January 16, 2024

VIA ELECTRONIC SUBMISSION EMAIL

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R—1813; RIN 7100—AG64

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Docket ID OCC—2023—0008

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RIN: 3064—AF29

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity

Ladies and Gentlemen:

KeyCorp and its subsidiaries, including its national bank subsidiary, KeyBank, National Association ("KeyBank," and together with KeyCorp and its subsidiaries, "Key") appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency's (the "OCC," and collectively with the FRB and the FDIC, the "Agencies") proposed rulemaking regarding amendments to the regulatory capital rule to implement the Basel III "endgame" framework (the "Proposed Rule"). As a general matter, we share the concerns and support the recommendations set forth in the comment letter jointly submitted by Key and other Category IV banking organizations. We also share the concerns and support the recommendations in the comment letter of the Bank Policy Institute and the American Bankers Association. This letter is intended to highlight perspectives unique to Key and focuses on certain issues raised by the Proposed Rule that could particularly impact Key, its customers, and the communities it supports.

Key is a regional bank headquartered in Cleveland, Ohio with a 15-state retail footprint that provides deposit, lending, cash management and investment services to both individuals and businesses. As a regional bank, Key strives to help its clients and communities thrive through various initiatives, including financial inclusion, and other community-focused efforts.

Key is subject to the Community Reinvestment Act's ("CRA") standards for large banking organizations, which include an evaluation of whether its residential mortgage, small business, and other activities meet certain volume, geographic distribution, and borrower profile criteria. Key also is evaluated on community development activities, such as the extent of its participation in low-income housing tax credit ("LIHTC") transactions. KeyBank has earned ten "Outstanding" ratings from the OCC on its CRA exams and is one of the only banks to achieve this level of consistency in outstanding performance since the CRA's passage in 1977.

A central focus of Key's social commitments is to make banking more inclusive via the products it offers and the investment it makes in its communities.[1] As part of this commitment, Key invests significant capital and resources in low-to-moderate income ("LMI") communities. For example, in 2022, Key invested $4.7 billion in affordable housing, $1.2 billion in LMI mortgages, and $366.5 million in LMI small business lending. In November 2021, Key also launched a Community Development Financial Institutions Specialty Group within its Community Development Lending and Investment business line with a primary focus of expanding economic access to LMI communities.

Key was also ranked as a Top Four affordable housing lender for 2022 by Affordable Housing Finance. Through its "One-Key Solution" designed to harness Key's platform across multiple business lines in providing comprehensive client service, Key offers affordable housing services including acquisition, construction, debt participation, federal and state LIHTC, lines of credit and subscription lines, refinancing, and tax credit equity and proprietary and multi-fund investments. In the past six years, Key has made almost $22 billion in affordable housing loans and investments. Given Key's longstanding focus on providing affordable housing and serving LMI communities, Key is uniquely positioned to comment on the ways the Proposed Rule would harm LMI communities and would work against the policy goals of the CRA.

In addition to the potential impact that the Proposed Rule would have on LMI communities, Key also wishes to highlight other areas of concern, including that: (1) the rule is not appropriately tailored to regional institutions such as Key, (2) the costs of implementation of certain elements of the Proposed Rule outweigh the purported benefits, and (3) the Proposed Rule would have an anti-competitive impact. In short, we respectfully submit that the Proposed Rule's capital treatment of certain products would make it more difficult for banking organizations like Key to meet community needs, and it would make it more expensive for banks to continuously innovate and expand product and service offerings activities, which

[1] *See generally* KEYCORP, 2022 ENVIRONMENTAL, SOCIAL, AND GOVERNANCE REPORT (2022), *available* here.

ultimately remain essential elements for Key and other banks to adequately serve their communities.

Key therefore respectfully requests that the Agencies re-propose the Proposed Rule to correct the issues identified in this letter. A list of proposed revisions to be included in a re-proposal is attached hereto as an Appendix.

EXECUTIVE SUMMARY

Here, we briefly summarize the key concerns and recommendations set forth in this letter, each of which is discussed further herein.

I. **Negative Impact on LMI Communities and LMI Initiatives**. As proposed, the risk weighting for residential mortgages would disproportionately hurt LMI borrowers by making it significantly more difficult for banks to provide financing for residential mortgages. In addition, the risk weighting for other consumer products would make the cost of credit higher for LMI communities and small businesses. Smaller banks serving LMI communities could also be adversely affected by the Proposed Rule because, as proposed, the risk weighting for bank exposures could make investments into or deposits with Community Development Financial Institutions ("CDFIs") or minority depository institutions ("MDIs") more expensive, thus discouraging partnerships between smaller and larger banks. These impacts highlight significant policy conflicts between the CRA and the Proposed Rule.

   Further, inconsistent with the Agencies' stated focus on promoting a level playing field across similarly situated market participants, the Proposed Rule places regional banks at a disadvantage relative to competitors offering similar products not subject to these requirements. As proposed, the residential mortgage risk weighting may further drive mortgage lending to nonbank lenders or to banks below the Proposed Rule's $100 billion asset threshold. Finally, the operational risk component in the Proposed Rule would increase capital costs for fee-based business where banks compete with nonbanks, such as broker-dealers that are not affiliated with banking organizations.

   We recommend that a re-proposed rule: (1) remove the twenty percent increase on residential mortgage risk weights (relative to the Basel framework), (2) retain the zero percent credit conversion factor ("CCF") for unconditionally cancelable commitments, (3) remove the ten percent increase on regulatory retail risk weights (relative to the Basel framework), (4) explicitly clarify that investments in funds that qualify as Part 24 investments would receive a 100 percent risk weight, (5) to further incentivize investments necessary to address the country's shortage of affordable housing, decrease the risk weight for affordable housing, (6) expand the scope of short-term bank exposures eligible for the lower twenty percent and fifty percent risk weights to all bank exposures with a maturity of three months or less, and (7) specify that renewable energy tax equity investments would receive a 100 percent risk weight.

II. **Negative Impact on Technology Investing by Banks**. Technology investing is an integral part of a bank's toolkit to grow and retain business. Key has used technology investments to, among other things, improve customer experience and products and remain competitive with nonbank competition. By eliminating the 100 percent risk weight for non-significant equity exposures, the Proposed Rule would make it more

expensive for banks to make strategic investments into fintech companies and other strategic partners. Therefore, we recommend that a re-proposed rule retain a 100 percent risk weight for non-significant equity exposures so as not to inhibit direct strategic investments or permissible venture capital investments.

III. **Lack of Tailoring**. By applying virtually identical capital requirements to Category II through IV banking organizations, the Proposed Rule would create a size cliff at $100 billion in total assets and could create a regional bank "desert" in the $100 billion to $500 billion range. This is because, first, banks below the $100 billion threshold would be strongly disincentivized from further growth while, second, banks slightly above the $100 billion threshold would be subject to the same capital requirements as banks many times their size and thus may feel compelled to grow in scale. While the lack of tailoring in the Proposed Rule is an issue across Category II, Category III and Category IV banking organizations, regional banks in Category IV would bear the brunt of this lack of tailoring, shouldering disproportionate financial and operational burdens both relative to their larger peers, which have greater resources to devote toward compliance with the Proposed Rule, and relative to smaller banks, which would not be subject to the Proposed Rule.

