

THE GOLDMAN SACHS GROUP, INC., SHEARA FREDMAN

Proposal and Comment Information

Title: GSIB-Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15), R-1889

Comment ID: FR-2026-0009-01-C66

Subject

GS Response to Docket No. 1889 and RIN 7100-AH22

Submitter Information

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Organization Type: Organization

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Submitted Date: 06/18/2026

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Please find attached The Goldman Sachs Group, Inc.'s response to the NPR: Regulatory Capital Rule (Regulation Q): Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)

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June 18, 2026

Via Federal eRulemaking Portal

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC-2026-0265

Benjamin W. McDonough
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1887, RIN 7100-AH20
Docket No. R-1889, RIN 7100-AH22

Jennifer M. Jones
Deputy Executive Secretary
Attention: Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AF29

Re: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations (OCC Docket ID OCC-2026-0265; Federal Reserve Docket No. R-1887, RIN 7100-AH20; FDIC RIN 3064-AF29); Regulatory Capital Rule (Regulation Q): Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15) (Federal Reserve Docket No. R-1889; RIN 7100-AH22)

Ladies and Gentlemen:

The Goldman Sachs Group, Inc. ("Goldman Sachs" or "we") appreciates the opportunity to comment on the jointly issued notice of proposed rulemaking to modify the regulatory capital rules applicable to Category I and II banking organizations and the market risk capital

framework for banking organizations with significant trading activity (the “B3F NPR”),¹ as well as the Federal Reserve’s notice of proposed rulemaking to modify its risk-based capital surcharge for Global Systemically Important Banking Organizations (the “G-SIB NPR,” and collectively with the B3F NPR, the “NPRs”).²

Introduction

We appreciate the Agencies’ continued efforts to modernize and streamline the capital framework in a manner that enhances risk sensitivity while preserving the safety and soundness of the banking system. The current proposal reflects meaningful progress relative to the 2023 proposals, and we appreciate the Agencies’ responsiveness to public feedback. Revisions to overall calibration, and the Agencies’ explanation of their approach, reflect a clear effort to address concerns about the substantial increase in capital the 2023 proposals would have required. The revised NPRs would substantially re-align the U.S. capital framework with the original objectives that the Basel Committee articulated in developing the final Basel III standards. These include addressing Risk-Weighted Asset (“RWA”) variability while remaining capital neutral in the aggregate and maintaining an appropriate G-SIB surcharge.³ The Basel Committee’s foundational goals were “enhancing robustness and risk sensitivity” as well as strengthening the “comparability of banks’ capital ratios”,⁴ but “not significantly increasing overall capital requirements”.^{5,6}

Although these improvements are important and welcome, we believe further refinements are warranted so that the capital framework appropriately captures underlying risk without imposing disproportionate costs on capital markets, including the potential that certain critical activities become uneconomic despite presenting limited incremental risk. Our recommendations in this letter are intended to build on the substantial progress already made. We have kept our comments focused on what we believe are the most important changes so that these rules may be finalized quickly.

¹ The Notice of Proposed Rulemaking was jointly issued by the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and the Federal Deposit Insurance Corporation (the “FDIC” and collectively with the OCC and the Federal Reserve, the “Agencies”), *Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations*, 91 Fed. Reg. 14952 (Mar. 27, 2026).

² Federal Reserve, *Regulatory Capital Rule (Regulation Q): Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)*, 91 Fed. Reg. 14908 (Mar. 27, 2026).

³ Basel Comm. on Banking Supervision, *Basel III: Finalising Post-Crisis Reforms*, Bank for Int’l Settlements (Dec. 2017), <https://www.bis.org/bcbs/publ/d424.pdf>.

⁴ Basel Comm. on Banking Supervision, *High-level summary of Basel III reforms*, Bank for Int’l Settlements (Dec. 2017), https://www.bis.org/bcbs/publ/d424_hlsummary.pdf.

⁵ Basel Comm. on Banking Supervision, *Basel III: Finalising Post-Crisis Reforms*, Bank for Int’l Settlements (Dec. 2017), <https://www.bis.org/bcbs/publ/d424.pdf>.

⁶ Mario Draghi, then Chair of the Group of Governors and Heads of Supervision and President of the European Central Bank, emphasized that the exercise was “not to increase capital”. Basel Comm. on Banking Supervision, *GHOS Media Conference*, Bank for Int’l Settlements (Dec. 2017), https://www.bis.org/bcbs/b3/ghos_20171207_2.htm.

In addition to finalizing these two NPRs, the Agencies should promptly finalize the Stress Testing Transparency NPR⁷ and adopt implementation timelines that align the capital effects from these rulemakings, whether they increase or decrease capital, to avoid unnecessary volatility in capital requirements and to retain capital neutrality in the aggregate.

G-SIB NPR

The Federal Reserve proposes meaningful improvements to the G-SIB surcharge framework, including incorporating adjustments to better capture economic growth, recalibrating the Short-Term Wholesale Funding (“STWF”) indicator to its intended 20 percent weighting, and removing the RWA denominator from the STWF calculation. These changes would resolve various longstanding conceptual and calibration flaws, collectively enhancing the framework’s risk sensitivity and internal consistency. This is also consistent with the Federal Reserve’s original intent to periodically review and adjust the G-SIB framework for factors unrelated to systemic risk, such as economic growth.⁸

In particular, updating the Method 2 coefficients to reflect historical and ongoing U.S. economic growth is in line with the Federal Reserve’s stated intent in the 2015 final rule and represents an important step toward ensuring that G-SIB surcharges remain appropriately calibrated over time.⁹ Absent such adjustments, firms may be penalized for balance sheet growth that merely reflects broader economic expansion rather than an increase in systemic footprint. The calibration reflected in the NPR appropriately balances these considerations, anchoring the framework to a level of capital that then-Chairman Powell considered “about right” in 2019.¹⁰

Similarly, restoring the calibration of the STWF indicator to its intended share of the overall score would improve the balance among the G-SIB framework’s components and reinforce its original design. As the Federal Reserve has not provided a sound analytical basis for normalizing a measure of funding risk by a metric that reflects asset riskiness, removing the RWA denominator would further enhance conceptual consistency. Because there is no correlation between STWF and RWA, retaining RWA in the denominator would cause the STWF indicator to drift out of balance over time. Eliminating RWA from the denominator would result in a more transparent and economically grounded measure of reliance on STWF, better aligning the indicator with its intended purpose within the G-SIB framework.

⁷ Federal Reserve, Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL, 90 Fed. Reg. 51856 (Nov. 2025).

⁸ Federal Reserve, Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49082, 49085, 49088 (Aug. 14, 2015).

⁹ Id. at 49085 (“The Board will periodically reevaluate the framework to ensure that factors unrelated to systemic risk do not have an unintended effect on a bank holding company’s systemic indicator scores.”).

¹⁰ *Monetary Policy and the State of the Economy: Hearing Before the House Comm. on Financial Services*, 116th Congress (Feb. 2019), testimony of Jerome Powell, Chairman, Board of Governors of the Federal Reserve.

