January 16, 2024

Via Electronic Mail

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

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
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Washington, DC 20429

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, suite 3E-218
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Re: Notice of Proposed Rulemaking Titled Regulatory Capital Rule; Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity (Docket No. R-1813 and RIN 7100-AG64; RIN 3064-AF29; and Docket ID OCC-2023-0008 and RIN 1557-AE78)

Ladies and Gentlemen:

U.S. Bancorp, together with its subsidiaries and affiliates (collectively, "U.S. Bank" or "we"), appreciates the opportunity to comment on the Federal Reserve Board's ("Board"), Federal Deposit Insurance Corporation's ("FDIC"), and Office of the Comptroller of the Currency's (together with the Board and FDIC, "Agencies") joint notice of proposed rulemaking (the "Proposal") on amendments to the regulatory capital rules applicable to large banking organizations and to banking organizations with significant trading activity.[1] Headquartered in Minneapolis, U.S. Bank serves millions of customers locally, nationally, and globally through a diversified mix of businesses

[1] Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64028 (Sept. 18, 2023).

including consumer banking, business banking, commercial banking, institutional banking, payments, and wealth management. U.S. Bank has been recognized for its community partnerships and customer service, including being named one of the 2023 World's Most Ethical Companies and Fortune's most admired superregional bank.

U.S. Bank fully supports the Agencies' goals of improving the capital rules to better reflect risk, reduce complexity, enhance consistency, and facilitate more effective assessments of capital adequacy. We believe, however, that several elements of the Proposal would result in significant, adverse, and unintended consequences to the customers and communities we serve, including consumers, small businesses, and the broader U.S. economy. We therefore write to describe these adverse effects and offer recommendations on how the Agencies should modify the Proposal to mitigate or avoid them, while continuing to advance the Agencies' objectives.

In summary, and as explained in detail below, we identify the following areas of concern and recommend that the Agencies implement the following changes to the Proposal:

- To avoid increasing borrowing costs for residential mortgages and reducing access to homeownership, especially for low-income and disadvantaged borrowers, the Agencies should not implement the proposed incremental 20 percent risk weight penalty on residential mortgages relative to the international "Basel III" standard set by the Basel Committee on Banking Supervision in December 2017 ("BCBS standard") and should maintain the existing deduction thresholds for mortgage servicing assets that apply to category III organizations.
- To avoid reducing access to consumer credit and harming consumer credit scores, the Agencies should not implement the proposed incremental 10 percent risk weight penalty on retail exposures relative to the BCBS standard or 10 percent credit conversion factor for unconditionally cancelable credit card and home equity line of credit ("HELOC") commitments.
- To avoid reducing access to credit for small businesses and increasing their borrowing costs, the Agencies should (i) not implement the proposed 10 percent risk weight penalty on retail exposures relative to the BCBS standard, (ii) not implement the requirement that an investment grade company have securities that are publicly traded to qualify for the preferential 65 percent risk weight, and (iii) incorporate a clear and transparent 85 percent risk weight for corporate small- and medium-sized businesses that do not qualify for the 65 percent risk weight.
- To avoid deterring bank participation in nationally legislated programs, such as tax equity investments in clean energy projects, preservation of historic buildings, and minority-owned depository institutions, as well as certain industry consortia and

other *de minimis* equity investments, the Agencies should expand the applicability of the 100 percent risk weight for certain non-publicly traded equity exposures.

- To avoid needlessly increasing costs to all bank customers, the Agencies should set the internal loss multiplier for operational risk capital requirements equal to a static value of one.
- To avoid unnecessarily intensifying the adverse effects of the Proposal on borrowers, the Agencies should adjust its transition provisions by (i) including a five-year transition period for the proposed changes to numerator deduction thresholds (if such changes are retained in the final rule) and the treatment of accumulated other comprehensive income ("AOCI"); (ii) incorporating this transition period into the Agencies' annual supervisory stress tests; and (iii) commencing the transition period for any future long-term debt requirements after the end of the transition period for the changes to the capital rules.