Accordingly, we recommend that a re-proposed rule better incorporate tailoring via the following changes:

- Exempt Category IV banking organizations from the countercyclical capital buffer (currently set at zero) and supplementary leverage ratio.
- Retain the twenty-five percent capital deduction threshold.
- Return the threshold for applicability of market risk for Category III and IV banks to one based solely on average aggregate trading assets and trading liabilities.
- Remove or tailor the application of operational risk requirements to Category III and IV organizations.

IV. **Overall Difficulties With Implementing the Proposed Rule**. For banking institutions like Key, the Proposed Rule would result in significant increased burdens with little corresponding benefit. First, the dual stack calculation framework would result in capital calculation challenges. Second, the operational risk framework for Category III and IV banks is overly punitive towards business lines that rely upon noninterest and fee-based income. Third, because the capital stress tests and stress capital buffer calculations already incorporate a component related to a bank's ability to withstand operational risk losses, the Proposed Rule advances a framework that double counts operational risk. Fourth, the market risk/credit evaluation adjustment capital charges under the Proposed Rule are overly complex given limited trading activity at most

regional banks. Fifth, the transition and implementation periods would unduly limit the time that banking organizations like Key would have to adopt the requirements, particularly those relating to the items that act as a deduction to capital, such as accumulated other comprehensive income ("AOCI") and deferred tax assets. Finally, the Proposed Rule would unnecessarily increase operational and compliance costs for Key and similar banking organizations, diverting financial and other resources from our mission to serve our communities.

We recommend that a re-proposed rule: (1) remove the dual stack calculation requirement and permit Key and other Category III and IV banking organizations to elect to continue to calculate regulatory capital under only the Standardized Approach, (2) remove or tailor the application of the stand-alone operational risk capital requirement to Category III and IV banks, (3) retain the currently-applicable market risk framework but consider the application of more stringent credit valuation adjustment ("CVA") capital requirements to banks with significant trading books, (4) remove the limit on the amount of adjusted allowance for credit losses ("AACL") includable in regulatory capital, and (5) extend the length of the implementation and transition periods.

COMMENTS ON THE PROPOSED RULE

Key is writing this letter to highlight unique perspectives and its focus on certain areas of concern raised by the Proposed Rule that would be particularly impactful to Key and its customers. The below discussion includes descriptions of those areas, as well as details on recommended revisions to the Proposed Rules. For ease of reference, we have included an appendix listing the recommended revisions to the Proposed Rule that are mentioned throughout this letter.

I. The Proposed Rule Would Be Harmful to LMI Communities and Conflicts with the Objectives of the CRA.

Congress designed and enacted the CRA in 1977 to address the long history of discrimination in lending and to ensure that banks are meeting the needs of the LMI consumers and communities they serve.[2] In October 2023, the Agencies published updates to the regulations implementing the CRA intended in part to incentivize banks to focus even more on community development activities.[3] Similarly, in recent years, members of FRB leadership spanning various ideologies have emphasized the importance of inclusivity in, and accessibility to, the financial system. In remarks celebrating former FRB Chair Janet Yellen's tenure, Governor Lael Brainard noted that, in many conversations, "Chair Yellen brought the subject of economic disparities to the forefront" and "consistently emphasiz[ed] the importance of an economy that works for everyone."[4] More recently, Vice Chair for Supervision Michael Barr expressed similar sentiments in remarks at the Bipartisan Policy Center shortly before the initial release of the Proposed Rule, highlighting that "[the FRB's] goal is a financial system that works for everyone."[5] Finally, in recent remarks at the Aspen Institute, FRB Governor Michelle Bowman underscored "foster[ing] an economy that works for everyone" as one of the most important of the FRB's roles as a central bank, noting specifically that "[a]n inclusive financial system recognizes that consumers come from a wide range of economic circumstances."[6]

Everyone, including Key, shares this common goal of economic inclusivity, but the Proposed Rule would severely undercut these aims given its impact on regional bank consumers—particularly LMI borrowers and those in LMI communities seeking financial services.

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[2] 12 U.S.C. § 2901(a)(3) ("regulated financial institutions have continuing and affirmative obligation[s] to help meet the credit needs of the local communities in which they are chartered").

[3] *See* Community Reinvestment Act (2023), available here.

[4] Gov. Lael Brainard, *Celebrating Excellence in Community Development*, Speeches, BD. GOV. FED. RSRV. SYS. (Dec. 3, 2018), *available* here.

[5] Vice Chair Supervision Michael S. Barr, *Holistic Capital Review*, Speeches, BD. GOV. FED. RSRV. SYS. (Jul. 10, 2023), *available* here.

[6] Gov. Michelle W. Bowman, *Building a More Inclusive Financial System through Collaboration and Action*, Speeches, BD. GOV. FED. RSRV. SYS. (Dec. 5, 2023), *available* here [hereinafter "Bowman Remarks"].

Additionally, consistent with concerns expressed by multiple leaders at the Agencies,[7] we are concerned that the objectives of the CRA and the substance of the Proposed Rule are at odds with one another in terms of policy objectives. On the one hand, the CRA encourages more investment toward LMI communities, while on the other hand, the Proposed Rule discourages such investments by subjecting them to more punitive requirements.[8]

Because of Key's ongoing focus on providing affordable housing and serving LMI communities, we first wish to highlight the ways in which the Proposed Rule would hurt LMI communities and conflict with the objectives of the CRA.

A. The Risk Weighting for Residential Mortgages Would Disproportionately Impact LMI Borrowers.

The residential mortgage risk weighting would make it significantly more difficult for banks to provide financing for residential mortgages. Specifically, the Proposed Rule would require banks to assign a higher risk weight for mortgages with a higher loan-to-value ("LTV"). Under the Proposed Rule, the risk weights applicable to residential mortgages are twenty percentage points higher than the Basel framework, resulting in a risk weight of forty percent for loans with an LTV below fifty percent up to a risk weight of ninety percent for loans with an LTV above 100 percent.

A significant number of high LTV loans are made to LMI borrowers and in LMI neighborhoods. For example, data gathered by the Bank Policy Institute ("BPI") shows that thirty-eight percent of loans to LMI borrowers would receive a risk weight of seventy percent or greater, while seventeen percent of loans to non-LMI borrowers would receive a seventy

[7] *See Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework*, Speeches, Statements & Testimonies, FDIC (Jul. 27, 2023), *available* here [hereinafter "McKernan Statement"] ("The increased capital requirements [on residential mortgages] could lead to an increase in interest rates for low- and moderate-income and other historically underserved borrowers who cannot always afford a [twenty percent] down payment, making it that much harder for these families to achieve homeownership"); *Statement by Governor Michelle W. Bowman*, BD. GOV. FED. RSRV. SYS. (Jul. 27, 2023), *available* here [hereinafter "Bowman Statement"] ("Increased capital requirements for certain types of loans may also lead to a reduction in credit availability or increased prices, which could disproportionately harm underserved markets, businesses, and communities.").

