January 16, 2024

Via Electronic Mail

Chief Counsel's Office
Attention: Comment Processing, Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Ms. Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
(RIN 3064–AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Notice of Proposed Rulemaking on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity. OCC Docket ID OCC–2023–0008, RIN 1557–AE78; Federal Reserve System Docket No. R–1813, RIN 7100–AG64; FDIC RIN 3064–AF29.

Dear Sirs and Madams:

We appreciate the opportunity to comment on proposed joint rulemaking by the Office of the Comptroller of the Currency, Treasury (the "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") to the current

regulatory capital rule for large banking organizations and banking organizations with significant trading activity (the "Capital Rule Proposal" or "Proposal").[1] We submit this letter on behalf of Ally Financial Inc., Detroit, Michigan; Citizens Financial Group, Inc., Providence, Rhode Island; Comerica Incorporated, Dallas, Texas; Discover Financial Services, Riverwoods, Illinois; Fifth Third Bancorp, Cincinnati, Ohio; First Citizens Bancshares, Inc., Raleigh, North Carolina; Huntington Bancshares Incorporated, Columbus, Ohio; KeyCorp, Cleveland, Ohio; New York Community Bancorp, Inc., Hicksville, New York; and Regions Financial Corporation, Birmingham, Alabama (the "Responding Banking Organizations"). The Responding Banking Organizations are either subject to Category IV banking standards or have total assets that are approaching Category IV's total asset threshold of $100 billion. In light of our size and position in the market, we submit this letter to comment on features of the Proposal that are of concern to banking organizations that have, or expect to have, more than $100 billion, but less than $250 billion, in total consolidated assets and their subsidiary depository institutions (the "Category IV Firms").

The Responding Banking Organizations consist primarily of traditional regional banking organizations that focus predominantly on domestic business activities. The Responding Banking Organizations have relatively simple operating models and none engage in significant trading or international activities or have meaningful interconnections with other financial firms. The Responding Banking Organizations are integral to the Main Street economy, but are less complex and much less likely to pose a systemic risk to the U.S. financial system than Category I, II and III banking organizations. While Silicon Valley, First Republic and Signature Bank showed that banking organizations other than those in Categories I, II and III can pose risks, those three institutions had unique features that created undue exposure and made them very different from the Responding Banking Organizations.[2]

This letter focuses on aspects of the Proposal of special importance to Category IV Firms. First, we underscore that the Proposal suffers because it is misaligned with the statutory tailoring framework by imposing the same capital requirements on banking organizations with over $100 billion in total consolidated assets regardless of comparative size, complexity or risk. There is no data or economic analysis that supports disregarding the statutory requirements. Thus, we strongly recommend that Category IV Firms not be subject to the dual-stack approach. Second, given the lack of data or rationale addressing the changes, the Agencies should delay implementing the Proposal until they release a comprehensive quantitative assessment of its impact. Third, if the expanded risk-based approach is applied to Category IV Firms, there are several key components that should be tailored in the framework's application to Category IV Firms. Fourth, the expanded risk-based approach should be revised as it applies to all banking organizations in several key areas

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[1] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64,028 (Sept. 18, 2023).

[2] Examples of such unique features include rapid growth in deposits that were invested in large interest-sensitive portfolio exposures, instead of through diverse lending activities; increased business complexity and size that were not met with enhanced corporate governance and risk management frameworks; overwhelming reliance on uninsured deposits; and concentrated business models with higher risk customers. *See, e.g.*, Federal Reserve, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (Apr. 28, 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf; FDIC, *FDIC's Supervision of Signature Bank* (Apr. 28, 2023), https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf.

to minimize harm to traditional banking activities. Fifth, the Proposal's Standardized Approach for calculating a banking organization's operational risk capital should be revised to reflect the actual risk level of banking organizations. Finally, the proposed transition and implementation period does not provide banking organizations with sufficient time to comply with the Proposal's new requirements.

We believe that our concerns can be resolved in a manner that better aligns the Proposal with the Basel Framework and the Agencies' policy goals. We further note that any review of the capital rules must be done in consideration of other regulatory initiatives, including the proposal related to long-term debt requirements. While this letter is intended to highlight areas of specific concern of the Responding Banking Organizations, we also support the comment letters regarding the Proposal submitted by the American Bankers Association and the Bank Policy Institute.

I. The Proposal is misaligned with the governing statute because many of the proposed revisions to the current regulatory capital rule are not tailored.

A. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act ("S. 2155"), established a tailoring framework.

Section 165 of the Dodd-Frank Act was enacted with a general purpose "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions."[3] Section 165 directs the Federal Reserve to establish enhanced prudential standards for financial institutions with $250 billion or more in total consolidated assets.[4] Congress made clear that the Federal Reserve must "prescrib[e] more stringent prudential standards" in a way that differentiates between financial companies (either on an individual basis or by category) according to "capital structure, riskiness, complexity, financial activities (including financial activities of subsidiaries), size" and other factors that reflect the level of risk to U.S. financial stability.[5]

Section 165 further provides that the Federal Reserve may apply enhanced prudential standards to any bank holding company or bank holding companies with total consolidated assets between $100 billion and $250 billion, which include the Responding Banking Organizations, under certain circumstances.[6] Before the Federal Reserve can apply enhanced prudential standards to banking organizations with total consolidated assets between $100 billion and $250 billion, the Federal Reserve must determine that applying the prudential standard is appropriate "to prevent or mitigate risks to the financial stability of the United States" or "to promote the safety and soundness of the bank holding company or bank holding companies."[7] The Federal Reserve's determination must account for the banking organization's risk to financial stability.[8]

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[3] 12 U.S.C. § 5365(a)(1).
[4] *Id.*
[5] *Id.* at § 5365(a)(2).
[6] *See id.*
[7] *Id.* at § 5365(a)(2)(C)(i).
[8] *Id.*

In 2018, Congress amended the Dodd-Frank Act when it passed S. 2155.[9] S. 2155, among other things, raised the threshold for the designation of systemic importance from $50 billion to $250 billion in assets. This change in threshold impacted whether and how enhanced prudential standards apply to certain institutions, such that it raised the asset threshold for general application of enhanced prudential standards from $50 billion to $250 billion. This statutory shift reflects Congress's intent to apply materially less demanding requirements on banking institutions with less risk than larger banking organizations that present the greatest risks. Accordingly, after S. 2155's passage, an Agency leader acknowledged that final rules must tailor regulations for firms with under $250 billion in total assets in a manner that comports with the level of risk posed by the firm.[10]

B. Contrary to statutory language and congressional intent, the Proposal requires all banking organizations with over $100 billion in total consolidated assets to comply with the same capital requirements without regard to comparative size, complexity or riskiness.