B3F NPR

The B3F NPR represents a significant step forward as it would mostly achieve the objectives set by the Basel Committee on Banking Supervision in 2017¹¹, such as reducing RWA variability, while effectively modernizing the capital framework. The NPR contains significant improvements relative to the 2023 proposal that would, among other things, incentivize model usage under the revised market risk framework, the Fundamental Review of the Trading Book (“FRTB”); eliminate the minimum haircut floors for repo-style transactions, ensuring pension funds, among other entities, can efficiently access financing markets; and remove the public listing requirement for Investment Grade (“IG”) counterparties, allowing U.S. businesses of all sizes to access bank financing on more economical terms.

Although the B3F NPR would improve the calibration of the regulatory capital framework in these ways, overlapping risk capture remain between Supervisory stress testing and the NPR, especially with respect to market, operational, and Credit Valuation Adjustment (“CVA”) risks. These overlaps, which are not a part of the international Basel framework, would penalize capital markets-oriented activity. The U.S. capital markets are the deepest, most dynamic, and liquid in the world, and are the backbone of U.S. economic growth. Goldman Sachs and other U.S. G-SIBs play a critical role in the U.S. capital markets and have proven to be a source of strength to the financial system during recent stress events, including the COVID-19 pandemic, the invasion of Ukraine, and the regional bank crisis of early 2023. However, certain parts of the B3F NPR may unintentionally hinder market-making and heighten volatility during stressful times, even though Federal Reserve staff recognize that trading activities can positively influence bank revenue when markets are under pressure.¹²

The Agencies should address certain design features and calibration aspects of the capital framework to avoid adverse impacts on the U.S. capital markets. Our recommendations would further the NPR’s stated goals of enhancing risk sensitivity, reducing complexity, and improving both consistency and transparency. They would also bring the U.S. capital framework closer to the calibration of international standards for G-SIBs in other major Basel jurisdictions, such as the U.K. and E.U. Even so, the U.S. framework would remain more conservative in many respects, particularly given that Supervisory stress test results translate into binding capital requirements through the Stress Capital Buffer (“SCB”).

1. Further refine the stress testing framework to address excessive capital requirements from the inclusion of operational risk within RWA

Operational risk capital would be excessive due to overlapping risk capture in Supervisory stress testing and B3F, resulting in capital requirements that would exceed historical loss experience. This would result in inefficient capital allocation, increased costs, and reduced capacity to support clients and markets. Addressing key design features of Supervisory stress testing, rather than operational RWA, would better align capital with U.S. Generally

¹¹ See Basel Comm. on Banking Supervision, *supra* note 3.

¹² See Zach Modig, Hulusi Inanoglu & David Lynch, *Impact of the Volcker Rule on the Trading Revenue of Largest U.S. Trading Firms During the COVID-19 Crisis Period*, p. 3 (Federal Reserve, Fin. & Econ. Discussion Series No. 2025-005, 2025), <https://www.federalreserve.gov/econres/feds/files/2025005pap.pdf>.

Accepted Accounting Principles (“GAAP”) while remaining consistent with the international Basel framework. It would also better align the U.S. capital framework with actual loss dynamics and existing loss absorption mechanisms, which would improve risk sensitivity while preserving conservatism.

Recommendations:

- A. **Align Supervisory stress testing loss timing with GAAP:** Recognize litigation losses consistent with GAAP’s “probable and reasonably estimable” standard. This would prevent artificial acceleration of losses, more accurately reflect multi-year loss development (which is consistent with historical experience), and reduce overstated losses early in the nine-quarter stress horizon
 - B. **Recalibrate stress severity to the intended horizon:** Use a nine-quarter horizon to determine the stress percentile (85th) based on historical frequency of severe recessions rather than an annual-horizon-based percentile (93rd) to avoid overstating cumulative losses. This adjustment would resolve the mismatch between the annual horizon in the historical calibration and the nine-quarter loss measurement window, thereby eliminating the overstatement of cumulative stress losses
 - C. **Mitigate overcalibration of operational risk loss by providing credit for litigation reserves:** Add back current litigation reserves, which comprise the vast majority of operational risk losses, to projected future stressed loss when calculating the SCB. This would ensure credit is provided for existing reserves which already reflect losses that are captured in the SCB and operational RWA framework
2. **Improve netting and enhance risk sensitivity in the design of the Fundamental Review of the Trading Book – Default Risk Capital (“FRTB-DRC”)**

The FRTB-DRC framework would overstate risk due to limited hedge recognition and the prohibition on the use of models, which other jurisdictions permit. Design flaws would result in materially higher capital on certain economically hedged portfolios of publicly listed equities and derivatives relative to portfolios with similar risks. This would result in inefficient hedging, higher costs, and reduced market liquidity, particularly in equity markets. These changes would disadvantage U.S. firms relative to international peers.

Refining FRTB-DRC would better align capital with actual Jump-To-Default (“JTD”) risk and observed hedging practices, improving risk sensitivity and market functioning.

Recommendations:

- A. **Allow full netting of derivative-versus-derivative hedges within the FRTB-DRC framework, or at a minimum for main indices and their constituents:** Permit full netting and maturity alignment for equity-based

derivative-versus-derivative hedges within FRTB-DRC. This is consistent with the treatment that would be permitted for cash-versus-derivative transactions within FRTB-DRC. At a minimum, if a broader change is not adopted, this treatment should be applied to equity derivatives referencing a main index and/or a derivative that references the individual constituents of a main index,¹³ where highly liquid derivatives markets and minimal rollover risk, even in stress, support full hedge recognition to avoid overstating residual risk

- B. **Recognize Optional Early Termination (“OET”)**: Recognize OET contracts in defining effective maturity-for-maturity matching purposes, reflecting the ability to exit positions. This would align capital with risk management practices and would avoid overstating residual exposure in hedged portfolios
- C. **Recognize correlations of default**: FRTB-DRC assumes all issuers will default simultaneously, which fails to recognize diversification across obligors and reflect the fact that defaults are not perfectly correlated. Incorporating default correlations would produce capital outcomes that more closely align with portfolio-level risk, observed default correlations, and internal model approaches, as well as align with other areas of the market risk framework, improving both risk sensitivity and comparability

3. **Adopt the Internal Models Methodology (“IMM”) for counterparty credit risk**

The discontinuation of IMM and reliance on SA-CCR for determining capital for cross-product netting would overstate exposure and largely negate the benefits of netting of repo-style transactions with derivatives. This would inflate capital requirements and particularly constrain Treasury- and repo-market intermediation, despite ongoing market-structure reforms and the industry's move toward more efficient cross-margining, including clearing requirements for U.S. Treasury cash and repo.¹⁴ Further, no other major Basel jurisdiction, including Japan, U.K., E.U., and Canada, has removed IMM from their respective frameworks.