[8] Both BPI and the ABA agree that the Proposed Rule and the proposed CRA revisions were at odds with one another. The BPI and the ABA sent a letter calling for the Agencies not to adopt final CRA rules until the capital rules are finalized. In particular, the letter warned that the capital rules "would reduce incentives to engage in mortgage lending, which is central to the CRA programs of many banks." The letter also cautioned that "[the] proposed changes, . . . would significantly affect the regulatory capital treatment of banks' CRA-related activities." *See* Bank Policy Institute and American Bankers Association, Comment Letter on Proposed Rule on Community Reinvestment Act (Aug. 22, 2023), *available* here.

percent or greater risk weight.[9] Further, data collected by the Urban Institute shows that nineteen percent of high LTV loans were made in LMI neighborhoods and that twenty-eight percent of high LTV borrowers were LMI consumers.[10]

The higher risk weight could limit a bank's ability to make high LTV loans that serve its LMI borrowers and communities. As such, the proposed risk weighting would be detrimental to LMI borrowers. As a general matter, high LTV loans in LMI communities to LMI borrowers facilitate first-time home ownership.[11] Moreover, research conducted by BPI further suggests that the risk weighting would disproportionately impact Black/African American borrowers.[12] In this regard, the risk weighting would contradict Vice Chair for Supervision Michael Barr's desire that the Proposed Rule "does not unduly affect mortgage lending, including mortgages to under-served borrowers."[13] Discouraging high LTV loans would also conflict with the objectives of the CRA.

In addition, residential mortgage loans to LMI borrowers represent a significant portion of the loans sold to government-sponsored entities ("GSEs"). By increasing the risk weights of high LTV residential mortgages, the Proposed Rule would further drive mortgage lending away from bank balance sheets and increase reliance on GSE mortgage programs for the industry, which has grown significantly in recent years.[14] Indeed, in September 2020, the Financial Stability Oversight Council ("FSOC") issued a statement arguing that the credit risk capital requirements on mortgages at GSEs are less than that of banks, and that this disparity could concentrate risk at GSEs. Accordingly, the FSOC "encourage[d] [the Federal Housing Finance Agency] and other regulatory agencies to coordinate and take other appropriate action to avoid market distortions that could increase risks to financial stability by generally taking consistent

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[9] *See The Basel Proposal: What it Means for Mortgage Lending*, BANK POL'Y INST. (Sept. 30, 2023), *available* here [hereinafter "BPI Mortgage Lending Article"]

[10] LAURIE GOODMAN & JUN ZHU, URB. INST., BANK CAPITAL NOTICE OF PROPOSED RULEMAKING: A LOOK AT THE PROVISIONS AFFECTING MORTGAGE LOANS IN BANK PORTFOLIOS 8 (2023), *available* here.

[11] GOODMAN & ZHU, *supra* note 10, at 9.

[12] *See* BPI Mortgage Lending Article, *supra* note 9 (noting that fifty two percent of loans to Black borrowers would receive a risk weight of seventy percent or more, compared to twenty two percent among White borrowers).

[13] *Statement by Vice Chair for Supervision Michael S. Barr*, BD. GOV. FED. RSRV. SYS. (Jul. 27, 2023), available here.

[14] Currently, GSEs account for more than half of the residential mortgage market. *Remarks by Jonathan McKernan, FDIC Board of Directors, at the New York State Bar Association and Mayer Brown on the Base Endgame and Long-Term Debt Proposals*, Speeches, Statements & Testimonies, FDIC (Oct. 4, 2023), *available* here [hereinafter "McKernan Remarks"] (citing to Fed. Nat'l Mortg. Ass'n (Fannie Mae)), Annual Report (Form 10-K) 84 (Feb. 14, 2023) (showing Fannie Mae had approximately twenty eight percent of single-family mortgage debt outstanding as of December 31, 2022); Fed. Home Loan Mortg. Corp. (Freddie Mac), Annual Report (Form 10-K) 12 (Feb. 22, 2023) (showing Freddie Mac's single-family mortgage portfolio as of December 31, 2022 was $2.986 billion, or approximately twenty-three percent of the $13.195 billion of single-family mortgage debt outstanding)).

approaches to the capital requirements . . . ."[15] In this regard, the Proposed Rule would be inconsistent with this recommendation and could further drive LMI customers to unregulated entities.

Ultimately, assigning increased risk weights could result in loans originated by a bank subject to the Proposed Rule being significantly more expensive than loans originated by smaller banks or nonbank lenders. Nonbank market participants usually have less robust risk management capabilities and are not subject to comprehensive regulation, thus presenting significant risk to the broader financial markets.[16] Even if nonbank lending does not raise systemic risk concerns, pushing ever more lending outside of the banking sector could still result in meaningful harms to consumers, given that nonbank lenders often are not subject to the same consumer protection oversight as banks. Further, even assuming that the systemic risks of certain large nonbank financials could be addressed by increased regulation upon being designated for prudential regulation by the FSOC, it is an open question whether nonbank lenders would continue to be willing to lend to LMI, small business, and other customers lacking access to financial services, particularly in recessionary financial environments.

Related to the issue of residential mortgage risk weighting, we also wish to request clarification regarding the risk weight for statutory multifamily mortgages. Statutory multifamily mortgages are an important way that Key and other banks provide cost-effective financing to LMI communities. The Proposed Rule would impose a fifty percent risk weight for such mortgages, but it does not clearly specify the risk weight that would apply to multifamily housing during the ***construction*** phase. In particular, the Proposed Rule would assign a 150 percent risk weight to any acquisition, development, and construction ("ADC") loan exposure. In order to promote the construction and financing of multifamily housing, a fifty percent risk weight would appear to be more appropriate for multifamily housing during the construction phase, but the rule as written is not clear as to whether such projects would qualify as such, or whether such exposures must be categorized as ADC. If so, the required 150 percent risk weight for statutory multifamily projects in construction would likely lead to banking organizations financing fewer such projects. Thus, we request clarification that the fifty percent risk weight for statutory multifamily mortgages also applies to multifamily construction that would qualify as statutory multifamily once completed.

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[15] FIN. STABILITY OVERSIGHT COUNCIL, STATEMENT ON ACTIVITIES-BASED REVIEW OF SECONDARY MORTGAGE MARKET ACTIVITIES 2 (2023), *available* here.

[16] Indeed, the FSOC expressed in its 2022 Annual Report concerns regarding the growth of nonbank mortgage companies' market share and associated serious financial stability concerns—particularly regarding liquidity risk. *See* FIN. STABILITY OVERSIGHT COUNCIL, ANNUAL REPORT 62–63 (2022), *available* here ("many nonbank mortgage companies have limited capital and loss-absorbing capacity").

The twenty percentage point increase on the Basel framework for residential mortgage loans should be removed. A re-proposed rule should also implement the same fifty percent risk weight on multifamily projects whether ADC or completed.

B. The Risk Weighting for Other Consumer Products Would Make the Cost of Credit Higher for LMI Communities and Small Businesses.

Generally, all of the basic economic forces that drive mortgage lending to nonbanks as capital requirements increase are operative in the case of other retail credit exposures. In addition to residential mortgages, the increased risk weights for many other consumer products (*e.g.*, consumer credit cards) under the Proposed Rule would make the cost of credit higher for LMI communities and small businesses. Under the Proposed Rule, risk weights for certain retail loans, leases, and lines of credit, including to certain small businesses,[17] would be materially higher than those set internationally. Specifically, the Proposed Rule would include an eighty-five percent risk weight for "regulatory retail" exposures; international regulations impose a seventy-five percent risk weight.