The Proposal ignores the tailoring framework established by the Dodd-Frank Act, as amended by S. 2155, and, instead, imposes fundamentally identical capital ratio calculations and requirements on all banking organizations within Categories I, II, III and IV. In particular, the following five parts of the Proposal would cut against the Dodd-Frank Act's tailoring framework and show that the Proposal is inconsistent with the statutory tailoring requirement:

- First, all banking organizations within Categories I, II, III and IV would have to calculate risk-weighted assets ("RWAs") using the same burdensome dual-stack approach.

- Second, every banking organization, regardless of category, would have to recognize unrealized gains and losses on available-for-sale debt securities and most other elements of accumulated other comprehensive income ("AOCI") in regulatory capital.

- Third, Category III and IV banking organizations would have to apply capital deductions and minority interest treatments currently required only of Category I and II banking organizations.

- Fourth, banking organizations in all four Categories would have to apply the Supplementary Leverage Ratio ("SLR") and countercyclical capital buffer ("CCyB") to dual-stack RWA calculations.

[9] Pub. L. 115.–174; 132 Stat. 1296.
[10] *See, e.g.*, Federal Reserve, Press Release, *Opening Statement by Chair Jerome H. Powell* (Oct. 10, 2019), https://www.federalreserve.gov/newsevents/pressreleases/powell-opening-statement-20191010.htm.

- Fifth, the calculation of market RWAs for every banking organization in Categories I, II, III and IV would be the same under the revised market risk capital rule.

Instead of being aligned with S. 2155's framework, the Proposal flatly ignores the statutory $250 billion threshold and sets a new threshold of $100 billion without justifying it or considering how a lower threshold would impact the U.S. financial system. We believe that the Agencies' blanket application of requirements to all banking organizations is misguided. In the aggregate, assets of Category IV Firms are less than the total assets of each of the two largest U.S. banking organizations, and the business activities of Category IV Firms are far less complex. The notion that Category IV Firms should be subject to the same gold-plating capital requirements and require the same resourcing is not logical. Even more, applying the same capital requirements to Category IV Firms would put key regional banks at a competitive disadvantage against the largest globally systemically important banks, smaller banking organizations not covered by the Proposal, and nonbanks. Indeed, increased capital requirements are associated with increased long-run exit rates of smaller banking organizations and a more concentrated industry overall.[11] This increase in long-run exit rates is driven by a drop in their profitability, and the net impact of heightened capital requirements is a sharp decrease in aggregate lending in the short run.[12] These effects have meaningful consequences for Category IV Firms and consumers alike, making it more difficult for regional banks to offer competitively priced traditional banking services relied upon by a wide range of consumers and communities. Harvard professor and former Federal Reserve Board member Daniel Tarullo emphasized the risks that heightened regulatory requirements pose to mid-sized regional banks, which include several of the Responding Banking Organizations.[13] Professor Tarullo describes the risk that more stringent regulations will create a less competitive and more concentrated industry.[14]

Ultimately, applying the same requirements for calculating capital and RWAs to all banking organizations with $100 billion or more in total assets, without any consideration of the statutory tailoring factors, would have far-reaching consequences on the U.S. banking industry. This is especially so given the cliff effects associated with crossing the $100 billion asset threshold, which will heavily effect banking organizations that are approaching the Proposal's $100 billion asset threshold. These cliff effects will curtail the growth of banking organizations, suppress acquisition activity, harm competition, limit the cost and availability of credit, and constrain mortgage servicing activity. Indeed, research published by the American Economic Association has found that regulatory cliff effects can heighten systemic risk.[15] The inevitable negative impact

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[11] *See* Dean Corbae & Pablo D'Erasmo, *Capital Requirements in a Quantitative Model of Banking Industry Dynamics*, Nat'l Bureau of Econ. Rsch. (Jan. 2019), https://www.nber.org/system/files/working_papers/w25424/w25424.pdf. Specifically, "a rise in capital requirements from 4% to 8.5%" has been found to result in "an increase in long run exit rates" of smaller banking organizations. *Id.* at 3.

[12] In the aggregate, lending across larger and smaller banking organizations decreases by "over 16% in the short run and nearly 1% in the long run." *Id.*

[13] David Wessel, *Talking to Dan Tarullo About Bank Mergers, Stress Tests, and Supervision*, Hutchins Ctr. on Fiscal & Monetary Policy at Brookings (Aug. 10, 2023), https://www.brookings.edu/wp-content/uploads/2023/08/ Talking-to-Dan-Tarullo-about-bank-mergers-stress-tests-and-supervision.pdf.

[14] *See generally id.*

[15] *See generally* Andreas Brøgger & Graeme Cokayne, *Regulatory Cliff Effects and Systemic Risk*, Am. Econ. Ass'n (2018).

of cliff effects on the U.S. banking industry is contrary to the Agencies' stated goals of "reduc[ing] risks to U.S. financial stability" and "promot[ing] competitive equity among U.S. banking organizations and their foreign peers and competitors."[16]

It is our view that the Proposal's failure to adhere to the statutory tailoring framework necessitates full reconsideration of the Proposal. In such reconsideration, we encourage the Agencies to calibrate enhanced prudential standards and requirements according to the risk of the relevant banking organizations. While such requirements will require additional infrastructure and resources for many of the Category IV Firms, they should not be so burdensome as to be cost-prohibitive for banking organizations just over or nearing $100 billion in total consolidated assets.

With these overarching concerns regarding the Proposal's lack of tailoring in mind, our specific suggestions to align with the legislative intent of tailoring are set forth in Parts III through VII.

II. The Agencies should, at minimum, delay the Proposal's implementation until the Agencies release a sufficient study on the Proposal's impact.

As described above, the Responding Banking Organizations have meaningful concerns about a number of parts of the Proposal. Our concerns are exacerbated by the dearth of evidence supporting several of the Proposal's key requirements or demonstrating that the potential benefits of the Proposal justify the costs. For example, the Proposal does not provide any evidence to support the Agencies' decision to raise the risk weights for residential real estate and retail credit exposures. Nor do the Agencies provide information regarding the impact of the dual-requirement structure for calculating each bank's RWAs. This lack of evidence and information regarding the impact of the Proposal is at odds with the foundational principles that the Agencies must provide enough information to facilitate meaningful comment periods and supply a reasoned explanation for its policies.[17]

The Agencies have acknowledged that the Proposal does not contain enough data and information and promised to provide more information on the Proposal's impact before a rule is finalized.[18] We welcome the Agencies' commitment to conducting a quantitative impact study on the Proposal's effect on capital requirements for banking organizations.[19] We further urge the Agencies to study not only the impact on banking organizations, but how proposed regulations impact consumers, small businesses and the health of the broader financial system. The Agencies

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[16] Capital Rule Proposal, *supra* note 1, at 64,032, 64,095.

[17] *See Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983); *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

[18] *See, e.g.*, Federal Reserve, *Proposals that Would Amend Capital Requirements for Large Banking Organizations in Line with the Basel III Accord and Modify Risk-Based Capital Surcharges Applicable to U.S. GSIBs* (July 18, 2023), https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-memo-20230727.pdf; Federal Reserve, *Statement by Vice Chair for Supervision Michael S. Barr* (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm.