Recommendation:

- A. **Adopt IMM to better reflect actual exposure dynamics, netting benefits, and Central Counterparty (“CCP”) practices**: This would avoid a one-size-fits-all calibration that reduces risk sensitivity, particularly as SA-CCR was not designed to accommodate repo-style transactions, and would ensure capital reflects actual portfolio risk and CCP margining practices, rather than simplified assumptions

¹³ See 12 CFR § 217.2 (2024) (defining "main index" for purposes of the regulatory capital rule).

¹⁴ *Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities*, Exchange Act Release No. 34-99149, 89 Fed. Reg. 2714 (Jan. 16, 2024) (to be codified at 17 CFR § 240.17ad-22).

4. Modify the CVA framework to account for regulated financial entities and exempt end-users

The proposed CVA framework would overstate risk and significantly increase capital requirements (96 percent increase compared to binding CVA requirements under the current capital framework¹⁵), particularly for end-user derivatives. This would raise hedging costs, reduce availability of risk management tools, and increase the volatility of earnings for corporates, pension funds, and insurers without a clear risk-based justification.

Recommendations:

- A. **Differentiate risk weights for regulated financial institutions:** Apply lower risk weights, such as 3 percent and 8.5 percent for regulated IG and non-IG financials, respectively, equal to the highest risk weights applicable to other corporate counterparties. This would reflect the lower CVA risk that is typically associated with these counterparties
 - B. **Exempt commercial end-users from CVA:** Align with existing margin exemptions and SA-CCR distinctions. This would avoid penalizing uncollateralized but prudently managed activity and preserve end-user access to derivatives
- 5. Exempt market-making positions from potential regulatory capital deductions related to investments in capital and covered debt instruments of Unconsolidated Financial Institutions (“UFI”), or expand the threshold to 25 percent of Common Equity Tier 1 (“CET1”) capital**

The UFI threshold deduction framework overstates risk and inadvertently penalizes effective hedging in trading activities due to restrictive netting rules and outdated assumptions about maturity and hedge effectiveness. This leads to reduced market-making capacity, and potential migration of activity to less regulated markets, weakening liquidity and increasing costs for end-users and investors.

Several other post-crisis reforms implemented since the UFI threshold was established now adequately address interconnectedness among financial entities. These reforms include the G-SIB surcharge, Single Counterparty Credit Limits (“SCCL”), the Largest Counterparty Default component of Supervisory stress testing, and liquidity regulations.

Recommendations:

- A. **Exclude trading book (covered) positions from UFI deductions:** Recognize that these positions are not long-term risk positions and are subject to

¹⁵ 91 Fed. Reg. 14952 (Mar. 27, 2026), at 15104 tbl. VII.4.

heightened risk management requirements in the trading book. This would avoid double counting the risk of interconnectedness within the financial system, which is already captured by other components of the capital framework

- B. Increase the UFI threshold to 25 percent of CET1:** Consistent with the 2019 Simplification rule,¹⁶ increase the 10 percent threshold to 25 percent for UFI. This would reduce unnecessary capital deductions and alleviate constraints on market-making

Further detail and supporting data are contained in the appendices of this letter. We urge the Agencies to consider these recommendations as they finalize the NPRs and the Stress Testing Transparency NPR. In addition to the issues discussed in this letter, there are other important comments in the letters from the Financial Services Forum (“FSF”), the Securities Industry and Financial Markets Association (“SIFMA”), the Bank Policy Institute (“BPI”), the American Bankers Association (“ABA”), the Futures Industry Association (“FIA”), the International Swaps and Derivatives Association (“ISDA”), and the Structured Finance Association (“SFA”). We are an active member of each of these organizations and generally support the recommendations in their respective letters.

Sincerely,

Sheara Fredman

Chief Accounting Officer

¹⁶ Federal Reserve, FDIC, OCC, *Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 84 Fed. Reg. 35234 (July 22, 2019).

Appendix A

Detailed Recommendations

Recommendation 1: Further refine the stress testing framework to address excessive operational risk capital requirements

The B3F NPR states that the Federal Reserve is “mindful of the overlaps between the capital and stress testing frameworks” and intends “to improve risk sensitivity of requirements in a way that considers the cumulative effect of the entire capital framework.”¹⁷ Although we appreciate the express acknowledgement of the interaction between the risk-based capital framework and the stress testing framework through the SCB requirement and the efforts made to address this issue, the overlapping risk capture across these frameworks would continue to result in excessive capital requirements, particularly for operational risk.

Based on the B3F NPR and the stress testing models proposed in the Stress Testing Transparency NPR, we estimate that U.S. G-SIBs collectively may be required to hold up to \$200 billion (“bn”) in capital for operational risk comprising \$100bn for stress losses associated with Supervisory stress testing¹⁸ and approximately \$100bn¹⁹ via the operational risk requirement in B3F. The \$100bn in stress losses represent a nine-quarter loss figure; and as trough quarters are not disclosed for each bank, it is conservative to assume that this full amount may translate into required capital.

The B3F NPR states that Category I and Category II holding companies experienced aggregate operational losses of approximately \$308bn between the first quarter of 2007 and the second quarter of 2025.²⁰ Based on a one-year time horizon, consistent with the operational risk exposure framework under the current Advanced Approaches, U.S. G-SIBs would be required to hold operational risk capital that is more than 10 times the average annual loss since 2007 (see Exhibit 1 below).

Further, even if scaled for asset growth, the highest consecutive, aggregate nine-quarter litigation-related loss, which makes up the majority of U.S. G-SIBs’ operational risk losses, is \$100bn, while the highest consecutive four-quarter litigation-related loss is \$50bn.²¹ This would suggest that the proposed operational risk capital calibration exceeds historical experience by two times on a nine-quarter basis and four times on a four-quarter basis.

¹⁷ 91 Fed. Reg. at 14959.

¹⁸ Of the \$140bn in operational risk losses attributed to banks subject to Supervisory stress testing under the models disclosed in the Federal Reserve’s proposed Supervisory Stress Test Model Documentation, \$100bn is attributed to U.S. G-SIBs, calculated based on the Federal Reserve’s methodology to allocate operational risk losses to banks based on total assets.

¹⁹ Based on FSF Quantitative Impact Study (“QIS”) as of 4Q25.

²⁰ 91 Fed. Reg. at 15009.

²¹ Calculations based on quarterly litigation-related expense and reserve disclosures from Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q filed with the SEC by the eight U.S. Global Systemically Important Banks (JPMorgan Chase & Co., Bank of America Corp., Citigroup Inc., The Goldman Sachs Group Inc., Morgan Stanley, Wells Fargo & Co., Bank of New York Mellon Corp., and State Street Corp.) from 2015 to 2024, scaled by assets to 4Q25 levels.

Exhibit 1: Operational Risk Capital versus Historical Losses

Supervisory Stress Testing and B3F Operational Risk		Highest Historical Consecutive Litigation-Related Losses (scaled by assets to 4Q25)		Average Aggregate Operational Risk Losses from NPR
\$100bn of stress test nine-quarter losses (from 2025 disclosure w/ proposed models)  \$100bn of B3F operational risk capital (from industry QIS)		\$100bn Over a nine-quarter period	AND	\$40bn Over a nine-quarter period
		\$50bn Over a four-quarter period		\$20bn Over a four-quarter period

Several refinements to the stress testing framework would reduce excessive operational risk capital, by aligning to GAAP, enhancing calibration to the nine-quarter projection horizon.

