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

Chief Counsel's Office
Attn: Comment Processing
Office of the Comptroller of the Currency
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James P. Sheesley
Assistant Executive Secretary
Attn. Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
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Submitted via email: regs.comments@federalreserve.gov and comments@FDIC.gov
Submitted to OCC via: Regulations.gov

Re: Request for Comment on Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity (Docket No. R-1813, RIN 7100-AG64¹)

Dear Ms. Misback:

Bloomberg L.P.² (“Bloomberg”) appreciates the opportunity to provide the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (“the Agencies”) with our comments regarding the joint request for comment on the proposed regulatory capital rule for large banking organizations and banking organizations with significant trading activity (“the Proposal”). Our response to the

¹ Available at: <https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant>

² Bloomberg, the global business and financial information and news leader, gives influential decision makers a critical edge by connecting them to a dynamic network of information, people and ideas. The company’s strength – delivering data, news and analytics through innovative technology, quickly and accurately – is at the core of the Bloomberg Terminal. Bloomberg’s enterprise solutions build on the company’s core strength: utilizing technology to allow customers to access, integrate, distribute and manage data and information across organizations more efficiently and effectively.

request represents the views of Bloomberg L.P. and draws on the Bloomberg's experience as a leading global provider of financial news, data, and analytics services.

The proposed rule sets out a restructuring of the regulatory capital framework for large banking organizations. It seeks responses on a wide variety of items including: the interaction of proposed revisions with existing rules, the pros and cons of expanding the scope of increased capital requirements to include Category III and IV banking organizations, due diligence requirements, the scope of the proposed definition of a subordinated debt instrument, and the impact of the proposed expanded risk-based framework for equity exposures.

Bloomberg appreciates the Agencies' engagement with the public on this important matter. Information from relevant stakeholders combined with careful and methodical deliberation are essential ingredients of sound rulemaking.

I. Responses to Questions from the Agencies

The Agencies posed thoughtful and important questions on a variety of topics throughout the proposal. Drawing on our experience as an industry leader in credit risk solutions, we appreciate the opportunity to provide feedback to the Agencies on items we feel are of particular importance in this space. With respect to the questions posed by the Agencies:

Question 1: *The Board invites comment on the interaction of the revisions under the proposal with other existing rules and with the other notice of proposed rulemaking. In particular, comment is invited on the impact of the proposal on the single-counterparty credit limit framework. What are the advantages and disadvantages of the proposed approach? Which alternatives, if any, should the Board consider and why?*

Bloomberg asks the Agencies to carefully consider whether there could be unintended consequences of the potential interaction between the proposed Basel III implementation and the existing Single Counterparty Credit Limit; and whether there could be reduced liquidity for participating banks in the case of a subsequent credit event.

Question 13: *How does the defaulted exposure definition compare with banking organizations' existing policies relating to the determination of the credit risk of a defaulted exposure and the creditworthiness of a defaulted obligor? What additional clarifications are necessary to determine the point at which retail and non-retail exposures should no longer be treated as defaulted exposures?*

Question 14: *In particular, the agencies seek comment on the ability of a banking organization to obtain the necessary information to assess whether the credit obligations of a borrower to creditors other than the banking organization would meet the proposed criteria?*

The Proposal notes (in 2.A. "Defaulted Exposures") that "A defaulted exposure would be any exposure that is a credit obligation and that meets the proposed criteria related to reduced expectation of repayment, and that is not an exposure to a sovereign entity, a real estate exposure, or a policy loan." This would include the need to "appropriately capture the elevated

credit risk of exposures where the banking organization’s reasonable expectation of repayment has been reduced, including exposures where the obligor is in default on an unrelated obligation.”³

Various practices, treatments, and communication of events of default exist. In some instances, cross-default language may be included in bond and loan documentation, which when triggered, move covered instruments to a condition of default. In some jurisdictions however, default on one obligation does not necessarily lead to default on other obligations, or even to debt restructuring. The identification of a default or a distressed restructuring, especially exposures away from the bank in question, could have a significant impact on the evaluation of the assets of that bank. The challenges of obtaining such information in a timely manner can be pronounced, especially for borrowers with different disclosure requirements by jurisdiction.

While there has been convergence in the definition of default and the timing of when it may be declared (e.g. 30 to 90 days in many instances), the impact of materiality may need to be reflected in updated risk management and supporting decisions (e.g., pricing), accounting (e.g., ASC 326 / IFRS9, Effective Interest Rate) as well as capital models (IRB and ICAAP).