[19] *See* Federal Reserve, *Federal Reserve Board Launches Data Collection to Gather More Information from the Banks Affected by the Large Bank Capital Proposal It Announced Earlier This Year* (Oct. 20, 2023), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.

should publish such a quantitative study and allow the public sufficient time to review and evaluate the results of the study.

The Agencies should re-propose any revisions to the current capital rule only after they conduct and publicly release a robust quantitative study. At minimum, implementation of any final rule should be delayed until the Agencies conduct a thorough quantitative study, share findings with the public and allow for adequate comment. At this point, there is not enough information about the Proposal's impact to allow the public to assess the Proposal and provide Agencies with necessary comment.

III. The Proposal's dual-stack framework for calculating risk-weighted assets should be eliminated for Category IV Firms.

Under the current U.S. regulatory capital rule, the manner in which banking organizations calculate their risk-based capital differs depending on the bank's category. Category I and II banking organizations are required to use both Advanced Approaches and the Standardized Approach to model risk when calculating RWAs, but Category III and IV banking organizations can elect to calculate RWAs using less complex methods than the procedures that meet requirements for Advanced Approaches. Allowing Category III and IV banking organizations to calculate RWAs using a different method is consistent with the tailoring framework.

Under the Proposal, banking organizations would have to calculate RWAs with a dual-stack approach, which is even more onerous than the dual-stack approach that is currently applicable only to larger Category I and II banking organizations. The proposed dual-stack approach would require Category IV Firms to calculate RWAs with both a Standardized Approach (which prioritizes consistency across banking organizations by basing capital requirements on regulatory risk weights) and a new expanded risk-based approach (which would include market RWAs under the new market risk capital rule). After making both calculations, banking organizations must use the lower, less favorable capital ratio to determine whether they comply with minimum requirements and buffer requirements, including the stress capital buffer (the "SCB"), regardless of whether the expanded risk-based approach or the Standardized Approach produces the lower capital ratio.[20]

The Proposal would impose this dual-stack approach on all firms with total assets of $100 billion or more and their subsidiary depository institutions in order "[t]o ensure that large banking organizations would not have lower capital requirements than smaller, less complex banking organizations."[21] However, the Agencies do not address how the proposed dual-stack approach achieves the Basel framework's goal of adequate risk sensitivity above and beyond a single-stack

[20] The Responding Banking Organizations would also like to observe an apparent inconsistency in the Proposal's dual-stack approach calculation. In certain circumstances, such as in the case of a commercial exposure, the binding risk weight across the two stacks will differ. Under the Proposal, a determination as to which stack will be binding would be based on various factors (*e.g.*, total operational losses for operational capital), such that a Category IV Firm applying a 100% credit risk weight to commercial loans may end up using the lower risk weight because it experienced operational losses that make the expanded approach the binding stack. This inconsistency is not addressed in the Proposal.

[21] Capital Rule Proposal, *supra* note 1, at 64,030.

approach.[22] Instead of providing a thorough analysis of the risk sensitivity of the Proposal's dual-stack approach, the Agencies assert that the proposed dual-stack approach "would be more risk-sensitive than the [current single stack Standardized Approach] by incorporating more credit-risk drivers (for example, borrower and loan characteristics) and explicitly differentiating between more types of risk (for example, operational risk, credit valuation adjustment risk)" and, as a result, would "better account for key risks faced by large banking organizations."[23] However, the Preamble does not provide any data to support requiring Category IV Firms to undertake, regardless of complexity, a substantial operational and compliance buildup to conduct two different calculations that will, based on estimates, yield results that are substantially similar for certain Category IV Firms. For these reasons, we recommend that the Agencies do not apply the dual-stack approach to Category IV Firms and instead apply the Standardized Approach for calculating RWAs to Category IV Firms, with an option to allow Category IV Firms to opt-in to an expanded risk-based approach, tailored in a manner consistent with the recommendations set forth in Part IV.

IV. To remain consistent with the statutory tailoring framework, if an expanded risk-based approach is applied to Category IV Firms, it should be tailored to reflect their business models.

A. The Proposal's new framework for calculating risk-weighted assets defies the Dodd-Frank Act's tailoring framework.

The Proposal's expanded risk-based approach is inconsistent with the Dodd-Frank Act's tailoring framework. The Agencies specifically highlight that the Proposal would "align the calculation of regulatory capital – the numerator of the regulatory capital ratios – with the calculation for banking organizations subject to Category I or II capital standards, providing the same approach for all large banking organizations."[24] The Agencies' failure to distinguish Category IV Firms from larger, more complex banking institutions is inappropriate considering S. 2155's recognition of a threshold of $250 billion in total assets to differentiate banking organizations that should, and should not be, subjected to heightened regulatory requirements based solely on their size.[25] The Proposal's non-recognition of a $250 billion RWA threshold is even more remarkable considering that there was a $250 billion RWA threshold under the Advanced Approaches framework that preceded the current statutory framework.[26]

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[22] *See id.*
[23] *Id.* at 64,030.
[24] *Id.* at 64,031.
[25] The language of S. 2155 does contemplate the application of more stringent prudential standards to banking organizations with over $100 billion in total assets, but only when the Federal Reserve accounts for a banking organization's risk-related factors (*e.g.*, capital structure, riskiness, complexity, financial activities and size) and determines that such prudential standards are needed to "prevent or mitigate risks" to U.S. financial stability or "to promote the safety and soundness" of the banking organization. 12 U.S.C. § 5365(a)(2)(C). The Proposal is improper because it fails to engage in the analysis required by S. 2155 before applying prudential standards to Category IV Firms.
[26] The Responding Banking Organizations acknowledge that the Advanced Approaches framework also applied to banking organizations with $10 billion or more in total on-balance sheet foreign exposure and the depository subsidiaries of those banking organizations. Federal Reserve, *Basel Regulatory Framework* (Feb. 13, 2017), https://www.federalreserve.gov/supervisionreg/basel/advanced-approaches-capital-framework-implementation.htm.

The Agencies seek to impose a dual-stack approach on all firms with total assets of $100 billion or more and their subsidiary depository institutions in order "[t]o ensure that large banking organizations would not have lower capital requirements than smaller, less complex banking organizations."[27] However, the Agencies do not address whether their proposed approach is adequately risk sensitive, which is a key objective of the Basel III reforms.[28] Instead of providing a thorough analysis of the risk sensitivity of the Proposal's requirements, the Agencies assert that the expanded risk-based approach "would be more risk-sensitive than the [current Standardized Approach] by incorporating more credit-risk drivers (for example, borrower and loan characteristics) and explicitly differentiating between more types of risk (for example, operational risk, credit valuation adjustment risk)" and, as a result, would "better account for key risks faced by large banking organizations."[29] However, the Preamble does not provide any data to support requiring Category IV Firms to undertake, regardless of complexity, a substantial operational and compliance buildup to manage risks they do not currently have.