A. All events associated with a single operational loss event should not be assumed to transpire in the first quarter of the nine-quarter projection horizon; in addition, operational risk losses related to litigation should be recognized consistent with GAAP over the nine quarters

In Supervisory stress testing, operational risk loss events are artificially accelerated and aggregated to their earliest reported date. This trains the model on data that show losses occurring sooner and in larger amounts than what are reported by banks to the Federal Reserve. Further, GAAP requires that loss contingencies be recognized only when they are both “probable” and “reasonably estimable.”²² This results in a recognition profile in which litigation-related losses generally evolve over time, becoming recognizable only after sufficient information emerges through the legal process. For U.S. G-SIBs, where litigation-related losses represent the vast majority of operational risk losses, this timing dynamic is well established and is also reflected in the Federal Reserve’s own operational risk model documentation.²³ In contrast, Supervisory stress test models recognize those losses in capital on a straight-line basis over the nine-quarter projection horizon, resulting in an inappropriate share of losses being recognized in the first year of the stress horizon.

It would be more appropriate for the Federal Reserve to differentiate the timing of loss recognition by loss type, recognizing activity-based losses on a simple, straight-line basis, consistent with the model disclosed as part of the Stress Testing Transparency NPR, while applying a recognition profile for litigation-related losses that aligns with GAAP’s “probable and

²² Accounting Standards Codification (ASC) § 450-20-25 (Fin. Acct. Standards Bd. 2026).

²³ Federal Reserve, *Supervisory Stress Test Model Documentation: Proposed Model Changes for 2026 Stress Test*, p. 31 (Oct. 2025), <https://www.federalreserve.gov/supervisionreg/files/proposed-model-changes-2025-to-2026.pdf> (“This assumption is made to promote consistency across data from different firms and to capture the economic impact of operational risk losses. However, many large loss events took several years to unfold, particularly legal events stemming from the 2007–2009 crisis. Therefore, this assumption may not be supported by historical data.”)

reasonably estimable" standard and actual observed patterns of loss emergence. This approach would also be consistent with the Federal Reserve's own acknowledgement in its operational risk model documentation that many large loss events, particularly legal events, take several years to unfold and that the assumption of first-quarter recognition may not be supported by historical data. This can be accomplished by removing the artificial acceleration and aggregation of operational risk loss events already reported by banks. Calibrating the timing of litigation-related loss recognition to historical operational loss data submitted by firms in the FR Y-14Q, Schedule E.1 would reflect actual loss emergence dynamics, which tend to be delayed and concentrated in later periods of the stress horizon, rather than assuming the full financial impact of a loss event is realized in the first quarter in which it is reported. This refinement would prevent the overstatement of operational risk losses early in the stress horizon and improve the accuracy and risk sensitivity of the stress testing framework.

B. Calibrate the percentile tail to the nine-quarter stress horizon rather than to an annual recession frequency²⁴

Supervisory stress testing is intended to assess losses over a nine-quarter horizon, so the severity of outcomes should be calibrated to that same time frame. As described in the Federal Reserve's Operational Risk Model documentation, the 93rd percentile referenced in the Stress Testing Transparency NPR is derived from the annual frequency of severe recessions — specifically, four severe recessions over the 60-year period from 1956 to 2015, implying a severe recession roughly once every 15 years (i.e., $1 - \frac{4}{60} \approx 0.93$). Applying this annual horizon tail measure directly to a nine-quarter loss projection creates a mismatch that systematically overstates the severity of cumulative stressed losses.

Using the same history but measured on a horizon-consistent basis yields four severe recessions across 27 nine-quarter periods, which corresponds to an 85th percentile severity (i.e., $1 - \frac{4}{27} \approx 0.85$). Accordingly, it would be more appropriate for the Federal Reserve to calibrate the loss percentile to a nine-quarter horizon, rather than an annual one. Aligning the percentile with the projection horizon would improve the internal consistency of the operational risk framework and result in a more accurate and risk-sensitive measure of stressed losses.

C. Add back current litigation reserves to projected stressed losses prior to the computation of the SCB

When banks recognize legal losses that are probable and reasonably estimable under GAAP, they establish litigation reserves by reducing earnings and consequently CET1 capital. The loss is accrued for in advance of any actual cash outflow occurring, effectively recognizing the estimated litigation loss for probable future payments.

²⁴ See Goldman Sachs' Stress Testing Transparency NPR Comment Letter, at 4-5 (Feb. 20, 2026).

The B3F operational risk framework, along with the Supervisory stress testing models, also aims to capture prospective capital outflows linked to operational risk. However, when some of these losses have already been reflected in equity through the creation of reserves, it is logical that these reserves should be treated as credit against future stressed losses.

We recommend that the Federal Reserve add back existing litigation reserves, either in whole or as part of an average balance, to the projected stressed losses before calculating the SCB. By doing so, only potential future losses not already incorporated into capital would be counted. This approach would help to mitigate the overcalibration of future operational risk losses, align more closely with GAAP, and ultimately produce a more accurate and risk-sensitive measure of stressed capital requirements.

Recommendation 2: Improve netting and enhance risk sensitivity in the design of FRTB-DRC

The proposed FRTB-DRC framework would not permit firms to use internal models and would insufficiently recognize equity hedging activities. Although the B3F NPR states that “[h]ighly liquid and simple products would likely receive relatively lower capital requirements,”²⁵ this would not be true in practice for equities under the FRTB-DRC framework, notwithstanding that U.S. public equities are highly liquid and are therefore highly modellable. The lack of appropriate hedge recognition could lead banks to use less liquid, more expensive hedges, undermining market liquidity and function. More broadly, the inability to use models for FRTB-DRC is inconsistent with the stated rationale for permitting firms to use internal models to calculate market risk capital requirements more generally.²⁶ Exhibit 2 shows how two portfolios with equivalent risk would result in vastly different capital requirements under FRTB-DRC because of insufficient hedge recognition.

²⁵ 91 Fed. Reg. at 15139.

²⁶ See 91 Fed. Reg. at 14959 (stating that “[m]arket risk is more easily and effectively modeled than credit and operational risk because data on trading positions are observed at a much higher frequency and depth” and that “the benefits of retaining models are larger for market risk than for other exposure types”).