Although many of our recommendations are targeted at specific areas of bank activity for which the capital treatment under the Proposal would significantly depart from the treatment under the current capital rules, the Agencies should also recognize in shaping the final rule that the Proposal will necessarily affect all areas of bank activity given the sweeping importance of capital requirements. Thus, to meet current or expected organizational needs for increases in capital levels, banks will reduce—and in many cases are already reducing—lending in areas that are ostensibly unaffected by the Proposal's changes to capital treatment. In other words, banks will likely respond to the Proposal by reducing lending in all areas, not just those specific areas for which capital requirements are increasing. Accordingly, the changes we recommend would likely produce additional benefits to customers and communities indirectly through channels not specifically identified herein.

With respect to these and other issues, we note our participation in and support of the comment letters submitted jointly by (i) the Bank Policy Institute and the American Bankers Association; (ii) the Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association; and (iii) Capital One Financial Corporation, The PNC Financial Services Group, Inc., Truist Financial Corporation, and U.S. Bancorp (the "Regional Bank Letter").

I. The Proposal Would Increase the Cost of Mortgages in the United States and Reduce Access to Homeownership, Particularly for Underserved Borrowers and Communities.

Homeownership is a key contributor to building wealth and financial security, and banks can play a powerful role in improving access to homeownership for all communities. U.S. Bank is well-positioned to comment on the Proposal's likely effects on

residential mortgage lending, because we are among the nation's leading residential mortgage lenders, serving over 1.5 million borrowers in a variety of communities throughout all 50 states.

U.S. Bank supports housing and homeownership in diverse and underserved communities and is strongly committed to helping to close the racial wealth gap. For example, we have launched U.S. Bank Access Home, a multipronged program to provide financial education, increase awareness of lending and financing options, and help fund mortgage loan officer development designed to reach underserved communities. Access Home Loan is U.S. Bank's recently launched special purpose credit program aimed at addressing the persistent gap in homeownership in majority-minority communities. We also offer the U.S. Bank American Dream loan, a low-down-payment mortgage product targeted to low-to-moderate income ("LMI") borrowers and census tracts with special features that are designed to help these buyers achieve their homeownership dreams. In addition, U.S. Bank serves as the master servicer to 40 housing finance agencies (13 state and 27 city or county), which play a central role in the nation's affordable housing system by supporting the purchase, development, and rehabilitation of affordable homes and rental apartments for low- and middle-income households. U.S. Bank also supports over 400 down payment assistance programs across the country, in addition to supporting our veterans via the VA loan program. See Appendix A for more information about programs offered by U.S. Bank to support first-time homebuyers and LMI borrowers.

A. Effective Risk Weights

We urge the Agencies to consider how the effective risk weights under the Proposal would adversely affect the cost of residential mortgages and access to homeownership. In particular, the Proposal's punitive treatment of residential mortgages relative to the BCBS standard could substantially increase the cost of mortgages and thereby reduce access to homeownership, especially for LMI and minority borrowers and communities. The Agencies have arbitrarily proposed to apply credit risk weights to residential mortgages that are 20 percent higher than the applicable risk weights under the BCBS standard, despite offering no clear safety and soundness rationale for this deviation. This incremental 20 percent penalty would increase the capital cost associated with mortgage exposures, particularly for higher loan-to-value ("LTV") mortgages, which would carry the highest risk weights under the Proposal.