B. The Agencies should tailor the expanded risk-based approach to better align requirements with actual risks posed by Category IV Firms and avoid the harms associated with overcapitalization.

A broad application of the expanded risk-based approach will significantly increase compliance costs for Category IV Firms, which are essentially regional banks. Indeed, if the expanded risk-based approach were applied to Category IV Firms, those organizations would be subjected to requirements more stringent than those in place before Congress passed S. 2155. The additional costs related to the Proposal's new requirements will be incurred not only during the initial implementation of the framework; ongoing resourcing requirements will also impose significant costs for Category IV Firms. Indeed, the Responding Banking Organizations expect to need to hire additional full-time staff and engage experts on an ongoing basis to maintain compliance with the Proposal's framework.

Increasing capital, particularly on the type of traditional banking activities at the center of the operating models of the Responding Banking Organizations, without regard to the relevant risks actually faced by a specific banking organization, discourages the offering of key banking services and is contrary to the general policy objectives and mission of the Agencies. Overcapitalization fails to achieve a clear benefit that would outweigh associated costs, and it also disincentivizes Category IV Firms from providing traditional banking products. A decline in traditional banking products will heighten risks to U.S. financial stability posed by increasing the participation of nonbank financial companies, including private credit firms and alternative mortgage lenders, who will likely absorb the market share that Category IV Firms can no longer serve. Increased competition from nonbanks, coupled with the increased costs associated with higher capital requirements, will strain Category IV Firms by decreasing their ability to pass on

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However, all of the Responding Banking Organizations have significantly less than $10 billion in total on-balance sheet foreign exposure.

[27] Capital Rule Proposal, *supra* note 1, at 64,030.

[28] *See id.*

[29] *Id.* at 64,030.

those increased funding costs.[30] Even more, a working paper published by the Basel Committee indicates that increased capital requirements result in bank credit that is more costly to borrowers and further shows that a 1% increase in capital requirements is associated with an increase of approximately 13 basis points in lending spreads.[31] Therefore, the Agencies' proposal to increase capital requirements is likely to result in financing and services that are more expensive for small business and everyday consumers. We describe the negative effects on banking services in further detail in Part V.

Furthermore, the Proposal's expanded and complex market risk and credit valuation adjustment ("CVA") requirements are not appropriate in light of the fact that Category IV Firms do not have substantial trading activities. These requirements would be applied to banking organizations that are not currently subject to the market risk capital rule because they have less than $1 billion in aggregate trading assets plus trading liabilities, as well as other banking organizations with between $1 billion and $5 billion in aggregate trading assets and liabilities.[32] If applied to banking organizations that, like the Responding Banking Organizations, have limited trading activities, these market risk, CVA and operational risk requirements would result in substantial compliance and operational burdens that are not commensurate with actual market risk exposures. The Proposal provides a potential exclusion whereby the Agencies may exclude a banking organization that would otherwise be subject to enhanced market risk and CVA capital requirements if it "determines that the exclusion is appropriate based on the level of market risk or level of CVA risk, respectively, of the [banking organization] and is consistent with safe and sound banking practices." [33] However, the Proposal does not describe a process or standards for making such a determination and introduces unnecessary applications and uncertainty.

For these reasons, we recommend the following modifications to appropriately tailor the expanded risk-based approach for Category IV Firms:

- First, the Proposal's market risk, CVA and operational risk requirements should be revised to calibrate to a banking organization's complexity. We recommend that the Agencies clarify that, if banking organizations do not meet the defined levels of complexity, they should not be subject to the enhanced market risk and CVA requirements. We further strongly urge the Agencies to tailor the expanded risk-based approach for Category IV Firms to also remove the operational risk requirements.

- Second, the CCyB and the SLR requirements for Category IV Firms should be removed. There is substantial history from the Agencies explaining why the CCyB and the SLR should be applied only to the largest and most complex banking

[30] *See* Basel Committee on Banking Supervision, *Working Paper 37: The Costs and Benefits of Bank Capital – A Review of the Literature* (June 2019), https://www.bis.org/bcbs/publ/wp37.pdf.
[31] *See id.*
[32] *See* Capital Rule Proposal, *supra* note 1, at 64,095–96.
[33] *Id.* at 64,229.

organizations (*i.e.*, generally those with $250 billion or more in total assets).[34] If the Agencies do apply these requirements to Category IV Firms, they should develop a tailored program that acknowledges the smaller size and different risk profiles of these banking organizations.

- Third, the requirement to apply the Standardized Approach to counterparty credit risk ("SA-CCR") should be removed. In 2020, the finalized capital rule explicitly permitted Category IV Firms to adopt SA-CCR or to use the current exposure method. At such time, the Agencies correctly recognized that adopting SA-CCR would "require[] internal systems enhancements and other operational modifications that could be particularly burdensome for smaller, less complex banking organizations."[35] There is no evidence that such option caused issues and there is no rationale for why the Agencies now believe that such additional burden is necessary to impose on Category IV Firms.

- Fourth, the Agencies should calibrate the SCB using a Standardized Approach. The Agencies highlight that the purpose of the SCB is to contribute "to the robustness and risk-sensitivity of the risk-based capital requirements" of the relevant banking organizations,[36] but they ignore the fact that applying the SCB to the revised methods for calculating RWAs would effectively require banking organizations to capitalize the same risks twice. To avoid complexity and overstating risk, especially with respect to operational risk, the SCB should be applied to the Standardized Approach for capital calculation.

V. The expanded risk-based approach should be revised in several key areas to minimize harm to traditional banking activities.

Though we believe that the expanded risk-based approach should not be applied to Category IV Firms in its current form, if the tailored version of the expanded risk-based approach remains applicable to Category IV Firms, we recommend revising five aspects of the expanded risk-based approach for all banking organizations, as they would better align the Proposal with the Basel Framework and the Agencies' policy objectives.

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[34] *See* Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59,230, 59,251 (Nov. 1, 2019) (regarding lower risk-based indicator levels of Category IV Firms); 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. 62,018, 62,031 (Oct. 11, 2013) (regarding initial implementation of Basel III in the United States); *see also* Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792, 52,805 (Aug. 30, 2012) (regarding the interconnectedness of large banking organizations).

[35] Standardized Approach for Calculating the Exposure Amount of Derivative Contracts, 85 Fed. Reg. 4,362, 4,367 (Jan. 24, 2020).

[36] Capital Rule Proposal, *supra* note 1, at 64,034–35.

A. To reduce harm to low- and moderate-income ("LMI") homebuyers, the Proposal's risk weights for residential real estate exposures should be lowered to match the Basel Framework.