Given this proposal is targeted to larger banks, how would these banks have flexibility in the capture and treatment of default? These institutions often have multi-national and multi-jurisdictional exposures and may not have exposure to or knowledge of every obligation of a borrower, who may also borrow from non-bank financial institutions. Further, for loans and for many bonds there is no standardized central repository of default events and conditions. Whatever definition of “default” is used, it should be flexible and clear enough to enable banks to execute effectively.

Question 16: *What alternatives to the proposed treatment should the agencies consider while maintaining a risk-sensitive treatment for credit risk of a defaulted borrower? For example, what would be the advantages and disadvantages of limiting the defaulted borrower scope to obligations of the borrower with the banking organization?*

With the maturation of global banking and the increased participation of non-banks in credit markets, limiting “*the defaulted borrower scope to obligations of the borrower with the banking organization*” would have the advantage of simplifying the recordkeeping and evaluation requirements on the bank and its exposure(s) to the defaulted entity, with the significant disadvantage of the bank not being fully aware of the borrower’s current financial position or obligations. This could be problematic for a bank in the case of borrower distress and borrower default (e.g., how could the bank position itself to perfect its claims to preserve capital?).

Question 17: *What are the advantages and disadvantages of assigning a range of risk weights based on the bank’s creditworthiness? What alternatives, if any, should the agencies consider, including to address potential concerns around procyclicality?*

³ See [Proposal](#) at 64039, Sec. A., *Defaulted Exposures*

By using a widely published Nationally Recognized Statistical Rating Organization (NRSRO) credit rating (“credit rating”) as part of the criteria, along with maintaining capital sufficiency and disclosure, this standard approach may be sufficient in stable markets.

However, when markets are more volatile, credit risks may also be more volatile, and credit ratings may not be as responsive to changes in economic or market conditions. Ratings or proxies may not even be available in a timely fashion for an entity to which a bank is exposed. As seen in the U.S. since the Global Financial Crisis (GFC), and the resulting Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, regulators and market participants have been gradually moving away from reliance on NRSRO ratings (i.e., through-the-cycle average long-term likelihood of survival measures), and towards quantitative default probabilities (dynamic point-in-time default probability measures).

In June 2023, the Securities and Exchange Commission (SEC) amended Regulation M to remove references to credit ratings and replace those references with new standards based on quantitative default probability measures.⁴ The amendments removed the reliance on external credit ratings, consistent with the objectives of Dodd-Frank, and replaced ratings with references to alternative standards of creditworthiness (i.e., probabilities of default from a structural credit risk model).

Another consideration is a bank with a split credit rating, where one agency rates a credit as investment grade (e.g., BBB- or Baa3 or better) and another agency rates the credit as speculative grade (e.g., BB+ or Ba1 or worse). Split ratings occur when a bank is deteriorating or improving at the time of evaluation to determine the grade of the bank. A split rating, in conjunction with maintaining sufficient capital, could result in some banks being classified as Grade A by some banks, and Grade B by others. This situation has the potential to create a different type of uncertainty across the banking sector, as well as increase the potential for confusion amongst the Agencies and other regulators. To clarify the treatment of split ratings at the time of evaluation, the Agencies should consider allowing banks to use a supplemental or alternative quantitative measure of default probability.

We would ask the Agencies to consider implementation language allowing the inclusion of quantitative metrics such as the probability of default, based on the merits, to determine the appropriate category (i.e. investment grade, speculative grade or sub-speculative grade).

Additionally, as macroeconomic conditions have continued to rapidly evolve over the past several years, we would welcome the Agencies’ consideration of the use of quantitative measures of credit risk as adjusted by macroeconomic factors. These tend to be more dynamic and forward looking than credit ratings as a supplement to or in place of ratings alone.

⁴ See Securities and Exchange Commission, “Removal of References to Credit Ratings From Regulation M” (June 20, 2023), 88 FR 39962, available at <https://www.federalregister.gov/documents/2023/06/20/2023-12591/removal-of-references-to-credit-ratings-from-regulation-m>. (Regulation M is a set of rules designed to preserve pricing integrity by prohibiting issuers and distribution participants from engaging in activities that could artificially influence the market for an offered security.)