Currently, off-balance sheet items like lines of credit that could become on-balance sheet loans are required to be "converted" into on-balance sheet items. Commitments that the bank can unconditionally cancel or revoke (such as "advised" lines), however, are not subject to any risk-based capital requirements. The Proposed Rule would abandon this approach and instead impose a CCF of ten percent on unconditionally cancelable commitments, such that a bank would have to hold capital against ten percent of the unused portion of a credit line, even though the bank can cancel the line at any time or otherwise refuse to extend credit. This increased CCF factor would apply to retail products, including HELOCs, credit cards, and small business lines of credit, making it more expensive to extend credit lines to or increase credit limits for consumers. Reduced access to credit lines or lower credit limits would increase consumers' credit utilization rates, thus potentially leading to lower credit scores. In turn, lower credit scores would adversely affect consumers' ability to access any kind of financing, including mortgages, auto loans or student loans. Moreover, by making these products more expensive, LMI borrowers would continue to have difficulty gaining access to

[17] The Proposed Rule introduces the concept of a small- or medium-sized entity ("SME"), defined to be an entity with annual reported revenue or sales less than or equal to $50 million (on a consolidated basis). Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64028, 64051, n. 92 (proposed Sept. 18, 2023). Only certain SME exposures that fall below certain size (total exposure to that borrower and its affiliates does not exceed $1 million) and granularity limits (no single regulatory retail exposure could be more than 0.2 percent of the bank's portfolio of regulatory retail exposures) would qualify for this category. *Id.* at 64186. All other SME exposures would be treated as corporate exposures, as described below.

credit,[18] potentially resulting in increased reliance on other forms of credit, including payday lenders.

In addition to the impact on consumers, the risk weighting would also impact small businesses in LMI communities. Since 2017, Key has issued $3.9 billion in small business loans to LMI communities. A top-performing Small Business Administration Preferred Lender for over two decades, Key sees small businesses as critical accelerators for the economic health of communities. Accordingly, Key has made significant investments in streamlining processes and providing solutions to improve small business owners' access to capital. For example, Key built initiatives like the KeyBank Small Business Check-In, which provides small business clients with an easy way to provide data regarding the state of their business, their goals, and their financial journey in advance of a personalized financial review with one of Key's bankers.

For loans to small businesses that do not fall within the "regulatory retail" category, *e.g.*, where the total size of the relationship is greater than $1 million, the Proposed Rule would not differentiate between small businesses and large corporations. First, the $1 million cut-off to qualify as "regulatory retail" means that many regional and other banks falling within the purview of the Proposed Rule would be less incentivized to develop relationships with small businesses, instead preferring that small business (inefficiently) obtain credit services from multiple banks. Second, the lack of differentiation for such non-regulatory retail exposures means that banks with an interest in developing relationships with SMEs have less of an incentive to lend to SMEs relative to larger (particularly publicly traded) corporates. Together, these increases would make it more expensive for American small businesses to access bank lending. This is all the more detrimental to small businesses in underserved communities.

The zero percent CCF for unconditionally cancelable commitments should be retained.

Additionally, a re-proposed rule should be calibrated by revising down by ten percent the risk weights for regulatory retail exposures to make them consistent with the risk weights of the Basel Framework.

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18 *See, e.g.*, *Consumer Financial Protection Bureau Study Finds Consumers in Lower-income Areas are More Likely to Become Credit Visible Due to Negative Records*, CONSUMER FIN. PROT. BUREAU (Jun. 7, 2017), *available* here (finding that consumers in lower-income areas are 240 percent more likely to become credit visible due to negative records, while consumers in high income areas are thirty percent more likely to become credit visible by using a credit card).

C. Community Investments Would Be More Expensive, Potentially Discouraging Partnerships with CDFIs and MDIs and Investments in Affordable Housing Programs.

The Proposed Rule would adopt the Basel Committee on Banking Supervision (the "Basel Committee")'s approach for unrated banks (SCRA), with a narrower exclusion for short-term exposures. The lower risk weights for short-term (three months or less) bank exposures would apply only to foreign bank exposures that are in the form of self-liquidating, trade-related contingent items that arise from the movement of goods. This would appear to exclude correspondent deposits and other inter-bank assets/liabilities.

As a founding member of the Economic Opportunity Coalition, a coalition of corporate organizations and social sector partners focused on accelerating inclusive economic growth, Key is committed to supporting CDFIs and MDIs as part of its commitment to the communities it serves. For example, in 2022, Key provided $67 million of debt financing and $6.5 million in equity financing to CDFIs, including loan funds, affordable housing lenders, and small business loan providers. Because supporting CDFIs and MDIs is so crucial to its commitment to serve historically underbanked communities, Key is concerned with the Proposed Rule's approach for unrated banks, which could impair market liquidity in the interbank market and impact the treatment of deposits held at MDIs. The risk weighting for bank exposures could make investments into or deposits with CDFIs or MDIs more expensive and discourage these partnerships between smaller and larger banks. This would harm the businesses and consumers served by these institutions, who are largely LMI and/or minority consumers.

Similarly, the operational risk component would make it significantly more difficult for banks to engage in affordable housing activities where many banks, including Key, have been industry leaders. Specifically, as discussed further in Section V.B. below, the formula for operational risk includes a Business Indicator ("BI"), which would include an approach to fee/services income that the Basel Committee itself has said is unworkable.[19] The calculation would make LIHTC syndication activities, which are fee based, more expensive for both syndicators and bank investors due to the added operational risk capital charge associated with fee income and expenses.

The LIHTC program is a federal government program intended to encourage the investment of private equity into the development of affordable rental housing for low-income households, and many banks invest in and lend to LIHTC projects to, among other reasons, meet the credit needs of their communities and receive CRA consideration.[20] In addition, Key specifically

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[19] McKernan Statement, *supra* note 7 (observing that the Proposed Rule's treatment of fee/services income in the business indicator "take[s] an approach that its own Basel Committee authors have said does not work.")

[20] *See, e.g.*, OFF. COMPTROLLER CURRENCY, LOW-INCOME HOUSING TAX CREDITS: AFFORDABLE HOUSING INVESTMENT OPPORTUNITIES FOR BANKS 6 (2014), *available* here.

leverages its experience in community development investment to focus its syndication business on investments that aid in financing, acquiring, developing, rehabilitating, managing, selling or renting housing for LMI individuals and in projects that qualify for low income housing tax credits. LIHTC syndications are an important way for banks (as well as other institutional investors) to invest in LIHTC directly and provide financing to affordable housing. These products play an important role in the affordable housing market. By making such activities more expensive, the Proposed Rule would discourage community-focused banks from engaging in LIHTC activities. This would harm the LIHTC market and could reduce the amount of affordable housing projects in development. Further, if the cost of fee-based business lines like LIHTC syndication activities increases for banks, it renders them less competitive than their nonbank competitors. This is inconsistent with the Agencies' stated focus on fostering a level playing field across similarly situated market participants.[21]

The Proposed Rule would also impose risk weights on certain types of equity investments, including for public welfare investment funds. It is not clear how these risk weights would apply to these types of funds. In particular, unlike the existing capital rule, the Proposed Rule does not specify whether these funds would qualify for a 100 percent risk weight as a Part 24 investment, or whether the look-through approaches in the equity exposure or market risk capital frameworks in the Proposed Rule would apply to these funds.[22]

More broadly, the acute shortage of affordable housing in this country is a significant public policy challenge that has threatened the financial well-being of millions of Americans. Consistent with the focus in the CRA and its implementing regulations on encouraging the financing of affordable housing by banks, the Agencies should apply a lower risk-weight to the financing of affordable housing to reflect that important public policy goal.