The Proposal's risk weights for residential real estate exposures are 20 percentage points higher than corresponding risk weights in the Basel Framework.[37] Despite this marked difference, the Agencies do not offer an empirical rationale for this increase. The Agencies also do not address the potential impact on the cost or availability of mortgage loans associated with these higher risk weights. Like FDIC Director McKernan, we are concerned that this heightened capital requirement could increase burdens faced by LMI homebuyers by increasing the interest rates for these borrowers. Research conducted by the Bank Policy Institute suggests that LMI borrowers with loans that originate in 2022 will have an average risk weight of approximately 57.5% under the Proposal.[38] That same research indicates that the average risk weight for loans to non-LMI borrowers would be a significantly lower 52.6%.[39] Additionally, increased capital requirements would further incentivize banking organizations to exit mortgage lending, which is already dominated by nonbank lenders.

We believe that the risk weights for residential real estate exposures in the Proposal should be changed to match corresponding risk weights in the Basel Framework. As FDIC Director McKernan observes in his statement dissenting from the Proposal, the risk weights in the Basel Framework are better aligned with the actual risk posed by residential real estate exposures, as demonstrated in a proposal and analysis submitted by U.S. bank regulators to the Basel Committee when the Basel Framework was being developed.[40]

B. The Agencies should adopt risk weights consistent with the Basel Framework for bank exposures.

The Basel Framework provides that short-dated exposures to banks are subject to lower risk weights than those applicable to other exposures to banks.[41] The Proposal would apply the risk weights in Table 2 of Section 111 to all exposures to banks, regardless of their original maturity dates.[42] The Proposal's risk weights are up to 25 percentage points higher (depending on the grade of the exposure) than the risk weights that apply to short-dated exposures under the Basel Framework. Despite the magnitude of this difference, the Proposal's Preamble offers limited rationale for the Proposal's deviation from the Basel Framework. Nor does the Preamble address why the Basel Committee's reasoning for applying the lower risk weights for short-term bank

[37] *Compare id.* at 64,190 (listing risk weights from 40% to 90% in Table 5 to § _.111), *with* Basel Committee on Banking Supervision, *CRE Calculation of RWA for Credit Risk; CRE20 Standardized Approach: Individual Exposures* 20.82 (listing equivalent risk weights from 20% to 70%); *see also* FDIC, *Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework* (July 27, 2023), https://www.fdic.gov/news/speeches/2023/spjul2723c.html [hereinafter, the "McKernan Statement"].

[38] Paul Calem & Francisco Covas, *The Basel Proposal: What it Means for Mortgage Lending*, The Bank Policy Inst. (Sept. 30, 2023), https://bpi.com/the-basel-proposal-what-it-means-for-mortgage-lending/.

[39] *Id.*

[40] *See* McKernan Statement, *supra* note 37.

[41] *See* Basel Committee on Banking Supervision, *supra* note 37, at 20.19.

[42] *See* Capital Rule Proposal, *supra* note 1, at 64,188–89.

exposures "to avoid interference with monetary policy channels and to prevent any negative impact on market liquidity in interbank markets" is not suitable for U.S. banking organizations.[43] The Proposal does not provide any rationale for limiting short-term bank exposures to such a significant extent or consider the potentially significant negative consequences on market liquidity in interbank markets or on monetary policy transmission.

We are concerned that the risk weighting of all exposures will undermine the Agencies' policy goals[44] by making investments into, or deposits with, community development financial institution funds ("CDFIs") or minority depository institutions ("MDIs") more expensive. Such investments and deposits are valuable forms of financing and funding for CDFIs and MDIs, which enable them to provide additional loans and services in LMI communities. If transacting with CDFIs and MDIs becomes more costly, this would discourage the creation of relationships by and between smaller and larger banking organizations. We are also concerned that the Proposal's definition of "bank exposure" is significantly limited compared to the Basel Framework's corresponding definition. The Basel Framework's definition of "bank exposure" allows banking organizations to assign risk weights for banks to securities firms that are subject to prudential and supervisory standards equivalent to those for banks.[45] However, in the U.S. Basel implementation, the Agencies categorize securities firms as general corporate exposures regardless of whether the firms are subject to bank-like supervision and regulation.[46] The Proposal also does not distinguish between U.S. and foreign securities firms, each of which may be subject to vastly different regulatory regimes.

Due to these concerns, we believe that the Agencies should adopt risk weights consistent with the Basel Framework for bank exposures to financial institutions, specifically the 30% risk weight for Grade A banks with Common Equity Tier 1 ("CET1") ratios at or above 14% and leverage ratios at or above 5%.[47] Risk weights should only be applied to financial institutions that are the subject of the Basel Framework, which include "investment firms" as defined in the European Union's and the United Kingdom's capital rules and U.S. swap dealers subject to the

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[43] Basel Committee on Banking Supervision, *Second Consultative Document: Revisions to the Standardized Approach for Credit Risk* (Dec. 2015), https://www.bis.org/bcbs/publ/d347.pdf.

[44] *See, e.g.*, OCC, Federal Reserve & FDIC, *Preamble to Final Amendments to Regulations Implementing the Community Reinvestment Act of 1977 (CRA)* (Oct. 24, 2023), https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-cra20231024.pdf (emphasizing that "the final rule is intended to build on and clarify important community development financing and services" through, among other entities, MDIs and CDFIs "that qualify under the current CRA framework"); OCC, *Acting Comptroller of the Currency Michael J. Hsu Remarks to the 2022 Community Development Bankers Association Peer Forum* (June 9, 2022), www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-66.pdf ("CDFIs and MDIs are critically important to providing the mortgage credit, small business lending, and other banking services to [LMI] communities.").

[45] *See* Basel Committee on Banking Supervision, *supra* note 37, at 20.16.

[46] 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. 62,018, 62,086 (Oct. 11, 2013) ("[A]lthough the Basel capital framework permits exposures to securities firms that meet certain requirements to be assigned the same risk weight as exposures to depository institutions, the agencies do not believe that the risk profile of securities firms is sufficiently similar to depository institutions to justify assigning the same risk weight to both exposure types.").

[47] *See* Basel Committee on Banking Supervision, *supra* note 37, at 20.21 n.15.

Agencies' capital rules under 17 CFR part 23, subpart E. Further, we believe that adopting the Basel Framework's approach to the scope of short-term bank exposures eligible for lower risk weights would better maintain market liquidity.

C. The Proposal's requirements for unconditionally cancellable commitments should be reflective of the credit conversion factor ("CCF") of 0%.

Under the expanded risk-based approach, Section 112(b)(1) of the Proposal would require banking organizations to calculate the exposure amount of unconditionally cancellable commitments by applying a 10% CCF.[48] Under the current capital rule's generally applicable Standardized Approach, unconditionally cancellable commitments are subject to a 0% CCF. The Agencies justify the proposed increase in CCF by asserting that, while banking organizations have the right to cancel these commitments, they "often extend credit or provide funding for reputational reasons or to support the viability of borrowers to which the banking organization has significant ongoing exposure, even when borrowers are under economic stress."[49] However, the Proposal did not provide any data justifying the assumptions.