Exhibit 2: Example of FRTB-DRC Hedge Recognition

Portfolio A	Tx	Description	Risk Exposure (Jump to Default)	U.S. Std Exposure	Scaled JTD
	1	Long \$100mm 1Y S&P swaps	100	100	100
	2	Short \$100mm 3M S&P futures	(100)	(100)	(25)
	Net Exposure		-	-	75

Portfolio B	Tx	Description	Risk Exposure (Jump to Default)	U.S. Std Exposure	Scaled JTD
	1	Long \$100mm 1Y S&P swaps	100	100	100
	3	Short \$100mm physical S&P ETF	(100)	(100)	(100)
	4	Long \$100mm physical S&P ETF	100	100	100
	2	Short \$100mm 3M S&P futures	(100)	(100)	(100)
	Net Exposure		-	-	-

Equivalent risk,
different capital
outcome by adding
transactions
3 & 4

The proposed U.S. FRTB-DRC would be gold-plated relative to other jurisdictions as it would not permit U.S. G-SIBs to use internal models, which limits risk sensitivity and disadvantages U.S. G-SIBs relative to their international peers.²⁷ Accordingly, the Agencies should refine the FRTB-DRC to more appropriately recognize equity hedging activities, as follows:

A. Allow for full netting of equity-based derivative-versus-derivative hedges within the FRTB-DRC framework, with targeted application at a minimum for main indices and main index constituents

The FRTB-DRC framework should permit banks to fully recognize economically offsetting positions where derivative instruments hedge other derivative positions. The NPR's maturity-based scaling framework would create an economic asymmetry by penalizing short-dated derivative hedges relative to cash positions – notwithstanding that derivatives markets are often more liquid, transparent, and resilient than underlying cash markets, resulting in incomplete hedge recognition and capital outcomes that do not reflect the underlying economic risk of a portfolio.

In practice, banks frequently hedge long-dated equity derivative exposures originating from client facilitation activities with short-dated, highly liquid index derivatives and derivatives linked to the indices' underlying constituents, particularly in products linked to broad equity indices. These positions are economically well hedged, as the underlying exposure is offset and the hedging instruments can be readily rebalanced or replaced with minimal rollover risk.

²⁷ See Regulation (E.U.) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (E.U.) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk, and the output floor, 2024 O.J. (L series, 19.6.2024). And see for the United Kingdom (PRA): Prudential Regulation Authority, Policy Statement PS9/24, Implementation of the Basel 3.1 standards near-final part 2 (Sept. 2024), together with the near-final PRA Rulebook: CRR Firms: Market Risk (Internal Model Approach) Instrument.

However, the proposed FRTB-DRC framework would penalize derivative-versus-derivative hedges when there is a maturity mismatch between the hedging instrument and the hedged position. This is not only more punitive than what is allowed today under the Basel 2.5 market risk capital framework, it would also lead to overstated residual risk, higher capital requirements, and increased costs for end-users.

More broadly, the inability to recognize these hedges would result in inconsistent capital outcomes for portfolios with equivalent risk profiles, depending solely on instrument form rather than economic substance. This is at odds with the stated objective of improving risk sensitivity and consistency within the market risk framework²⁸ and may reduce market liquidity and add risk by discouraging balanced hedging strategies.

The Federal Reserve should permit full netting and maturity alignment for derivative-versus-derivative positions within FRTB-DRC, consistent with the treatment of cash-versus-derivative hedges. At a minimum, if a broader change is not adopted, this treatment should be applied to equity-based exposures linked to main indices, as defined in the capital framework,²⁹ where the depth, liquidity, and observed rollover behavior of derivative markets provide strong empirical support for effective hedge recognition, especially in times of stress (see Exhibits 3 and 4 below).

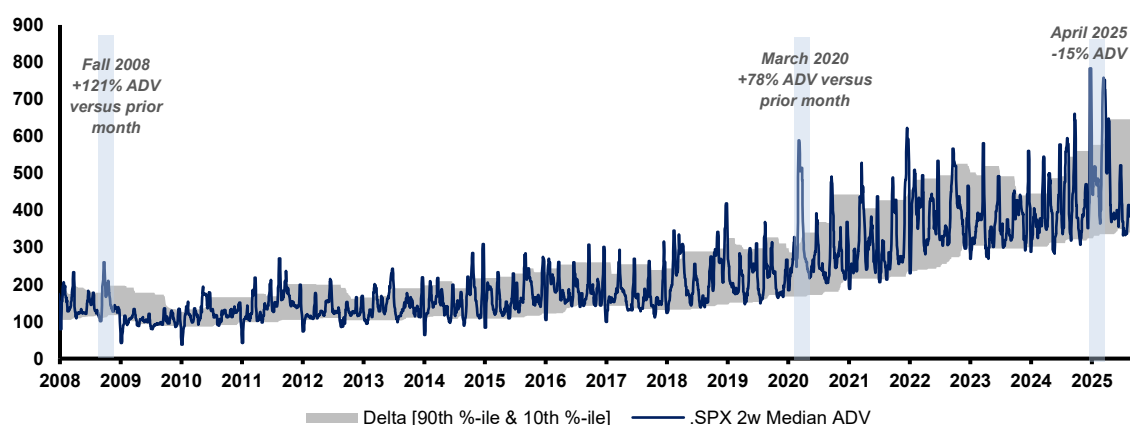
²⁸ 91 Fed. Reg. at 15017.

²⁹ 12 CFR § 217.2 (2025).

Exhibit 3: Equity Futures Average Daily Volume (“ADV”)

Index Name	ADV over 1-month (\$bn)		
	2021 ADV	2025 ADV	Delta
S&P 500	6,936	10,283	+48%
NASDAQ 100	3,004	5,283	+76%
S&P/TSX 60	100	111	+11%
RUSSELL 2000	410	484	+18%
Total	10,450	16,161	+55%

Exhibit 4: S&P 500 Index 2-Week Median ADV (\$bn)



B. Recognize OET clauses for derivatives

In addition to expanding the proposed maturity alignment to cover derivative-versus-derivative transactions, the B3F NPR should recognize OET clauses as a valid mechanism for hedge effectiveness. OET provisions allow a bank to exit a position prior to its contractual maturity. Such provisions are a core risk management tool. As a result, the relevant economic maturity of a position is not solely its contractual term, but the earliest point at which the position can be terminated.

For equity swaps, the notice period associated with an OET clause effectively defines this shorter horizon, creating a practical maturity alignment with the underlying exposure. In this context, rollover risk is not the binding constraint assumed in the proposal. Where an OET clause can be exercised, banks are not reliant on rolling hedges in stressed markets but can instead reduce or eliminate risk exposure directly. Failing to recognize OET therefore understates the degree of hedge effectiveness and overstates the residual risk capitalized in FRTB-DRC.

Absent recognition of OET, firms may be incentivized to adopt alternative hedging strategies that are less efficient and impose additional costs on clients. Accordingly, the Federal Reserve should recognize OET clauses as defining the effective maturity of a position for purposes of FRTB-DRC.

C. Introduce a correlation parameter in FRTB-DRC

As proposed, the FRTB-DRC framework would aggregate JTD exposures in a manner that effectively assumes perfect correlation across all obligors. This assumption would materially overstate portfolio risk, particularly for well-diversified trading portfolios where exposures span multiple issuers, sectors, and geographies.