Although the Agencies assert that this 20 percent penalty on residential mortgage lending is necessary to ensure competitive equity with smaller banks,[2] their reasoning fails

[2] 88 Fed. Reg. 64170.

to consider additional elements of the capital framework that increase the effective risk weights and marginal funding costs applicable to residential mortgages for large banking organizations that are subject to the Proposal. For example, each new mortgage loan that a bank makes would generally cause an incremental increase in the bank's operational risk capital requirement under the Proposal. Consequently, large banks subject to the Proposal will need to factor this cost into their mortgage pricing. We estimate this effect to increase the effective risk weight attributable to a residential mortgage exposure by approximately 10 percent. In addition, the Agencies' annual supervisory stress tests—applicable solely to large banks—penalize mortgage lending through the Stress Capital Buffer, which further increases the effective risk weight attributable to each mortgage loan.

Given the higher effective risk weights, the banking industry is likely to increase the price of mortgages for consumers or reduce mortgage lending activities. Borrowers who are first-time home buyers, LMI borrowers, minority borrowers, or members of LMI communities will be most severely affected, because they generally rely on higher LTV mortgages, which carry the highest risk weights under the Proposal.[3] As a result, the Proposal would be at odds with longstanding policy goals, legislation, and initiatives aimed at expanding the homeownership rate and closing the racial wealth gap in the United States. For example, the Proposal would inhibit the type of lending that the Community Reinvestment Act was designed to encourage and may cause banks to exit certain underserved markets as a result. In addition, the Proposal would result in greater involvement of nonbank financial companies in mortgage finance, which the Financial Stability Oversight Council ("FSOC") has identified as a growing source of risk to financial stability.[4] Specifically, as recently highlighted by Chairman Gruenberg, nonbank companies already outstrip banks in mortgage originations by a factor of two-to-one.[5] Any reduction in bank mortgage lending would augment the shift to nonbank mortgage companies not subject to stringent capital requirements.

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[3] *See* Goodman, Laurie & Zhu, Jun, Urban Institute, BANK CAPITAL NOTICE OF PROPOSED RULEMAKING—A LOOK AT THE PROVISIONS AFFECTING MORTGAGE LOANS IN BANK PORTFOLIOS Urban Institute (2023), https://www.urban.org/research/publication/bank-capital-notice-proposed-rulemaking.

[4] Financial Stability Oversight Council, ANNUAL REPORT 24-26 (2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf ("FSOC Annual Report").

[5] Remarks by FDIC Chairman Martin J. Gruenberg at the Exchequer Club on the Financial Stability Risks of Nonbank Financial Institutions (Sep. 20, 2023), https://www.fdic.gov/news/speeches/2023/spsept2023.html ("Gruenberg Exchequer Club Speech").

B. Mortgage Servicing Assets

The Agencies have proposed to reverse the changes they made in 2019 as part of their Capital Simplifications Rulemaking[6] to the deduction thresholds for mortgage servicing assets, among other assets. The change will further reduce the amount of mortgage servicing assets that category III and IV banking organizations can hold on their balance sheets without incurring significant capital penalties and will thereby increase costs for category III and IV banking organizations that service mortgages. These increased costs will affect pricing, directly or indirectly, for mortgage borrowers (in addition to the added costs described above), resulting in increased mortgage pricing and reduced access to homeownership. These changes also will further push mortgage servicing activity into the unregulated financial sector, which could result in consumer harm as unregulated firms generally are not subject to the same degree of risk management and consumer compliance standards that apply to regulated banking organizations. Moreover, this element of the Proposal would further contribute to the systemic risks highlighted by the FSOC with respect to nonbank financial institutions' involvement in mortgage servicing.[7] As recently highlighted by Chairman Gruenberg, nonbank mortgage servicers currently manage over 55 percent of all U.S. mortgages, a five-fold increase in a single decade, and commonly carry their mortgage servicing assets at multiples of their common equity capital.[8]

C. Recommendations

We recommend that the Agencies revise the Proposal's treatment of residential mortgage lending and servicing to avoid these unintended consequences to homeownership. In particular, the Agencies should not implement the incremental 20 percent risk weight penalty relative to the BCBS standard on residential mortgage lending and should maintain the existing deduction thresholds for mortgage servicing assets for category III and IV banking organizations. Following these changes, the revised framework would continue to apply robust capital requirements that would be conservative in light of historical loss experience while mitigating unintended consequences to homeownership in the United States.