The Agencies' opaque justification is particularly worrisome because an increased CCF will make a number of banking services, including those that benefit consumers, including LMI borrowers, more expensive for banking organizations to offer. While the Agencies' stated rationale for increasing the CCF for unconditionally cancellable exposures from 0% to 10% focuses on large commercial relationships, retail exposures will face substantial impact. Many credit cards and home equity lines of credit are "unconditionally cancellable" under the Proposal, but today would be assigned a CCF of 0% under the Standardized Approach. In addition to imposing direct costs, an increased CCF will incentivize banking organizations to cancel or reduce unused credit lines of consumers, which would then lower their credit scores. The effect of lower credit scores would be far reaching, impacting products like home equity lines of credit, credit cards and small business lines of credit.

Increasing the CCF for unconditionally cancellable commitments to 10% would inflate the risk of these commitments, due to high credit limits of transactors and low utilization rates for unconditionally cancellable commitments. The Agencies should improve risk sensitivity and minimize harm to consumers by excluding retail exposures from the unconditionally cancellable commitments and reducing the CCF for other unconditionally cancellable commitments to 0%.

D. The retail exposure risk weights do not reflect actual risk and should be lowered to conform with corresponding risk weights in the Basel Framework.

Under the Proposal, a "regulatory retail exposure" would be defined as a retail exposure that meets three criteria: (i) the product criterion, (ii) an aggregate limit and (iii) a granularity limit.[50] In addition, as noted in Part V.C above, there is a new 10% CCF applied to the unused portion of retail lines of credit, which we recommend be removed.

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[48] Capital Rule Proposal, *supra* note 1, at 64,193.
[49] *Id.* at 64,056.
[50] *Id.* at 64,186.

A retail exposure would include an exposure to a natural person or persons and certain exposures to small- and medium-sized enterprises.[51] The Proposal would also differentiate the risk-weight treatment for retail exposures based on whether the exposure qualifies as a transactor exposure, which is a regulatory retail exposure that is either "a credit facility where the balance has been repaid in full at each scheduled repayment date for the previous 12 months or an overdraft facility where there has been no drawdown over the previous 12 months."[52] Under Section 111(g) of the Proposal, transactor exposures would be subject to a 55% risk weight, regulatory retail exposures that are not transactor exposures would be subject to an 85% risk weight and other retail exposures would be subject to a 110% risk weight.[53]

The retail exposure risk weights detailed in the Proposal deviate from those in the Basel Framework, but the Agencies have not explained why the international standard is not appropriate for the U.S. banking system. While the Proposal provides some detail and examples on how to classify regulatory retail exposures, there is little discussion on how the operational burden of classifying and tracking retail exposures in this manner is outweighed by the benefit of proposed changes to risk weights. This cavalier approach to the impact on retail lending activities is surprising. The increased cost of these activities will result in higher costs for consumers, as well as a reduction in available credit. This impact is particularly acute in credit card and personal loan offerings – those with a limited credit history are likely to be disproportionately impacted. Due to the increased costs associated with these products, banking organizations will likely reduce their lending capacity, further requiring consumers to look to nonbanks for their credit needs.

With that in mind, we recommend that the Agencies adopt retail exposure risk weights consistent with the Basel Framework – that is, regulatory retail exposures should be assigned a risk weight of 75%, transactor exposures should be assigned a risk weight of 45%, and other retail exposures should be assigned a risk weight of 100%.[54] Aligning retail exposure risk weights with the Basel Framework will increase the risk sensitivity of the final rule and better conform with fully examined international standards.

E. The current rule's 25% deduction threshold for mortgage servicing assets ("MSAs") and deferred tax assets ("DTAs") should be retained.

The Proposal would require Category IV Firms to deduct MSAs that individually exceed 10% of CET1 capital or that exceed 15% of CET1 capital in the aggregate.[55] In contrast, under the current rule, Category IV Firms must deduct from CET1 capital "any amount of MSAs, temporary difference DTAs that the banking organization could not realize through net operating loss carrybacks, and investments in the capital of unconsolidated financial institutions that individually exceed 25 percent of [CET1] capital of the banking organization minus certain

[51] *Id.*
[52] *Id.* at 64,051–52, 64,187.
[53] *Id.* at 64,191.
[54] Basel Committee on Banking Supervision, *supra* note 37, at 20.68.
[55] Capital Rule Proposal, *supra* note 1, at 64,036–37.

deductions and adjustments."[56] These deductions reflect the earlier rulemaking that subjected banking organizations not subject to the Advanced Approaches to a simplified deduction framework, in light of the Agencies' determination that "the 25 percent [CET1] capital deduction threshold would have appropriately balanced risk-sensitivity and complexity for non-Advanced Approaches banking organizations."[57]

The Agencies provide no rationale for changing the current capital rule's simplified 25% deduction threshold for MSAs and DTAs, which was the product of a robust notice-and-comment period and is aligned with the tailoring framework established by S. 2155. The current 25% deduction threshold is better calibrated to capital requirements because current accounting standards typically result in larger allowances for credit losses when compared to those for temporary difference DTAs. In practice, this means that the Proposal's 10% and 15% thresholds are too low for Category IV Firms, which have simpler business models and fewer activities that can offset DTAs than larger banking organizations with more diverse activities. Furthermore, maintaining the current 25% deduction threshold for MSAs and DTAs is particularly appropriate given the additional burdens placed on Category IV Firms by the Proposal's elimination of the AOCI opt-out election and adoption of the current expected credit loss ("CECL") framework. Removing the AOCI opt-out election and imposing the CECL framework on Category IV Firms will likely increase DTAs across the U.S. banking industry because CECL raises thresholds for loan and credit losses.

The punitive treatment of DTAs contemplated by the Proposal undermines the Agencies' efforts to foster market stability because DTAs often increase under stress conditions – raising the deduction threshold would put even more stress on a banking organization by increasing capital requirements during periods of loan losses. This increase in DTAs in stress scenarios does not ultimately impact the realization. As the Agencies previously noted in the preamble to the Capital Simplification Rule, "[a] banking organization's ability to realize its temporary difference DTAs is dependent on future taxable income; thus, the [25 percent] deduction threshold, together with a 250 percent risk weight for non-deducted temporary difference DTAs, will continue to protect banking organization capital against the possibility that the banking organization would need to establish or increase valuation allowances for DTAs during periods of financial stress."[58]

Without a well-reasoned justification for increasing capital deductions of MSAs and DTAs for Category IV Firms, we recommend that the Agencies retain the current 25% deduction threshold for MSAs and DTAs for Category IV Firms to better calibrate capital requirements.

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[56] *Id.* at 64,037.
[57] Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35,234, 35,237 (July 22, 2019).
[58] *Id.* at 35,239.

VI. The equity risk weights described in the Proposal restrict the ability of banking organizations to make equity investments that further the Agencies' public policy goals.