This design feature would perversely reduce incentives for diversification and contribute to inconsistent outcomes across portfolios with similar economic risk, particularly when combined with other limitations in the FRTB-DRC framework, such as restricted hedge recognition. It also fails to appropriately reflect the inherent diversification and continuous rebalancing of trading book positions, disproportionately impacting market-making. To illustrate, for a portfolio with \$100bn of gross long exposure across N investment-grade corporates (assuming risk weight of 4.1%), varying N from 1 to 10,000 produces a linear aggregation under FRTB-DRC as proposed of issuer-level exposures, irrespective of the degree of diversification (see Exhibit 5 below).

Exhibit 5: Illustrative Diversification Outcome Under Proposed FRTB-DRC

Number of entities (N)	FRTB-DRC RWA (\$bn)
1	51.25
5	51.25
10	51.25
100	51.25
1000	51.25
10000	51.25

In practice, default events are imperfectly correlated, even under stressed conditions. Internal models and historical observations consistently demonstrate that diversification across exposures materially reduces aggregate loss severity. Empirical evidence supports the assumption that default correlations are materially below one, suggesting that diversified portfolios benefit from meaningful risk reduction relative to concentrated exposures.³⁰ By ignoring these diversification benefits, the proposed FRTB-DRC approach would not differentiate between concentrated portfolios and diversified portfolios with the same gross

³⁰ See, e.g., Sten Bergman, *CDOs: CDO Evaluator Applies Correlation and Monte Carlo Simulation to Determine Portfolio Quality*, S&P Global (Nov 14, 2001), <https://www.spglobal.com/ratings/jp/regulatory/article/-/view/sourceId/1586429>.

exposure, particularly when compared to internal models and internationally implemented capital frameworks that permit internal models.

To address this issue, the Agencies should introduce an explicit correlation parameter (ρ_{ij}) into the FRTB-DRC aggregation by replacing the current linear summation of JTD exposures with a correlation-weighted square-root aggregation for both long and short positions. Specifically, aggregate long and short exposures would be calculated as:

- $RW_{long} = \sqrt{(\sum JTD_i^2 + \sum \sum \rho_{ij} \cdot JTD_i \cdot JTD_j)}$
- $RW_{short} = \sqrt{(\sum JTD_i^2 + \sum \sum \rho_{ij} \cdot JTD_i \cdot JTD_j)}$

where ρ_{ij} represents Supervisory default correlations across obligors, calibrated at a conservative level (e.g., ~0.3) to reflect joint default risk across issuers. This approach would still be 2 – 2.5 times more conservative relative to correlations observed during the Global Financial Crisis (“GFC”).³¹ These correlation-adjusted aggregates would then feed directly into the existing FRTB-DRC construct, including the Hedge Benefit Ratio (“HBR”) and the final charge calculated as:

- $FRTB-DRC = \max(RW_{long} - HBR \times RW_{short}, 0)$

Substituting correlation-weighted aggregates in place of simple JTD summation in the FRTB-DRC calculation would recognize partial diversification across issuers while still capturing systemic co-movement risk, thereby improving risk sensitivity and better aligning capital outcomes with portfolio-level exposure dynamics.

Recommendation 3: Adopt IMM to calculate counterparty credit risk for derivatives, repo-style transactions, and eligible margin loans

Although the B3F NPR would provide a framework for recognizing cross-product master netting agreements using SA-CCR, the benefits of cross-product netting would be significantly limited in practice. For many netting sets, the maturity mismatch between repo-style transactions and derivatives would diminish the cross-product netting benefit by more than 95 percent. Virtually none of the intended benefits of cross-product netting would be realized in practice, including in cases where banks facilitate access to cleared U.S. Treasury markets.

Adopting IMM would address this issue as IMM is specifically designed to measure counterparty credit risk exposures for derivatives and repo-style transactions and therefore provides a more risk-sensitive framework than SA-CCR as proposed in B3F. These exposures are inherently dynamic and closely linked to market conditions, hedging strategies, and portfolio composition, and are accordingly better captured through models that reflect firm-specific risk

³¹ See Jordan Nickerson & John M. Griffin, *Debt Correlations in the Wake of the Financial Crisis: What are Appropriate Default Correlations for Structured Products?* 125 Journal of Financial Economics (2017) <https://doi.org/10.1016/j.jfineco.2017.06.011> (estimating average pairwise default correlations at 0.125).

characteristics. The use of IMM would align the treatment of counterparty credit risk with the broader regulatory approach to trading-related activities, where models are recognized as appropriate tools for capturing complex and evolving risks.

More broadly, trading book exposures – including repo-style transactions, which the B3F NPR recognizes as falling within the broad category of “trading-related activities”³² – are better captured through models, as evidenced by the Agencies’ decision to retain internal models under FRTB. Not allowing counterparty credit risk models would therefore represent an inconsistent treatment within the broader capital framework and may reduce alignment between capital requirements and actual risk management practices.

Further, CCPs are shifting toward cross-margining and cross-product netting frameworks in an effort to reduce the amount of margin required of clients by up to 80 percent for portfolios of repos and futures on Treasuries.³³ With clearing banks receiving less margin, a flawed framework for recognizing cross-product netting within the capital rules would result in higher capital requirements, which may ultimately create capacity constraints for Treasury and repo clearing markets (see Exhibit 6 below).

³² 91 Fed. Reg. at 15112.

³³ See Fixed Income Clearing Corporation & CME Group, *Enhanced Cross-Margining Arrangement Between FICC and CME Group* (announcing expanded cross-margining program for U.S. Treasury securities, repo transactions, and CME interest rate futures, with estimated margin savings of up to 80 percent for eligible portfolios); see also FICC, *GSD Cross-Margining Program* materials available at the DTCC website.

Exhibit 6: Impact on Exposure Based on Cross-Product Netting (\$mm)

		Exposure Under Current U.S. Standardized Rule: Collateral Haircut Approach for Repo + SA-CCR for Derivative		Exposure Under 2026 NPR: Cross-Product Netting Under 2026 NPR and CCP Cross-Margining Model		
Portfolio Description	Notional	Exposure with Current CCP Margin Model	Exposure with CCP Cross-Margining Model	Exposure Calculated Under 2026 NPR	Exposure Calculated by CCPs*	2026 NPR versus CCP
1 1d Repo of UST 2Y + 3mo Future on UST 2Y	200	0.9	1.1	1.0	0.2	▲ 5x Higher
2 1d Repo of UST 30Y + 3mo Future on UST 30Y	200	6.9	9.2	7.7	1.5	

* Assumes full 80% margin effect

- **The 2026 NPR may actually result in higher exposure compared to current requirements** due to a flawed SA-CCR based framework
- This increase **works against the efficiency gains** the CCPs are trying to deliver and **risks hindering Treasury market intermediation**
- **IMM is designed to reflect the benefits of cross-product netting** for derivatives and repos and will more closely mirror the calculations by the CCPs

Cross margining is widely acknowledged as a critical step in making Treasury markets more efficient by freeing up capital that was previously tied up in separate margin requirements for repos and futures for Treasuries. B3F acknowledges that: “[C]ross-margining agreements may more accurately reflect the economic risk of the transactions associated with each [CCP].”³⁴ However, the NPR’s application of cross-product netting in the capital rules works against the efficiency gains the CCPs are trying to deliver, and risks hindering Treasury-market intermediation. In the absence of mitigation for the limitations noted on cross-product netting, IMM should be permitted as it is already calibrated and approved for cross-product netting and more closely mirrors the calculations performed by the CCPs.