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[6] Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35234 (July 22, 2019).

[7] FSOC Annual Report at 24-26.

[8] *See* Gruenberg Exchequer Club Speech.

II. The Proposal's Treatment of Credit Card Exposures Would Reduce Access to Consumer Credit and Harm Consumer Credit Scores.

U.S. Bank is one of the largest issuers of credit cards in the United States, serving millions of consumer and business customers. We offer a diverse array of credit card products, with terms and features designed to serve customers from consumer to small business to large corporate.

A. Effective Risk Weights

The Proposal would apply unduly high risk weights for retail exposures, including credit card exposures, relative to the BCBS standard. In particular, the Agencies have arbitrarily proposed to apply credit risk weights to retail exposures that reflect a 10 percent incremental penalty relative to the robust risk weights under the BCBS standard, without offering any safety and soundness justification. The ostensible basis for this penalty is to maintain competitive equity between large and small banks, but again the Agencies fail to account for other elements of the capital framework that increase the effective risk weights applicable to large banks' credit card exposures. In combination with an estimated 10 percent incremental operational risk capital requirement, the Proposal produces an effective risk weight of 65 percent for a transactor exposure and 95 percent for regulatory retail exposures. In addition, the Agencies' supervisory stress tests further increase effective capital requirements for these exposures through the Stress Capital Buffer and most recently subjected retail exposures to average loss rates of 17.4 percent.[9] Moreover, the Proposal's 10 percent credit conversion factor for unconditionally cancelable lending commitments, including credit card commitments, also does not apply to smaller banking organizations and would further increase the cost of credit card lending for large banking organizations, as described in more detail below.

The resulting higher effective risk weights and Stress Capital Buffer requirements will increase the capital costs to large banks that engage in credit card lending and offset any perceived disparity with the capital requirements applicable to smaller banking organizations. The banking industry collectively will pass higher capital costs along to credit card borrowers through higher pricing, reduced lending, and reduced card benefits.

[9] Board of Governors of the Federal Reserve System, 2023 FEDERAL RESERVE STRESS TEST RESULTS, Table 8 (June 2023), https://www.federalreserve.gov/publications/files/2023-dfast-results-20230628.pdf.

B. Credit Conversion Factor

The Proposal also would apply a 10 percent credit conversion factor to all unconditionally cancelable lending commitments, including credit card lines and HELOCs. The Agencies provide no empirical basis for this change, which is inconsistent with actual borrower behavior, particularly in the context of credit cards. Credit card agreements allow banks to refuse to extend credit at any time, with or without cause. Although the Agencies assert as justification for the proposed credit conversion factor that banking organizations may provide funding under unconditionally cancelable commitments for "reputational reasons or to support the viability of borrowers to which the banking organization has significant ongoing exposure,"[10] this comment appears to relate to commitments made to substantial or core business customers and overlooks that the majority of unconditionally cancelable commitments (including most credit card and HELOC commitments) are made to retail customers.

The direct result of this new credit conversion factor will be to introduce a new cost for banking organizations to provide credit card and HELOC lines. The banking industry collectively will pass higher capital costs along to credit card borrowers through higher pricing, reduced lending, and reduced card benefits. In addition, the new credit conversion factor will incentivize banks to cancel or reduce credit lines for consumers and other borrowers, thereby reducing consumers' access to credit. Reductions in credit availability would negatively impact consumer credit scores and contribute to higher overall borrowing costs for consumer lending, both within and outside of the banking sector.