The current risk-weight approach for equity exposures includes a slate of risk weights for various equity exposure types. These risk weights include "the 100 percent risk weight for non-significant equity exposures whose aggregate adjusted carrying value does not exceed 10 percent of the banking organization's total capital" and "the 100 and 300 percent risk weights for the effective and ineffective portion of hedge pairs."[59] Under the current rule, banking organizations can use internal models to determine publicly traded and non-publicly traded equity exposures and equity derivative contracts.[60] Further, under the current rule, non-significant equity exposures that are less than 10% of a banking organization's capital have a risk weight of 100%.

The Proposal would change the current simple risk-weight approach for equity exposures in multiple ways. Of particular interest to the Responding Banking Organizations is the Agencies' proposal to require equity exposures, including non-significant equity exposures, that are not publicly traded to receive a risk weight of 400%, unless they are otherwise eligible to receive a risk weight of 100%.[61] The Agencies have not provided any evidence that suggests the current risk weighting for non-significant equity exposures is inadequate. As we emphasize in Part II, the Proposal's general lack of supporting evidence makes it difficult to assess the impact of the Proposal and offer a comprehensive comment. In the context of proposed changes to the simple risk-weight approach for equity exposures, the Agencies would in practice make it more difficult to make equity investments without explaining how those heightened burdens are offset by benefits. This is especially notable because imposing higher capital requirements for such investments seems contrary to the Agencies' public policy objectives.

We believe that the Proposal would unduly limit the ability of banking organizations to make equity investments, including equity investments that are beneficial from a policy perspective. Equity investments impacted include (i) certain tax credit transactions that do not fully meet the community development requirements, (ii) investments in early-stage companies that frequently need a mixture of debt and equity to fund their business activities, (iii) investments in venture capital funds that provide similar benefits as small business investment companies, and (iv) strategic investments in financial partners that benefit the banking organization's business strategy. These types of investments, which generally align with the Agency's policy goals, would be more difficult to undertake under the Proposal's requirements.

The following examples illustrate the importance of certain equity investments and the broad negative impact the Proposal's equity risk weights would have if codified in a final rule:

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[59] Capital Rule Proposal, *supra* note 1, at 64,076.
[60] *Id.* at 64,074.
[61] Equity exposures eligible to receive a risk weight of 100% are (i) exposures that qualify as community development investments under Section 24 (Eleventh) of the National Bank Act or (ii) exposures to an unconsolidated small business investment company or held through a consolidated small business investment company.

- First, investments related to low-income housing and renewable energy that would not otherwise qualify as community development investments would be assigned a 400% risk weight under the Proposal instead of the 100% risk weight under the current simple risk-weight approach. This would discourage investments in projects supporting important public policy goals like affordable housing, renewable energy and historic preservation. These types of tax credit transactions have a materially different risk profile than other equity investments, generally with a predetermined rate of return based on the tax credits. The Proposal's risk weights should recognize this distinction.

- Second, only equity exposures to an unconsolidated small business investment company or held through a consolidated small business investment company described in Section 302 of the Small Business Investment Act would receive a 100% risk weight under the Proposal. If a small business investment company decided to wind down and, in connection with that decision, voluntarily surrendered its license, the entity would no longer be a small business investment company as described in Section 302 of the Small Business Investment Act. As a consequence, the 100% risk weight would cease to apply. There is no supervisory or policy reason for a heightened risk weight to apply in these circumstances.

- Third, the value provided by venture capital funds in supporting early-stage companies was acknowledged in the 2020 amendments to the Volcker Rule, which excluded qualifying venture capital funds from the restrictions due to their "support [of] capital formation, job creation, and economic growth, particularly with respect to small businesses and start-up companies."[62] Banking organizations make noncontrolling investments in venture capital funds and financial technology companies for financing, as well as to support the companies that provide the banking organizations with services. The application of a 400% risk weight to venture capital investments is inconsistent with the policy rationale previously provided and would discourage banking organizations from participating in key asset management activities and diversifying revenue streams, which are important for reducing operational risk and maintaining banking services that benefit the public. At minimum, the 400% risk weight should only be applicable to early-stage venture capital investments where the main purpose of the investment is capital growth as opposed to relationship-based equity investments.[63]

- Fourth, equity investments arising from overfunded pension assets and deferred plan assets could be assigned a 400% risk weight under the Proposal instead of the current 100% risk weight. Applying a heightened risk weight to pension assets and deferred plan assets would harm rank-and-file employees who are plan

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[62] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 46,422, 46,444 (July 31, 2020).

[63] *See* Federal Reserve, *Instructions for Preparation of Consolidated Financial Statements for Holding Companies, Reporting Form FR Y-9C* (Sept. 2023), https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=b35eb32f-786a-4150-a2ae-70b400a4f9e6.

beneficiaries. We ask for clarification that the exclusion of equity positions arising from deferred compensation plans, employee stock ownership plans, and retirement plans would, from the scope of market risk covered position, also apply to overfunded pension assets and deferred plan assets. If such exclusion is not applied, the Proposal should avoid inflicting harm on U.S. workers by maintaining the current 100% risk weight for pension assets and deferred plan assets.

- Fifth, the current rule's hedge pair treatment assigns a 100% risk weight to the effective portion of a hedge pair. This approach is well aligned with risk and facilitates the risk-management activities of Category IV Firms. For example, in the context of deferred compensation programs, under the current rule banking organizations can use exposures to hedge obligations to employees. But if the Agencies removing the hedge pair treatment, Category IV Firms would be unable to manage risk in this way. We therefore recommend maintaining the current hedge pair treatment in order to avoid unnecessary costs to hedging and allow banking organizations to continue effective risk-management processes.

With those concerns in mind, we encourage the Agencies to revise the Proposal's treatment of small business investment company exposures so that an exposure to a small business investment company continues to be treated as such if that company has, in connection with a decision to wind down, voluntarily surrendered its license under the Small Business Investment Act. Additionally, we recommend that the Agencies retain the 100% risk weight for non-significant equity exposures and the 100% risk weight for the effective portion of a hedge pair. We also recommend that the Agencies apply the 100% risk weight to equity investments in projects that qualify for tax credits or that are part of programs established under the Internal Revenue Code, such as those for low-income housing, renewable energy or historic preservation, whether or not they qualify as community development investments under Section 24 (Eleventh) of the National Bank Act.

VII. The Proposal's Standardized Approach for calculating operational risk capital is not calibrated to the actual risk level of banking organizations.