A re-proposed rule should explicitly clarify that investments into funds that qualify as Part 24 investments would receive a 100 percent risk weight.

Additionally, a lower risk weight should be applied to financing for affordable housing.

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[21] *See, e.g.*, Press Release, Bd. Gov. Fed. Rsrv. Sys., *FRB Issues Policy Statement to Promote a Level Playing Field For All Banks With a Federal Supervisor, Regardless of Deposit Insurance Status* (Jan. 27, 2023), *available* here; *see also McDonough: Credit Risk and the "Level Playing Field*," Speech, FED. RSRV. BANK N.Y. (Nov. 2, 1998), *available* here.

[22] When a national bank makes a public welfare investment directly into a project or into a subsidiary, each project or investment individually must meet the Part 24 standards. However, in the case of an investment into a non-subsidiary community and economic development entity ("CEDE"), the activities of the CEDE, in the aggregate, must meet the primary beneficiary standards, such that a look-through approach applied to a public welfare fund could result in a risk weight based on the component parts that is greater than the 100 percent risk weight otherwise assigned to public welfare investments.

Further, the scope of short-term bank exposures eligible for the lower twenty percent and fifty percent risk weights should be expanded to all bank exposures with a maturity of three months or less.

Finally, a re-proposed rule should not apply or better tailor application of the operational risk requirements to Category III and IV organizations.

D. Increases in Equity RWA Would Make Renewable Energy Investments More Expensive.

In line with its commitment to support clients and communities, Key plans to continue to provide financing to solar and other green energy projects. In the future, Key's investments in these projects may also take the form of tax equity. Participating in the financing of these projects is an important part of Key's continued dedication to supporting its clients with expertise, new products, and new capabilities in their transition to an inclusive, equitable, and low-carbon economy. Beyond the importance of these projects to Key, these deals are a vital component of public policy initiatives to promote a more sustainable economy.[23]

The Proposed Rule would allow banks to assign a 100 percent risk weight to community development investments like LIHTC equity investments and new market tax credits on the rationale that these investments "generally receive favorable tax treatment and/or investment subsidies that make their risk and return characteristics different than equity investments in general."[24] Tax equity exposures, like LIHTC equity investments and new market tax credits, are subject to government oversight and restrictions, and have risk and return characteristics much different from other equity investments. The Proposed Rule, however, would treat tax equity investments in a manner inconsistent with LIHTC and new market tax credit investments by declining to extend a 100 percent risk weight to investments in renewable energy tax credits. This would deter banks from participating in such investments and would directly contradict other recent public policy initiatives which to fully succeed will require increased participation in tax equity markets.

Therefore, a re-proposed rule should specify that renewable energy tax equity investments would receive a 100 percent risk weight.

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[23] For example, "[t]he Inflation Reduction Act (IRA) is predominantly a tax incentive bill that extended and expanded federal tax incentives to decarbonize the U.S. economy, including technology such as clean energy manufacturing. . . . Energy finance experts believe that the current $20 billion annual market for tax equity must increase to more than $50 billion to meet the goals of the IRA and fulfill the demand created by the new incentives." *See* Congressman Sean Casten, Letter to Chairman Powell, Chairman Gruenberg and Acting Comptroller Hsu (Dec. 18, 2023), *available* here.

[24] 88 Fed. Reg. at 64077.

II. The Proposed Rule Would Make It More Difficult for Banks to Invest in Fintech and to Compete with Nonbanks, Reducing Bank Stature and Continuing the Trend of Banking Activities Moving to Unregulated Entities.

Top-performing banks maintain a consistent, strategic focus on technology and over the past ten years the percentage of banks' technology spending has grown on a steady basis. Technology investing has proven to be one of the best ways for banks to grow and retain business and to ensure that banks continue to meet customer and community needs, and a focus on technology partnerships and investment continues to be a point of focus for Key.

In this regard, Key has had success in multiple fintech partnerships that comprise both an equity investment and a commercial relationship; these equity investments allow Key to help drive innovation for the benefit of clients. For example, Key's strategic investment in and partnership with AvidXchange in 2015 allowed Key to deliver a best-in-class accounts payable automation solution to middle market and commercial clients. In 2017, Key made a strategic investment coupled with a commercial partnership with Billtrust to offer clients a comprehensive accounts receivable technology solution. More recently, in 2022, Key made a strategic investment in OvationCXM following the start of a commercial partnership that allowed Key to improve customer satisfaction via the company's journey orchestration and digital customer experience platform. These types of non-controlling strategic investments currently generally receive a 100 percent risk weight as a non-significant equity exposure, which makes them a cost-effective way for banks to partner with and invest in financial technology, but under the Proposed Rule, these types of investments would often receive a 400 percent risk weight as a non-publicly traded equity exposure, making them significantly more expensive.

Qualifying venture capital funds provide a similar benefit as small business investment companies to communities and are permitted investments under the Volcker Rule.[25] A 100 percent risk weight should also continue to apply to these investments. These funds also help

[25] *Compare* 15 U.S.C. § 661 ("It is declared to be the policy of the Congress and the purpose of this chapter to improve and stimulate the national economy in general and the small-business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply.") *with* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 46422, 46444 (Jul. 31, 2020) ("The agencies believe the exclusion for qualifying venture capital funds will support capital formation, job creation, and economic growth, particularly with respect to small businesses and start-up companies. These banking entity investments in qualifying venture capital funds can benefit the broader financial system by improving the flow of financing to small businesses and start-ups. The agencies expect that the new exclusion for qualifying venture capital funds will provide banking entities with an additional avenue for providing funding to smaller businesses, which can help to support job creation and economic growth.").

banks to partner with fintech companies and other innovative financial products in a cost-effective and low-risk way, helping regional banks to compete with nonbanks and global systemically important banks ("G-SIBs") and to continue meeting customer needs. A public policy that discourages investments by banks into nonbank financial service companies will make it harder for banks to compete, which could continue the trend of banking and financial services activities moving to less closely regulated nonbanks, and potentially creating additional systemic risk due to the lack of regulation.

Accordingly, the 100 percent risk weight for non-significant equity exposures should continue to apply, so as not to prevent otherwise safe and sound venture capital investments and direct strategic investments into fintech companies.

III. The Proposed Rule Is Not Appropriately Tailored for Banking Organizations Like Key.

The Proposed Rule would apply virtually identical capital requirements to Category II through IV banking organizations and thus would create a size cliff at $100 billion, including with respect to growth, mergers, and cost of credit. The Proposed Rule, particularly when combined with other pending proposals, presents a risk that a regional bank "desert" would be created between the $100 to $500 billion range, with little incentive for banks to remain in this size range or for smaller banks to grow.