The use of a single, standardized model across banks would also introduce the risk of a “monoculture” in capital modeling, whereby all firms are required to apply the same standardized assumptions in determining capital requirements regardless of their individual risk profiles. This can reduce the overall resilience of the capital framework as it limits the diversity of modeling approaches and may lead to systematic underestimation or overestimation of risk under certain market conditions. By contrast, IMM is subject to rigorous Supervisory approval,

³⁴ 91 Fed. Reg. at 14986.

validation, and ongoing governance in order to ensure that model outputs align with observed risk while preserving appropriate conservatism.

The Federal Reserve should therefore permit banking organizations to use IMM to determine counterparty credit risk exposures with Supervisory approval, consistent with the current Advanced Approaches framework.

Recommendation 4: Modify the CVA framework to account for regulated financial entities and exempt end-users

The Agencies estimate that the B3F NPR would increase the binding CET1 capital requirement for CVA risk by approximately 96 percent³⁵ compared to current binding requirements. This increase would likely have adverse effects on counterparties that rely on derivatives to hedge commercial risk, primarily through higher costs and reduced availability of hedging solutions. End-users, including corporations, insurance companies, and pension funds, use derivatives to manage exposures to interest rates, foreign exchange, commodities, and other risks, and their ability to do so efficiently is a key stabilizing force within the broader economy.

Although the aggregate impact of CVA on total capital requirements may appear modest, the effects at the product and activity level are more pronounced, as banks allocate capital based on specific exposures. For example, the capital required for an uncollateralized interest rate swap with an IG financial counterparty would increase 2 to 6.5 times with the introduction of CVA as proposed. The proposed CVA framework would disproportionately increase the cost of derivatives transactions that support central risk management activities, particularly for pension funds seeking to protect long-term portfolios and provide stable returns to beneficiaries, as well as for corporations hedging commercial risks. To mitigate these impacts, the Agencies should recalibrate the CVA framework to better align with underlying risk and existing regulatory treatment. In particular, the CVA framework should differentiate between regulated and unregulated financial counterparties and exempt transactions with end-users from CVA capital requirements, consistent with broader post-crisis reforms and established policy objectives.

A. Enhance granularity of CVA risk weights for financials

Under the B3F NPR, the Supervisory risk weights for CVA counterparty credit risk sensitivities would be calibrated at 5 percent for all IG financial institutions and 12 percent for all non-IG financial institutions, without distinction based on the degree of the financial institution's level of prudential regulation. This uniform treatment would not reflect the meaningful differences in underlying credit and CVA risk between regulated financial institutions and unregulated entities.

Regulated financial institutions, including banks, insurers, and certain asset managers, are subject to robust capital, liquidity, and Supervisory requirements, which materially reduce the likelihood and severity of credit deterioration and, by extension, CVA volatility. Treating

³⁵ 91 Fed. Reg. at 15104 tbl. VII.4.

these counterparties identically to unregulated entities within the CVA framework therefore would result in an overstatement of counterparty credit risk and reduce the risk sensitivity of the capital framework.

To mitigate this miscalibration, the Agencies should distinguish between regulated and unregulated financial institutions for purposes of CVA risk weights. Regulated IG and non-IG financial institutions should be assigned risk weights of 3 percent and 8.5 percent, respectively. These calibrations are equal to the highest risk weights applicable to other corporate counterparties, ensuring that regulated financial institutions are not treated more conservatively than corporates with similar or higher empirical default risk.³⁶

This recommended approach reflects observed credit performance and default correlation dynamics, whereby regulated financial institutions exhibit lower default volatility and more stable credit profiles, while maintaining a conservative buffer by selecting values at the upper end of comparable corporate risk weights. Unregulated financial institutions should continue to receive the existing 5 percent and 12 percent risk weights, respectively.

Differentiating risk weights in this manner would improve the risk sensitivity of the CVA framework by more accurately reflecting the lower risk profile of regulated financial institutions, while maintaining appropriate conservatism for unregulated counterparties.

B. Exclude commercial end-users from CVA

In addition, derivatives with commercial end-users as counterparties should be excluded from CVA risk capital requirements, consistent with the broader statutory and regulatory framework that recognizes the importance of end-user hedging. Congress and regulators have previously provided targeted relief for end-users to facilitate prudent risk management, including exemptions in the uncleared swap margin rules³⁷ and the exclusion of commercial end-users from the application of the Supervisory “alpha” factor in SA-CCR.³⁸ Extending a similar exclusion within the CVA framework would also align with implementation of CVA in other Basel jurisdictions, including the E.U. and U.K., and would maintain appropriate incentives for end-users to hedge commercial risks.

Importantly, excluding end-users from CVA would not eliminate capital requirements on these exposures. Derivatives with end-users would remain subject to counterparty credit risk capital requirements under SA-CCR, or IMM, as well as capital requirements arising from stress testing, including the Global Market Shock (“GMS”), which informs the SCB. As a result, banks would continue to hold capital against the underlying credit risk of these transactions, such that the capital framework remains prudent and robust.

³⁶ *Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations*, 91 Fed. Reg. 14952 (Mar. 27, 2026), at 91 Fed. Reg. at 15104.

³⁷ 7 U.S.C. § 6s(e)(4); Federal Reserve, FDIC, OCC, Farm Credit Administration, Federal Housing Finance Agency, Margin and Capital Requirements for Covered Swap Entities, 81 Fed. Reg. 50605 (Aug. 2, 2016).

³⁸ 12 CFR § 217.132(c)(5)(iv) of current U.S. capital rules.

Under the proposed CVA framework, however, CVA capital requirements would materially increase the capital held against derivatives with commercial end-users, particularly for uncollateralized transactions, which are common given that end-users typically do not maintain large pools of liquid assets to post as margin. This increase would, in turn, raise the cost of hedging for corporations and other end-users, leading to higher costs for goods and services, reduced corporate investment, and diminished risk management activity. In some cases, end-users may elect to forgo hedging altogether, increasing their exposure to market volatility and amplifying risks within the broader economy.

The economic importance of accessible hedging is well established. U.S. corporations routinely rely on derivatives to manage input costs, foreign exchange exposures, and other financial risks, enabling them to operate through periods of market stress without passing through excessive volatility to consumers or reducing investment. Increasing the cost of these hedging activities would undermine this stabilizing function and may ultimately reduce economic resilience.

Finally, adopting an end-user exemption would promote international consistency, as other major jurisdictions, including the European Union, broadly exempt end-users from CVA capital requirements. Failure to provide a similar exemption in the United States risks placing U.S. companies at a competitive disadvantage and may incentivize the migration of derivatives activity to jurisdictions with more balanced calibration.

