PUBLIC SUBMISSION

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Comment

The agencies have a laudable goal and focusing supervision on material risks rather than paperwork makes sense, but this proposal overcorrects and raises the threshold for intervention so high that supervision becomes structurally late to fast-moving crises. A workable rule requires three specific structural fixes to replace the flawed mechanisms in the draft. 1) The final rule must replace the “likely” harm standard with Stress-Based Triggers to capture vulnerabilities before a crisis hits. 2) The rule should adopt “Dual Materiality Thresholds” using absolute dollar floors alongside relative percentages to account for systemic externalities. 3) The agencies should bifurcate MRA closure into “Standard” and “Complex” tracks to prioritize resources and prevent backlog.

Question 14 of the NPRM asks when an MRA for interest rate risk would have been “permissible” for Silicon Valley Bank under this new framework and on any reasonable reading of the proposal the answer is not until days before failure. Throughout 2021 and 2022, SVB’s vulnerabilities were observable and stable, meaning material harm was not “likely” under “current conditions” because the shock hadn’t happened yet. It was a vulnerability and not a probable loss, so by the time harm became “likely,” the institution was beyond saving and the proposal institutionalizes this lag.

The proposal requires a practice to be “likely” to harm the institution before examiners can act and this is operationally blind to modern contagion. Systemic crises like the 2023 uninsured deposit runs do not offer polite warnings and are driven by sentiment shifts that leave institutions looking placid until the moment of rupture. The agencies’ own analysis acknowledges that under “current conditions,” SVB showed no material harm, so the “likely” standard transforms supervision from a preventive function to a reactive one. The final rule should replace the “likely” standard with Stress-Based Triggers and define an unsafe practice as one that “could materially harm the institution under stress conditions that are plausible.” This allows examiners to cite a vulnerability like unhedged duration risk based on plausible rate scenarios and they should not have to wait for rates to actually rise, which restores the preventive authority that the proposal accidentally strips away.

The agencies correctly apply stricter proportional scrutiny to large banks but by a purely relative standard. However strict this scrutiny is, it answers the wrong question because it simply asks whether the specific bank can survive the loss, rather than the more important question of what happens to the system when the loss occurs. A community bank losing 5% of deposits loses $35 million and that is a tragedy for shareholders, but a large bank losing 5% loses $35 billion and that is a systemic externality. It forces asset fire sales that depress prices for all other banks, signals a “market-wide” defect that triggers contagion runs, and effectively “taxes” the real economy via credit contraction. The final rule should adopt dual materiality thresholds and define materiality as the lower of a relative percentage for solvency or an absolute dollar floor for externalities.

The proposal rightly identifies “forever MRAs” as a resource drain but raising the bar for MRA issuance creates a de facto “Too Big to MRA” loop where large banks can accumulate weaknesses that are individually “immaterial” at their scale and therefore never trigger the MRAs that, in practice, drive composite rating downgrades. Relegating governance issues to non-binding “supervisory observations” is a mistake because it allows control gaps to metastasize. The rule needs a mechanism for quick entry and exit. “Supervisory Observations” cannot be a permission slip for inaction and the rule must mandate that if an observation is ignored for two exam cycles, it automatically converts to a binding MRA. To solve the resource constraint, the agencies should split MRA closure into two tracks where “Standard MRAs” for quantitative limits or specific errors close immediately upon verification of the fix, while only “complex MRAs” regarding risk culture or modeling require a longer validation period.

The central failure in 2023 was not primarily due to identification of issues but escalation and examiners failed to drive known vulnerabilities to a forceful supervisory conclusion. This proposal makes that worse by erecting higher barriers to action. By adopting stress-based triggers and absolute dollar floors, you can build a regime that stops the next SVB in 2022 rather than documenting its autopsy in 2023.

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