In 2017, Chair Powell stated that "tailoring of regulation is one of [the FRB's] most fundamental principles." Under this fundamental principle, Chair Powell explained that the FRB believes regulation should "decrease in intensity and stringency as we move down through the regional banks and of the community banks."[26] This principle is reflected in the law. Section 165 of the Dodd-Frank Act, as amended by S. 2155, provides that the FRB "shall . . . differentiate among companies on an individual basis or by category," in prescribing prudential standards.[27] In addition, the statute requires additional considerations before the FRB may impose certain enhanced prudential standards on banking organizations that, like Key and other Category IV firms, have more than $100 billion in total assets but are not currently subject to those enhanced prudential standards.[28]

The Proposed Rule disregards what Chair Powell has described as one of the FRB's most fundamental principles. It is also inconsistent with the S. 2155 framework and imposes more punitive requirements for Category IV banks. Indeed, FRB Governors Bowman and Waller along with FDIC Vice Chair Hill each suggested that the Proposed Rule may violate the

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[26] Hearing Before the Senate Banking Committee on the Nomination of Jerome H. Powell, of Maryland, to be Chairman, Board of Governors of the Federal Reserve System (Nov. 28, 2017), *available* here.

[27] 12 U.S.C. § 5365(a)(2).

[28] 12 U.S.C. § 5365(a)(2)(C).

tailoring provisions as amended by S. 2155.[29] In this regard, the Proposed Rule would not appropriately differentiate between the size of institutions and is further inconsistent with Congress' express intent.

Further, the lack of tailoring in the Proposed Rule would negatively impact competition between differently sized banks. The overall effect of the Proposed Rule would be that regional banks would bear a disproportionate financial and operational burden relative to G-SIBs (which have more resources) and smaller banks (which would not be subject to the Proposed Rule), potentially causing regional banks to be less competitive with both G-SIBs and community banks. We believe clients, customers and communities are best-served when there is appropriate choice and competition in the financial services industry, which includes banking organization of all sizes. The regional banking "desert" that may result from this lack of tailoring could reduce the availability of competitive banking services for certain types of customers, particularly commercial clients of regional banks. Many small and medium-sized business have banking needs that are too big to be fully served by smaller banks, but that may not receive adequate attention from larger banks. These smaller and middle market businesses are a backbone to the economy, but they will likely find products and services less available and more expensive in a market where there are fewer regional banks.

A re-proposed rule should better incorporate tailoring, including by making the following changes:

- ***Exempt Category IV banking organizations from the countercyclical capital buffer (currently set at zero) and supplementary leverage ratio.*** Less than five years ago, the Agencies when extending the supplementary leverage ratio to Category III institutions also considered whether to apply the supplementary leverage ratio to Category IV institutions as well. The Agencies opted not to do so, noting that existing capital requirements for Category IV banking organizations "would maintain the risk sensitivity of the current capital regime and resiliency of [Category IV] banking

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[29] Bowman Statement, *supra* note 7 ("I am also concerned that today's proposal moves one step closer to eliminating the tailoring required by S. 2155 from the prudential capital framework."); *Statement by Governor Christopher J. Waller*, BD. GOV. FED. RSRV. SYS. (Jul. 27, 2023), *available* here ("[A]s this proposal applies to all firms with more than $100 billion in assets, I am concerned that we are headed down a road where we would be no longer in compliance with section 165 of the Dodd-Frank Act, as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act, which mandates tailoring for firms above $100 billion in assets and provides that firms with between $100 billion and $250 billion in assets are not subject to enhanced prudential standards unless a standard is affirmatively applied to such firms based on specific factors set out by Congress. It is unclear to me whether this proposal meets that statutory bar."); *Statement by Travis Hill, Vice Chairman, FDIC, on the Proposal to Revise the Regulatory Capital Requirements for Large Banks*, Speeches, Statements & Testimonies, FDIC (Jul. 27, 2023), *available* here [hereinafter "Hill Statement"] ("The proposal undoes almost all of the tailoring of the capital framework for large banks, and is a repudiation of the intent and spirit of S. 2155.").

organizations' capital positions" because Category IV firms have "lower risk-based indicator levels relative to their larger peers."[30]

- ***Retain the twenty-five percent capital deduction threshold.*** Retaining this threshold would be consistent with the Agencies' conclusions from their required ten-year review in connection with the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA")[31] and aid the transition resulting from the implementation of the current expected credit losses ("CECL") framework and the removal of the AOCI opt-out.

- ***The threshold for applicability of the market risk capital rule to Category III and IV banks should, as under the current rules, be based solely on average aggregate trading assets and trading liabilities, with the threshold adjusted to account for growth since the 1990s, as the Agencies have proposed.*** The revised and enhanced market risk rules in the Proposed Rule would have limited value for banking organizations like Key that engage in limited trading activities.

- ***Do not apply or better tailor application of the operational risk requirements to Category III and IV organizations.*** Operational risk is already accounted for in stress testing for Category III and IV organizations,[32] and, as the Agencies have previously explained, is also already incorporated to at least some degree in the risk weightings for credit risk,[33] so including a standalone operational risk calculation as currently proposed in the calculation of capital would be duplicative.

IV. Implementation of the Proposed Rule Would Result in Significant Increased Burden with Little Corresponding Benefit.

For an institution like Key, implementing the Proposed Rule would result in significant increased burdens with little corresponding benefit. We outline key issues below.

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[30] Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230, 59251 (Nov. 1, 2019).

[31] In promulgating final rules following Congress's enactment of the EGRPRA, the Agencies highlighted that "[r]elative to the treatment in the current rule, the [twenty-five] percent common equity tier 1 deduction threshold in the final rule may also serve to mitigate the adverse effects of potential increases in temporary difference [deferred tax assets] stemming from [the CECL framework] or from changes to the tax code." Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35234, 35239 (Jul. 22, 2019).

[32] *See* INSTRUCTIONS FOR THE CAPITAL ASSESSMENTS AND STRESS TESTING REPORTS (REPORTING FORM FR Y-14A) 5 (2022), *available* here.

[33] See Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord, 68 Fed. Reg. 45,900, 45,902 ("Because the general risk-based capital rules include a buffer for risks not easily quantified (for example, operational risk and concentration risk), general banks would not be subject to an additional direct capital charge for operational risk.").

A. The Dual Stack Calculation Framework Would Result in Capital Management Challenges.

Under the Proposed Rule, banking organizations like Key would be required to calculate their risk-based capital ratios under both the standardized approach and the "expanded risk-based approach," with the higher of the two being used to set the firm's minimum capital requirements—the so-called "dual stack calculation." The standardized approach would be calculated by adding general credit risk and market risk. The expanded risk-based approach would be calculated by adding total credit risk, equity risk, market risk, and CVA risk minus any adjusted allowance for credit losses not included in tier one or two capital and any amount of allocated transfer risk reserves.

The challenges in operational burdens associated with the dual stack calculation contradict its stated goals: to improve consistency and risk measurement.[34] Given the different inputs used to calculate the standardized approach and the expanded risk-based approach, the dual stack calculation may result in two different risk weights for the same product depending on the other elements of the capital calculation, leading to unpredictability and potential adverse product pricing as banks would have to assume the most punitive capital treatment, likely limiting capital made available for the economy. For example, a relevant factor in which stack is binding are the total operational losses calculated under the expanded risk-based approach, such that a large operational loss at an institution could have the effect of making the expanded-risk based approach the binding stack for that institution, which could then increase (or decrease) the risk weight that applies to certain exposures, such as commercial loans, entirely unrelated to the credit risk of those loans. In addition, the dual stack calculation would make it challenging to assess the actual cost of capital for different types of transactions or exposures and would create inconsistencies between institutions with respect to the same exposures, depending on which approach is binding at any point in time for each institution. For example, two similarly situated institutions each owning the same percentage share of the same loan or exposure would be required to apply different risk weights to the same exposure if one firm's binding capital stack is the standardized approach while the other firm's is the expanded risk-based approach. For banks like Key, these challenges in operational burdens bear no meaningful relationship to the loss absorbency benefit, if any, produced by the dual-stack approach.

