:

1) publish sensitivity analyses demonstrating Proposal performance across materially adverse economic environments, including scenarios involving higher interest rates, deteriorating commercial credit conditions, commercial real estate stress, residential property value declines, and funding market pressures.
2) disclose the extent to which calibration outcomes depend upon specific historical periods, economic assumptions, or temporary policy interventions.

Absent such analysis, commenters cannot meaningfully assess whether the Proposal promotes resilient prudential standards or instead risks embedding cyclical optimism into permanent capital requirements. The expediency to execute policy preferences by agency principals does not contravene an agency's requirements under the Administrative Procedure Act.

IV. **Conclusion**

This rulemaking, as proposed, cannot be finalized lawfully or defensibly. The agencies have presented a Proposal that moves capital requirements in one direction only— downward— for precisely the category of banking organizations whose undercapitalization caused or contributed to the most significant bank failures since the 2008 financial crisis, without a credible empirical foundation, without a Collins Amendment compliance demonstration, and without a data record sufficient to support the quantitative claims on which the entire calibration rests.

Those deficiencies should be addressed in a reproposal. Better Markets restates its three core demands with full clarity for the administrative record.

First, the agencies must immediately finalize the AOCI recognition requirement with an additional element to incorporate gains and losses in HTM securities, extend the treatment to all banking organizations with total consolidated assets above $10 billion, use only a two-year transition period from the effective date and include a requirement of full public disclosure of AOCI-adjusted capital ratios from the beginning of the transition. This element of the Proposal is legally sufficient, empirically supported, and addresses a demonstrated and ongoing gap in the transparency of regulatory capital ratios. The critical element of the Proposal should not be included in the reproposal process.

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[74] *Supra* 11.

Second, the agencies must withdraw and formally repropose—not merely supplement or amend—the proposed risk-weight reductions for residential mortgage exposures, corporate exposures, other assets, the elimination of the MSA deduction threshold, derivatives exposures, especially the expanded cross-product netting recognition, changes to credit risk mitigation, credit valuation adjustment and certain modifications to the securitization framework. Any reproposal must be accompanied by a complete, publicly available Collins Amendment compliance analysis that establishes, with institution-category-level granularity: the capital requirements in effect for covered institutions as of July 21, 2010; the capital requirements established by the 2013 Basel III final rule for those same institutions; the net capital impact of the proposed reductions on each affected institution category; and an affirmative demonstration that no covered institution is brought below the statutory floor on any applicable capital measure. A reproposal that does not include this analysis in full, subject to public comment before the close of the comment period, will be infirm on its face and would be vulnerable to subsequent challenge or rescission accordingly.

Third, as a condition of any reproposal, the agencies must issue a formal data collection—ideally through a formal Paperwork Reduction Act notice—that gathers the loan-level and portfolio-level information necessary to support a credible, institution-specific impact analysis for each proposed change. The data relied upon in this Proposal was collected on a voluntary basis from 32 large bank holding companies for a different rulemaking, never validated for application to smaller covered banking organizations, and cannot support the empirical claims the agencies have made about appropriate risk-weight calibration for the institutions this Proposal actually governs. A reproposal built on the same data foundation will fail for the same reasons and should not be published until that foundation has been replaced with data that is fit for purpose.

The agencies have been placed on explicit notice of each 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 record is insufficient, that the statutory floor has not been demonstrated to be respected, and that the calibration methodology has been shown to rest on data that is unrepresentative of the institutions subject to the rule. That is not a defensible posture, legally or as a matter of prudential policy. Better Markets will continue to monitor this rulemaking closely and will pursue all available avenues—including potential judicial review—to ensure that the final capital framework for covered 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.

We respectfully urge the agencies to address the concerns identified in this letter before finalizing the proposed amendments and welcome the opportunity to discuss these issues further.

Sincerely,

Phillip Basil
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