Question 18: *What are the advantages and disadvantages of incorporating specific capital levels in the determination of each of the three categories of bank exposures? What, if any, other risk factors should the banking agencies consider to differentiate the credit risk of bank exposures? What concerns, if any, could limitations on available information about foreign banks raise in the context of determining the appropriate risk weights for exposures to such banks and how should the agencies consider addressing such concerns?*

Credit ratings have been useful as a general measure of average long-term credit risk in larger economies. Given the increased interconnectedness of regulated and unregulated credit markets and the speed of credit event transmission, a quantitative approach which takes into account current market conditions and produces a forward-looking, period-by-period, evaluation of point-in-time default probability would provide a robust, independent, and on-demand estimate of credit risk. This estimate could augment a bank's evaluation of another institution's credit strength. Additionally, quantitative credit risk analysis of banks can provide additional coverage and transparency in countries, regions, and securities where ratings agency coverage may not be as broad or active.

Question 109: *As the pricing conventions for certain products (for example, callable and puttable bonds) do not explicitly use an implied volatility, the agencies seek comment on the merits of allowing banking organizations to ignore the optionality of callable and puttable bonds that are priced using yield-to-maturity of the instrument if the option is not exercised relative to the merits of specifying a value for implied volatility (for example, 35 percent) to be used in calculating the vega capital requirement for credit spread risk positions when the implied volatility cannot be measured or is not readily available in the market. What are the benefits and drawbacks of specifying a value for the implied volatility for such products and what should the specified value be set to and why? What, if any, alternative approaches would better serve to appropriately capture the vega sensitivity for positions within the credit spread risk class when the implied volatility is not available?*

As a global firm with banking clients subject to regulation in multiple jurisdictions, Bloomberg has seen this question come up repeatedly in discussions, both with banks and with regulators. We think it is best to ground the approach to addressing such issues in common market practice whenever possible. In this case, common market practice in pricing callable and puttable bonds is to incorporate the implied volatility of interest rates, but not the implied volatility of bond credit spreads. On the negative side, as data and models typically develop together, the financial industry currently lacks both robust implied volatility data for bond credit spreads and pricing models that could make use of it. However, robust implied volatilities are available for most markets, and path-dependent pricing models for bonds with optionality are both broadly available and widely used. Even if an individual desk uses yield-to-maturity pricing, believing the volatility risk they are missing out on to be minimal for the particular instruments they trade, risk departments will likely include interest rate volatility as a risk factor in modeling bonds. This is also widely encouraged by other regulators, who need to consider not only which risks a bank is exposed to today, but also which risks it might be exposed to in the future as the portfolio or market conditions change.

Based on the above, we find it appropriate for the Agencies to require a treatment of implied volatility of interest rates (GIRR vega) for banks that have exposure to bonds with optionality, or that could be expected to have such exposure in the future. Other potential benefits of this approach include: better consistency with modeling of interest rate derivatives, better alignment with global standards (both Basel and individual jurisdictional implementation), and better consistency across the implementation of the entire Basel III market risk framework. To see how all three of these considerations come together, consider BCBS MAR 23.4 FAQ1, which reads as follows:

Are bonds with multiple call dates considered instruments bearing other residual risks for the purpose of the RRAO?

Yes. Bonds with multiple call dates would be considered as instruments bearing other residual risks, as they are path-dependent options.

This aligns RRAO treatment of bonds with multiple call dates with the treatment of Bermudan interest rate options, which are often used to hedge their interest rate volatility risk. This highlights that the volatility risk exposure of callable and puttable bonds is considered significant enough to warrant *supplementary* treatment under the RRAO; it would be unusual indeed to leave only the supplementary calculation in place while excising the primary calculation of GIRR (both vega and curvature).

On the other hand, we find it highly justifiable for the Agencies to relieve banks of any obligation to calculate *CSR vega* for callable or puttable bonds, regardless of whether they use yield-to-maturity pricing. Both yield-to-maturity and path-dependent pricing for bonds typically do not explicitly incorporate credit spread volatility as a separable component. Note that this does not mean that non-linearity of spreads is ignored altogether. *CSR curvature* requires only the ability to stress credit spreads, based on existing spread data.

Question 111: *The agencies solicit comment on the appropriateness of calculating the curvature risk-weighted sensitivity for the commodity risk class using the upward and downward shocks assuming a parallel shift of all tenors for each curve. Would a relative shift be more appropriate for calculating risk-weighted sensitivity for the commodity risk class and why?*

In our experience, Bloomberg finds standard practice across the industry to be bumping commodity curves in relative (percentage) terms, with the same percentage applied to each point on the curve, rather than a parallel shift. For curvature, we have implemented the Basel III requirement that the highest risk weight along the curve would be used as the bump size, in percentage terms, across the entire curve. We believe this is consistent across the industry and is straightforward to implement in calculators. Whereas a parallel shift for curvature would require selecting an additional point to anchor the conversion of the risk weight-based percentage shift into an absolute shift that would then act as the (parallel) shift size. In addition, in the calculation of curvature, which requires a large shift, using absolute parallel shifts makes it somewhat probable that a curve could drop into negative territory in the down scenario. While negative rates are a common feature of interest rate modeling, they have hardly ever been observed for

commodities, and in any case, it would be difficult to guarantee that instances of commodity curves going negative in the down scenario would be economically feasible.