Recommendation 5: Exempt market-making positions from the UFI threshold, or expand the threshold to 25 percent of CET1, consistent with the Simplification Rule

The threshold deduction for non-significant investments in the capital of unconsolidated financial institutions under the current capital framework does not appropriately recognize the role of hedging in market-making activities. Limiting the circumstances in which long positions may be offset with short positions can penalize prudent risk management by failing to align capital treatment with the underlying economic risk. This, in turn, increases costs and may discourage bona fide market-making activity.

Netting of a long position is permitted only when the corresponding short position has an equal or longer maturity, or a residual maturity of at least one year. While the one-year condition may be sensible for longer-term banking book investments, it is not appropriate for trading book positions, which are typically shorter-dated and actively risk managed.

The current UFI framework appears to be premised on the empirically unsupported view that equity hedges cannot be rolled,³⁹ despite evidence to the contrary, including in stressed markets. Unaddressed, this issue could lead to the shifting of activity to unregulated non-banks, which may impair market liquidity and resiliency in periods of stress, while increasing costs for

³⁹ See OCC, Federal Reserve, 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 Fed. Reg. 62018, 62065 (Oct. 11, 2013) (“The agencies believe that the proposed maturity requirements will reduce the possibility of ‘cliff effects’ resulting from the deduction of open equity positions when a banking organization is unable to replace the hedge or sell the long equity position.”).

retail investors and those invested in index funds through retirement and college savings accounts.

A. Remove UFI exposures that are subject to market risk capital requirements from the threshold deduction

The current requirement to aggregate, and potentially deduct, covered positions from the UFI threshold is no longer necessary in its existing form, as the original policy objective of mitigating interconnectedness within the financial system⁴⁰ is now comprehensively addressed through other post-crisis regulatory reforms (see Exhibit 7 in Appendix B below). As reflected in the broader capital and liquidity frameworks, regulators have implemented a range of measures that directly target interlinkages among financial institutions, including the G-SIB surcharge, which explicitly incorporates an interconnectedness indicator, and the SCCL framework, which constrains concentrated exposures to individual financial counterparties.

In addition, liquidity and derivatives regulations further limit contagion risk by discouraging and mitigating reliance on financial sector exposures. For example, the Liquidity Coverage Ratio (“LCR”) and Net Stable Funding Ratio (“NSFR”) frameworks impose more stringent treatment on funding sourced from financial institutions and generally exclude such exposures from recognition as high-quality liquid assets. Similarly, margin requirements for uncleared swaps require the exchange of collateral between registered swap dealers and security-based swap dealers and financial end-users, reducing the potential for loss transmission through bilateral exposures. These measures operate in combination to address the same systemic concerns that originally motivated the UFI deduction.

The application of the threshold deduction to covered positions results in an overly conservative treatment that does not accurately reflect their economic risk profile. In contrast to longer-term, banking book exposures, trading positions are typically subject to daily valuation, margining, and active risk management, which materially reduces the likelihood of contagion through interconnectedness channels. As a result, the current capital framework double counts interconnectedness risk, as exposures are penalized both through the UFI deduction and through other capital and liquidity requirements designed to address the same underlying concern.

Accordingly, it would be more appropriate for the Federal Reserve to exclude covered positions from the UFI framework or otherwise adjust the treatment to avoid duplicative capital charges. Modernizing the UFI framework in this manner would better align capital requirements with the underlying risk of these exposures, while preserving the effectiveness of existing regulations that already comprehensively address interconnectedness risk across the financial system.

B. Increase the deduction threshold UFI to be 25 percent of CET1, consistent with the Simplification Rule

The current 10 percent threshold for deductions of UFI is overly conservative and should be increased to 25 percent. The Agencies have previously determined that a higher threshold is appropriate without compromising safety and soundness, as evidenced in the capital

⁴⁰ See 78 Fed. Reg. at 62062.

simplification rule for non-Advanced Approaches banks, which increased the deduction thresholds for certain exposures, including investments in unconsolidated financial institutions, from 10 percent to 25 percent of CET1 capital.⁴¹

As discussed above, interconnectedness risks are already addressed through the G-SIB surcharge, the SCCL, and liquidity and uncleared swap margin rules. In this context, the current threshold double counts risk by applying deductions that are not well aligned with the broader capital and prudential framework. Increasing the threshold to 25 percent would better align the treatment of these exposures with both the economic characteristics of trading activities and existing regulatory precedent, while reducing distortions to market-making.

⁴¹ OCC, Federal Reserve, FDIC, *Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 84 Fed. Reg. 35234, 35237-38 (July 22, 2019).

Exhibit 7: Rules that Address Interconnectedness in the Capital Framework

Topic	Rule Name	Effective Date	How the Rule Addresses Interconnectedness
Capital / Liquidity	Largest Counterparty Default (12 CFR Part 252)	November 14, 2013	Banks must hold capital against instantaneous losses from largest counterparty across derivatives and securities financing transactions
Capital / Liquidity	SFI / NSFI Capital Deduction Thresholds (12 CFR Part 217)	January 1, 2014	The rule directly limits cross-holdings of capital instruments among financial institutions
Limit Activity and / or Concentration	Covered Funds Restrictions in the Volcker Rule	April 1, 2014	Banking entities are generally prohibited from owning, sponsoring, or maintaining certain relationships with hedge funds and private equity funds, limiting exposure to highly interconnected non-bank financial entities
Capital / Liquidity	Liquidity Coverage Ratio ("LCR")	January 1, 2015	Wholesale funding from financial institutions generally receives a 100 percent runoff rate, severely penalizing reliance on inter-financial-institution funding and short-term interconnectedness
Markets Reform	Derivatives Clearing Requirements & Margin Rules	April 1, 2016	Swap dealers and security-based swap dealers generally must centrally clear standardized derivatives and exchange daily variation margin and initial margin on non-cleared swaps with dealers and financial end-users, reducing bilateral interconnectedness and counterparty contagion across the financial system
Limit Activity and / or Concentration	Single-Counterparty Credit Limits ("SCCL") (12 CFR Part 252)	October 5, 2018	A G-SIB may not have net credit exposure to any other G-SIB exceeding 10 percent of Tier 1 capital
Capital / Liquidity	G-SIB Surcharge on Interconnectedness Indicator (12 CFR Part 217)	January 1, 2019	Higher levels of exposure to other financial institutions increase the firm's G-SIB surcharge through the Interconnectedness indicator
Capital / Liquidity	Total Loss Absorbing Capacity ("TLAC") / Long-Term Debt ("LTD") Holdings Deduction Rule	April 1, 2021	Must deduct from regulatory capital any direct, indirect, or synthetic investment in unsecured TLAC or LTD instruments issued by another G-SIB (domestic or foreign) beyond a certain limit
Capital / Liquidity	Net Stable Funding Ratio ("NSFR")	June 21, 2021	Funding from financial institutions generally receives little or no available stable funding credit, while inter-financial-institution assets carry elevated required stable funding factors