Under the current capital rule, Category I and II banking organizations are required to calculate RWAs for operational risk using the advanced measurement approaches, which are informed by each bank's internal models.[64] These internal models make use of assumptions and data that a bank determines best measures its level of risk. The Agencies have determined that changes are necessary in part because they have concluded that the current operational risk requirements complicate the capital planning process and result in less comparable outputs.[65] However, the result is not reflective of the actual risk, which was highlighted by Governor Waller of the Federal Reserve, who noted that operational losses do not tend to occur contemporaneously with losses on credit and market risk.[66]

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[64] Capital Rule Proposal, *supra* note 1, at 64,082.
[65] *See id.*
[66] Federal Reserve, *Statement by Governor Christopher J. Waller* (July 27, 2023), https://www.federalreserve.gov/

The Proposal would replace the current approach for determining operational risk with a Standardized Approach for calculating a banking organization's operational risk capital requirements.[67] Under the Standardized Approach, the operational risk capital requirements would be a function of a banking organization's business indicator component ("BIC") and its internal loss multiplier ("ILM"). The BIC would be based on a banking organization's business indicator, multiplied by scaling factors that increase with the business indicator. The business indicator is based on the sum of the following three components: an interest, lease, and dividend component; a services component; and a financial component. The ILM would be based on the ratio of a banking organization's historical operational losses to its BIC, increasing the banking organization's operational risk capital requirement as historical operational losses increase. The Proposal would require that the ILM be equal to at least 1.

In justifying a Standardized Approach for calculating a banking organization's operational risk capital requirements, the Agencies emphasize two points regarding the Proposal's new approach to the ILM. First, the Agencies observe that a Board of Governors of the Federal Reserve System paper supports a conclusion that "[h]igher historical operational losses are associated with higher future operational risk exposure."[68] Second, the Agencies underscore that "operational risk management deficiencies can be persistent" in its experience implementing the current capital rule.[69]

We believe that the standardized operational risk capital framework outlined in the Proposal is not calibrated to actual risks. We find this lack of calibration concerning because the new standardized operational risk framework would scale up capital requirements, imposing material costs and burdens on Category IV institutions without any identified benefits. The new standardized operational risk framework would increase capital requirements based on an organization's historical losses, which has an outsized impact on Category III and IV banking organizations that have significant fee-based income. Indeed, the Proposal's operational framework would drive up capital requirements more than any other proposed change, accounting for 137.5% of the total RWA increase for banking organizations in Categories III and IV.[70] In particular, Category IV Firms that generate significant revenue from guarantees, consumer accounts and lockers are likely to be most impacted by the Proposal's standardized operational risk framework. The standardized operational risk framework is also rigid in the sense that it does not adjust to changes to an organization's operating profile, and the ILM calculation is based on loss data over only the prior 10 years. Therefore, significant changes to a bank's operating profile, including divestiture or stoppage of a business activity, do not impact the ILM.

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newsevents/pressreleases/waller-statement-20230727.htm ("[T]here is no discussion [in the Proposal] on why operational risk capital needs to be an additional charge as opposed to just using the existing capital stack to absorb operational losses. Having an additional layer of operational risk capital would make sense if large operational risk losses tend to occur contemporaneously with credit and market losses. But there is little evidence of that.").

[67] Capital Rule Proposal, *supra* note 1, at 64,083–94.

[68] *Id.* at 64,086.

[69] *Id.*

[70] *Id.* at 64,168.

Another example of the standardized operational risk framework's rigidity is that it does not adjust to reflect Comprehensive Capital Analysis and Review operational losses. In practice, that means that under the Proposal's expanded risk-based approach, operational losses are double counted. The Agencies' impact analysis suggests that the Proposal's operational risk framework would, if finalized, represent the largest driver of increased RWA under the expanded risk-based approach.[71] As noted above, we believe that Category IV Firms should not be subject to the Proposal's dual-risk framework. Nonetheless, we recommend that the Agencies remove 1 as the ILM floor to improve risk-sensitivity.

VIII. The transition and implementation periods outlined in the Proposal are insufficient to allow banking organizations to conform to the new regulatory capital regime.

The Proposal details various transition provisions meant to "provide applicable banking organizations sufficient time to adjust to the proposal while minimizing the potential impact that implementation could have on their ability to lend."[72] At a high level, the Agencies propose a three-year transition period for both the expanded risk-based approach and the AOCI regulatory capital adjustments for institutions subject to Category III and IV capital standards.[73] As for the transition for the expanded risk-based approach, an institution's expanded total risk-weighted assets would be phased in between July 1, 2025 and June 30, 2028, with a growing share of total risk-weighted assets needing to be transitioned each year of the transition.[74] As for the AOCI regulatory capital adjustments, Category III and Category IV Firms have three years to comply with the elimination of the AOCI opt-out election.[75]

As previously discussed, the Proposal, as a whole, shifts the burden on Category IV Firms, which are typically regional banks, and imposes stifling regulatory burdens that do not align with the risks inherent to banking. The Proposal's transition provisions would require banking organizations to undertake a breakneck transition to comply with the Agencies' requirement. The Agencies' proposed transition period fails to account for operational burdens, as well as the particular circumstances of banking organizations approaching the Proposal's $100 billion total-asset threshold. Specifically, the Proposal's heightened data requirements necessitate a longer transition period, the extent of the AOCI regulatory capital adjustments means that Category IV Firms need more time to mitigate costs, and the Proposal is completely silent with regard to how

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[71] *Id.*

[72] *Id.* at 64,166.

[73] *Id.*

[74] *Id.* The Proposal's transition provisions mean that a bank would multiply expanded total risk-weighted assets (as defined in the Proposal) by a specific phase-in amount for each transition period. These phase-in amounts are: 80% of expanded total risk-weighted assets from July 1, 2025 to June 30, 2026; 85% of expanded total risk-weighted assets from July 1, 2026 to June 30, 2027; 90% of expanded total risk-weighted assets from July 1, 2027 to June 30, 2028; and 100% of total risk-weighted assets beginning on July 1, 2028. Banking organizations would then use that product as the denominator of its risk-based capital ratios.

[75] *Id.* The AOCI adjustment amount transition provisions mean that if a bank's AOCI adjustment amount is positive, it should *multiply* its AOCI adjustment amount by a percentage enumerated in Table 10 of the Proposal, and then *subtract* that product from its CET1 capital. If a bank's AOCI adjustment amount is negative, it should *multiply* its AOCI adjustment amount by a percentage enumerated in Table 10 of the Proposal, *subtract* that product from its CET1 capital, and then *subtract* that amount from its CET1 capital.

the implementation and transition timeline would apply to banking organizations that are approaching, but not yet at, the $100 billion total-asset threshold.

The Agencies' proposed transition and implementation periods should be lengthened to provide banking organizations with adequate time to comply with, and manage the consequences of, the Proposal's stringent regulatory requirements. We recommend that the Agencies extend the Proposal's transition and implementation periods to five years. Extended phase-in periods for the expanded risk-based approach and AOCI regulatory capital adjustments, for example, will allow banking organizations to provide liquidity and manage any volatility in regulatory capital ratios. We also recommend that the Agencies clarify that banking organizations that cross the $100 billion total-asset threshold will be subject to five-year transition and implementation periods upon becoming subject to the capital framework's requirements.

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Again, we value the opportunity to comment on the consequential Proposal and express our views. Please feel free to contact any of the Responding Banking Organizations, Rosemary Spaziani at rspaziani@wlrk.com or Richard K. Kim at rkim@wlrk.com if you have questions or desire additional information.

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