Further, we are not aware of any problems with defining curvature for commodities in terms of simple relative shifts across the entire curve that would indicate moving to parallel shifts as a solution.

Question 112: *The agencies seek comment on the appropriateness of adding the subspeculative grade category for non-securitizations and for correlation trading positions. What, if any, operational challenges might the proposed bucketing structure pose for banking organizations and why? What, if any, alternatives should the agencies consider to better capture the risk of these positions?*

Bloomberg welcomes the fact that the Agencies are continuing to progress toward de-emphasizing or removing requirements for banks to use external credit ratings from the bucketing process of non-securitizations, correlation trading positions and securitization positions of non-CTP. However, procedural and operational burdens flow from a lack of clarity or guidance as to how to measure speculative and sub-speculative grade categories. Bloomberg seeks similar or further clarification for all three credit quality grades, in addition to clarifying the definition of a “subspeculative grade” category. In particular, the current definition of “investment grade” was set out in 2013 and the market has changed significantly since then. For example, with the growth in private unrated issuances, there is a need for market participants to be able to consistently evaluate these issuances.

In addition to seeking clarity, Bloomberg proposes that guidance include the use of a structural credit risk model as a complement to, or substitution for, credit ratings, to determine credit quality grade for non-securitizations, correlation trading positions and securitization positions non-CTP bucketing.

Moreover, Bloomberg strongly recommends the use of quantitative measures of default probabilities for all credit quality grades (Investment Grade, Speculative and Sub-speculative) as noted for non-securitizations, correlation trading positions and securitization positions non-CTP, as it provides the following benefits:

- 1) Aligns the data points banks use across regulations and promotes a unified and consistent definition of credit quality across functions and teams.
- 2) Clear numerical criteria streamline operations, creates robust policies, procedures, and repeatable results by fostering automation and lessening the dependence on manual interventions, the potential for human error, and the need for ad-hoc documentation.
- 3) Lessens both intended and unintended bias.

Question 118: *The agencies solicit comment on the proposed definition of liquid market economy. Specifically, would the proposed criteria sufficiently differentiate between economies that have liquid and deep equity markets? What, if any, alternative criteria should the agencies*

consider and why? What, if any, of the proposed criteria should the agencies consider eliminating and why?

Bloomberg welcomes a data driven and dynamic approach to defining “liquid market economy.” Bloomberg believes that most of the data components to define ‘liquid market economy’ are available, however, additional technical guidance is needed on how to demonstrate “no material controls on liquidation of direct investment”.⁵

Question 127: *The agencies request comment on the appropriateness of allowing banking organizations to net the gross default exposures of derivative contracts and the underlying positions that are deliverable to satisfy the derivative contract. What, if any, additional criteria should the agencies consider to further clarify the netting of gross default exposures and why? What, if any, positions should the agencies consider allowing to net that would not exhibit default risk? For example, what are the advantages and disadvantages of the agencies allowing Uniform Mortgage Backed Securities that are issued by two different obligors to fully offset, even though such a treatment would not eliminate the default risk of either obligor independently?*

We are pleased to see the Agencies raise this question explicitly, as we find the current language the Proposal uses to discuss netting in the mortgage-backed section to be somewhat ambiguous. To raise one important example, while the Proposal mentions in several places that the ability to deliver a pool into a TBA (a “to-be-announced” forward mortgage trade) is sufficient for the TBA to net against the pool, it does not appear to be stated anywhere that it is necessary. While we understand that the Agencies are still considering what other criteria may be appropriate, for example, to enable netting of TBAs against pools, we would hope that whatever conclusion is reached, it is clearly and explicitly spelled out in the final version of the rule, as this use case (pools hedged with TBA’s) is common across the industry, particularly for US-based banks.