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[34] *See* Bowman Statement, *supra* note 7 ("The first proposal under consideration would substantially increase risk-based capital requirements for banks with more than $100 billion in assets. In my view, there is insufficient evidence that the benefits produced by this proposal would justify the costs."); Hill Statement, *supra* note 29 ("[S]etting increasingly risk-sensitive standardized risk weights always involves choosing winners and losers, promoting homogeneity across the industry, and adding substantial complexity to the capital framework, along with the inevitability of misjudging and mispricing risk."); McKernan Statement, *supra* note 7 ("The dual-requirement structure also introduces internal inconsistencies that compound into incoherence.").

The dual stack calculation requirement should be removed and Key and other Category III and Category IV banking organizations should be permitted to elect to continue to calculate capital under only the standardized approach.

B. The Operational Risk Framework Is Overly Punitive Towards Business Lines That Rely Upon Noninterest and Fee-Based Income, and Operational Risk Loss Is Already Reflected in the Stress Testing / Stress Capital Buffer and the Operational Risk Charge.

The Proposed Rule's operational risk capital requirements are a large driver of the projected increase in risk weighted assets for Category III and IV banks, which are not currently subject to a separate operational risk requirement. The Proposed Rule's treatment of operational risk has been a source of criticism, even from within the Agencies.[35]

The formula for operational risk is BI multiplied by the ILM. Consistent with the Basel framework, BI would include fee/services income, which would be a significant contributor to operational risk capital. The ILM reflects an assumption that banks with a history of greater operational risk losses are more likely to experience operational risk losses in the future. The Proposed Rule, unlike the international implementations of Basel III, would floor ILM at one. Requiring Category III and IV banks to separately calculate operational risk in this manner provides little to no capital benefit and could negatively affect business lines that rely on noninterest and fee-based income, which are importance sources of revenue diversification for banks that would otherwise be even more dependent on net interest income.

Additionally, the capital stress tests and stress capital buffer calculations already incorporate a component related to a bank's ability to withstand operational risk losses. Banks already model and estimate operational losses in the annual Comprehensive Capital Analysis and Review ("CCAR") process. Specifically, Schedule E ("Operational Risk") of the FR Y-14Q requires a banking organization to submit its Operational Loss History data.[36] Because CCAR

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[35] *See* Hill Statement, *supra* note 29 ("[T]he [BI] component is in effect a proxy for size but it is a very different proxy for size than that which regulators use for any other purpose, and one that is especially punitive for fee-income businesses."); Bowman Statement, *supra* note 7 ("Today's proposal also adopts a punitive treatment for noninterest and fee-based income through the proposed operational risk requirements, exacerbated by the use of an internal loss multiplier that may result in an excessive overall capital charge for operational risk."); McKernan Statement, *supra* note 7 ("The first Basel consultative document acknowledged that this approach "does not lend itself to accurate application in the case of banks engaged predominantly in fee-based activities. The second consultative document reiterated that the approach resulted in "overcapitalization of banks with high fee revenues and expenses."); *see also* McKernan Remarks, *supra* note 14 (noting that the Basel Committee "acknowledged that its approach [to operational risk capital] would result in overcapitalization of banks with high-fee revenues . . . That leaves us trying to defend an approach for operational-risk capital that its own Basel authors have said does not work for high-fee-revenue banks.").

[36] BD. GOV. FED. RSRV. SYS., INSTRUCTIONS FOR THE CAPITAL ASSESSMENTS AND STRESS TESTING INFORMATION COLLECTION, REPORTING FORM FR Y-14Q 75 (2023), *available* here.

is already used to model the stress capital buffer, banks would expend unnecessary operational energy in reporting operational risk loss. Further, the addition of the operational risk capital charge would amount to double counting. Thus, the inclusion of an additional operational risk capital charge could result in duplicative operational efforts for banks like Key as well as double-counting.

The operational risk calculation requirement should not be applied to Category III or Category IV banks, or it should, at a minimum, be better tailored and reconciled with the stress capital buffer calculation to avoid double counting.

C. Market Risk / Credit Valuation Adjustment Is Not Appropriately Tailored to Category IV Banking Organizations.

The Agencies have historically recognized that only banking organizations with significant trading activities should be subject to market risk capital requirements. The current approach—which has remained in place for nearly three decades—places in scope firms "whose trading activities equals [ten] percent or more of its total assets, or whose trading activity equals $1 billion or more."[37] In adopting this approach, the Agencies rejected the concept of applying the market risk rule on the basis of "differential criteria based on total [asset] size," noting that "all institutions with significant market risk, regardless of size, should measure their exposure and hold appropriate levels of capital."[38] Under the current framework, the opposite is also true: a banking organization that does *not* have significant exposure to market risk is not subject to the market risk framework, even if it is of similar asset size to a banking organization that is subject to that framework.

The new market risk and CVA capital requirements would depart from this longstanding approach. The Proposed Rule would apply these requirements to all Category I through IV banking organizations without regard to an individual firm's average aggregate trading assets and trading liabilities. Other banking organizations would be subject to the rule if they had average aggregate trading assets and trading liabilities over the previous four calendar quarters equal to $5 billion or more, or equal to ten percent or more of total consolidated assets at quarter end. The applicability of the revised marker risk rule and CVA capital requirement is not appropriately tailored to the burdens that application of these standards to regional banks would entail, as most regional banks have relatively small trading books and present little risk to the overall trading market or the larger financial market because of such trading activity. As such, the immense resources and labor to develop enhanced programs outweighs any of the expected benefits of the market risk rule and CVA capital requirement.

[37] Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. 47358, 47361 (Sept. 6, 1996).
[38] 61 Fed. Reg. at 47361.

We believe that Agencies' current approach to the market risk rule is sound because, by tying applicability of the rule to trading assets and liabilities, the rule subjects only banking organizations with high levels of trading activities to market risk requirements. We also support the Agencies' proposal to raise the trading assets and liabilities threshold, which has not been adjusted for decades.

We therefore recommend that: (1) the threshold for the application of the market risk capital rules should continue to be based on a banking organization's market risk, not its overall size, and (2) if the Agencies determine that it is necessary to apply a market risk framework to banking organizations that, like Key, do not have extensive trading activities but are subject to the existing market risk capital rule, only the currently-applicable market risk framework should be retained for such organizations and the new market risk calculation should not apply. Additionally, similar to the approach taken under the Volcker Rule in which regulatory requirements increase as trading activity increases, the Agencies should consider the application of more stringent CVA capital requirements to only banks with significant trading books.

D. The Cap on AACL Results in Duplicative Counting of Capital Dollars.

The Proposed Rule would limit the inclusion of AACL[39] in the calculation of tier two capital at 1.25 percent of standardized total risk-weighted assets not including any amount of the AACL. AACL is, by its definition, a loss absorption concept. Imposing a limit on the inclusion of AACL in the calculation of tier two capital would require banks to count capital dollars earmarked for AACL more than once in the computation of tier two capital under the Proposed Rule.