One concern with basing netting eligibility in relation to TBAs on a deliverability criterion alone is that deliverability depends on such criteria as coupon and maturity, which are not directly connected to the default risk that the default risk charge (DRC) is intended to capture. Put another way, consider a book which is long one bond (A) and short another (B), where A and B share the same issuer and seniority. Under the DRC, B could be used to offset A, even if they do not share the same coupon, maturity, or call features. Now suppose that instead of a short position in bond B, we have a put option on bond B. This is a derivative, deliverable into bond B, but not bond A, that could presumably still offset A (as A and B can offset each other and B and the option on B can be used to offset B). If this is correct, then should a similar transitivity principle apply in the mortgage-backed securities case as well?

Question 135: *The agencies seek comment on the proposed threshold of 75 percent for assigning a credit or equity index to the corresponding sector or the investment grade indices bucket. What would be the benefits and drawbacks of the proposed threshold? What, if any, alternative thresholds should the agencies consider that would more appropriately measure the majority of constituents in listed and well-diversified credit and equity indices?*

⁵ See [Proposal](#) at 64122, *Equity Risk*

The 75 percent threshold for assigning a credit or equity index to a corresponding sector or the index bucket seems appropriate, as it is compatible with BCBS standards as well as other major jurisdictions. However, from a practical point of view, Bloomberg urges the Agencies to provide greater clarity on the definition of “Listed and well-diversified” credit or equity indices. Specifically, it would be helpful to have clarity around what constitutes a “large number of individual equity or credit position.”⁶ Additionally, Bloomberg seeks more clarity around what the threshold is for “...with no single position representing a substantial portion of the index’s total market value.”

Question 136: *The agencies seek comment on all aspects of the proposed treatment of index instruments and multi-underlying options under the standardized measure for market risk. Specifically, the agencies request comment on any potential challenges from requiring the look-through approach for all index instruments and multi-underlying options that are nonsecuritization debt or equity positions for the standardized default risk capital calculation. What, if any, alternative methods should the agencies consider that would more appropriately measure the default risk associated with such positions? What would be the benefits and drawbacks of such alternatives compared to the proposed look-through requirement?*

Should the Agencies ultimately decide to allow alternatives to the look-through approach for calculating the DRC for well-diversified indices, Bloomberg would support this approach. The challenges of the look-through approach, and the importance of having alternate approaches to look-through available for index, fund, and other multi-underlying instruments have been highlighted by multiple financial industry participants over the last several years, dating back to the original publication of the Basel III framework. The introduction of alternative approaches by the BCBS in the final version of the global framework was an important step forward, however it has been partially undermined by ambiguity about its applicability. Like many market participants, we believe that banks that can choose an alternative approach to look-through for the sensitivities-based method (SBM) should be able to choose an alternative to look-through for the DRC as well – otherwise many challenges remain.

The regulatory guidance on how banks are expected to represent such indices as single positions for the calculation of SBM, including bucketing guidelines, represents an important step in developing practical alternatives to the look-through approach. We believe that additional concrete guidance in the final proposal as to how to treat indices as single positions for the DRC could be similarly helpful.

Additional comments:

Bloomberg supports the Agencies’ ongoing Unit Test and Hypothetical Portfolio Exercise initiatives as we believe they help clarify the regulatory framework, promote consistency across the industry, as well as give banks a running start in ensuring they can carry out all required

⁶ See [Proposal](#) FN 374: “An equity or credit index would be considered well diversified if it contains a large number of individual equity or credit positions, with no single position representing a substantial portion of the index’s total market value.”

regulatory calculations. The feedback that the Agencies have been providing is a useful supplement to clarify the rules where needed. As these exercises uncover differences in interpretation or ambiguities in the rules, we urge the Agencies to compile and publish some of the resulting clarifications as part of the final rule or through an FAQ.

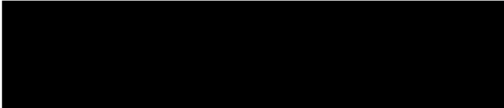
We would also pose the following broader question for consideration as the final rule is developed: as noted in the Summary, the “revisions would include replacing current requirements that include the use of banking organizations’ internal models for credit risk and operational risk with standardized approaches.”

We would ask the Agencies to consider situations where the internal model may show a different level of credit risk than a standardized approach would indicate. How would deteriorating economic or market developments be considered in evaluation of credit risk under a standardized approach? How specific or dynamic would analysis of an investment or other exposure need to be to varying economic scenarios? Lastly, how would banks consistently classify assets into investment grade, speculative and the proposed sub-speculative grade?

Conclusion

Bloomberg appreciates the opportunity to provide our comments in response to the Proposal. We would be pleased to discuss any questions the agencies may have with respect to this letter.

Very truly yours,



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