Therefore, the limit on the amount of AACL includable in regulatory capital should be removed to ensure that AACL is not double-counted.

E. The Transition and Implementation Periods Are Inappropriately Short.

The Proposed Rule includes a three-year transition period from the date that the rule becomes effective to fully implement the rule. Most elements of the calculation of regulatory capital would apply upon the effective date of the rule. Notably, however, international proposals, such as those in the EU and UK, included a longer transition period.

There are a few aspects of the Proposed Rule that would make difficult a three-year transition and implementation period, and particularly impacted are any of the items that act as a deduction to capital, such as AOCI and deferred tax assets. Most notably, first, the Proposed Rule would remove the availability of the AOCI opt-out for Category III and IV firms after the

[39] Due to changes in GAAP, all large banking organizations no longer use ALLL (allowance for loan and lease losses). 88 Fed. Reg. at 64037.

three-year transition period. Second, the Proposed Rule would include a risk weight for retail exposures based on the exposure's status as a "transactor."[40] The Proposed Rule would apply an additional ten percent on top of the Basel framework's risk weights for such exposures. The data requirements for the classification of a retail exposure being "With Transactor" and "Without Transactor" would require significant resources.

Banks should be given the opportunity to effectively and carefully implement changes to regulatory capital requirements for safety and soundness reasons. The Proposed Rule inflicts a significant impact on many banks—particularly Category III and IV banks—and includes substantial enhanced data requirements.

Therefore, the transition and implementation period should be longer than the three years currently contemplated.

F. Increased Operational and Compliance Cost.

As the foregoing indicates, the Proposed Rule would make numerous changes to the regulatory capital rules currently applicable to Key and other regional banks. These changes would impose significant operational and compliance costs that far outweigh any corresponding benefits. Some of the costs of the Proposed Rule would be significant one-time costs; others significantly increase compliance costs on an ongoing basis.

For example, regional banks would need to develop and create new systems capable of producing newly required data; they would need to run two sets of capital calculations; and they would need to make continual and sustained investments in expertise and technology in order to complete many of the newly required calculations. Requiring banks to build out systems and make other investments to be able to comply with the Proposed Rule would have tangible impacts on lending (and could incentivize further consolidation in the banking industry or push activity into the unregulated "shadow" banking sector). Further, banks may choose to exit certain lines of business and be more selective in choosing consumers to lend to in order to comply with the capital requirements of the Proposed Rule. Indeed, FDIC Director McKernan warned that "regulatory capital could drive standardization in banks' business models and balance sheets, and perhaps even give regulators considerable influence over the pricing and allocation of investable funds."[41] There is limited evidence that increasing capital for large regional banks would have a meaningful net benefit for macroeconomic stability. Given the uncertain benefits of the Proposed Rule in contrast to the very clear costs and

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[40] A "transactor" is a borrower who is a natural person in relation to a credit facility such as a credit card or chart charge card where, for each of the previous twelve months, the borrower has either paid the balance in full at each scheduled payment or has not drawn on the facility.

[41] McKernan Remarks, *supra* note 14.

complexity of the Proposed Rule, Key believes the Proposed Rule is not appropriately balanced as applied to regional banks.[42]

A re-proposed rule should more thoroughly consider operational compliance burdens, particularly with regard to regional banking organizations.

V. Conclusion.

The Proposed Rule's risk weights on consumer products would harm LMI communities and conflict with the policy goals of the CRA. Additionally, the Proposed Rule would make it more difficult for banks to invest in fintechs and to compete with nonbanks, continuing the trend of banking activities moving to unregulated entities that may be less willing, or able, to serve LMI communities and small businesses. Further, the Proposed Rule is not appropriately tailored to banking organizations like Key and would result in sizeable burdens that significantly outweigh the purported benefits. For these reasons, Key respectfully submits that the Agencies should re-propose the Proposed Rule to correct the issues identified in this letter.

* * *

Key appreciates the opportunity to provide comments to the Proposed Rule and respectfully asks for the Agencies' consideration of the recommendations and suggestions in this letter. If you have any questions regarding the content of this letter or would like more information on the subject, please do not hesitate to contact the undersigned.

[Signature page follows.]

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[42] *See* McKernan Remarks, *supra* note 14.

Respectfully submitted,

KeyCorp

By:________________________
Clark H.I. Khayat
Chief Financial Officer

Appendix

Proposed Revisions to be Included in a Re-Proposal of the Proposed Rule

For ease of reference, the following lists the proposed revisions Key believes should be included in a re-proposal of the Proposed Rule included throughout the comment letter.

1. The twenty percentage point increase on the Basel framework for residential mortgages should be removed.

2. A re-proposed rule should implement a fifty percent risk weight for multifamily projects, whether ADC or completed.

3. The zero percent credit conversion factor for unconditionally cancelable commitments should be retained.

4. A re-proposed rule should be calibrated by revising down by ten percent the risk weights for regulatory retail exposures to make them consistent with the risk weights of the Basel Framework.

5. A re-proposed rule should explicitly clarify that investments into funds that qualify as Part 24 investments would receive a 100 percent risk weight.

6. To further incentivize investments necessary to address the country's shortage of affordable housing, decrease the risk weight applicable to financing for affordable housing.

7. The scope of short-term bank exposures eligible for the lower twenty percent and fifty percent risk weights should be expanded to all bank exposures with a maturity of three months or less.

8. A re-proposed rule should specify that renewable energy tax equity investments would receive a 100 percent risk weight.

9. The 100 percent risk weight for non-significant equity exposures should continue to apply.

10. A re-proposed rule should better incorporate tailoring, including by (a) exempting Category IV banking organizations from the countercyclical capital buffer and supplementary leverage ratio and (b) retaining the twenty-five percent capital deduction threshold.

11. The dual stack calculation requirement should be removed and Key and other Category III and Category IV banking organizations should be permitted to elect to continue to calculate regulatory capital under only the standardized approach.

12. The operational risk calculation requirement should not be applied to Category III or Category IV banks because the stress capital buffer calculations applicable to such banks are already reasonably conservative. If operational risk capital charges are applied to Category III or Category IV banks they should, at a minimum, be better tailored and reconciled with the stress capital buffer calculation to avoid double counting.

13. The threshold for the application of the market risk capital rules should continue to be based on a banking organization's market risk, not its overall size, with the threshold adjusted to account for growth since the 1990s, as the Agencies have proposed. If the Agencies determine that it is necessary to apply a market risk framework to banking organizations that, like Key, do not have extensive trading activities but are subject to the existing market risk capital rule, only the currently-applicable market risk framework should be retained for such organizations and the new market risk calculation should not apply.

14. Similar to the approach taken under the Volcker Rule in which regulatory requirements increase as trading activity increases, the Agencies should consider the application of more stringent CVA capital requirements to only banks with significant trading books.

15. The limit on the amount of AACL includable in regulatory capital should be removed to ensure that AACL is not double counted.

16. The transition and implementation period should be longer than the three years currently contemplated.

17. A re-proposed rule should more thoroughly consider operational compliance burdens, particularly for regional banking organizations.