C. Recommendations

Given the likelihood of consumer harm under the Proposal, we urge the Agencies to revise the Proposal's treatment of credit card exposures and unconditionally cancelable commitments. In particular, the Agencies should align the risk weights for retail exposures with the BCBS standard (i.e. they should not implement the proposed 10 percent risk weight penalty relative to the BCBS standard). In addition, the Agencies should not apply the proposed 10 percent credit conversion factor to unconditionally cancelable credit card and HELOC commitments, and any new credit conversion factor for these commitments should be supported by strong empirical evidence, including data on historical borrower behavior. Based on currently available evidence regarding unconditionally cancelable credit card commitments, the credit conversion factor should be 3.0 percent, because time-series average aggregate historical data support this

[10] 88 Fed. Reg. 64056.

level.[11] These changes would continue to apply capital requirements that would be conservative given historical experience while avoiding unnecessary harm to consumers and other borrowers.

We also note that the Proposal's "proxy" methodology for calculating the undrawn portion of a commitment with no pre-set spending limit could produce lower capital requirements for commitments without pre-set spending limits than those with pre-set spending limits. As illustrated in Appendix B, the potential for the Proposal to incentivize the removal of these limits to reduce exposure on certain customers could be an unintended consequence of the Proposal's "proxy" methodology.

If, notwithstanding the likely adverse effects on consumers described above, the Agencies nonetheless adopt the proposed 10 percent credit conversion factor for credit card commitments, we recommend that for unconditionally cancellable commitments with contractual credit limits (such as credit cards), the off-balance sheet exposure amount should be equal to the lesser of (i) 10 percent of the unused portion of the commitment and (ii) the off-balance sheet exposure amount that would be calculated for the commitment under the "proxy" methodology if the commitment had no contractual credit limit. Although this would not negate the substantial increase in cost for these products, it would mitigate the effect for customers with limited credit line utilization, whose credit lines banks may otherwise be incentivized to cut under the Proposal. Additionally, it would reinforce prudent risk management by eliminating incentives to remove contractual limits on certain commitments where exposure amounts would otherwise be lower without a contractual credit limit.

III. The Proposal Would Reduce Access to Credit for Small Businesses and Increase Their Borrowing Costs.

According to research from the U.S. Small Business Administration, small businesses in the United States have generated two out of every three jobs added in the past 25 years.[12] U.S. Bank is proud to be a leading lender to small businesses, serving over 1.3 million small businesses. We are an active supporter of small businesses and

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[11] *See* TCH Research Study, "Empirical Analysis of BCBS-Proposed Revisions to the Standardized Approach for Credit Risk," The Clearing House (May 2016), https://bpi.com/wp-content/uploads/2018/07/20160519_tch_study_bcbs_standardized_approach_for_credit_risk.pdf.

[12] U.S. Small Business Administration Office of Advocacy, Daniel Wilmoth, Small Business Facts (April 2022) https://advocacy.sba.gov/wp-content/uploads/2022/04/Small-Business-Job-Creation-Fact-Sheet-Apr2022.pdf.

offer a variety of products and services with flexible terms and features designed to meet the needs of every borrower.

A. Effective Risk Weights

As described above, relative to the BCBS standard the Proposal would apply unduly high effective credit risk weights to retail exposures, which include many small business loans, through the application of an arbitrary 10 percent risk weight penalty. The Agencies do not offer empirical evidence, historical data, or a safety and soundness rationale to support this 10 percent penalty. As explained above, the penalty does not ensure competitive equity between large and small banks because large banks' exposures to small businesses would be further penalized through the Proposal's operational risk capital requirement and the Agencies' existing supervisory stress tests, resulting in higher effective risk weights.

The Agencies also, without explanation, elected to exclude from the Proposal a feature of the BCBS standard that would decrease lending costs for small- and medium-sized businesses through the application of a preferential 85 percent risk weight: the "Corporate SME" category.[13] The Proposal would apply this 85 percent risk weight more narrowly than the BCBS standard through the "Regulatory Retail Exposure" category. However, the Proposal's Regulatory Retail Exposure category is an inadequate substitute for the BCBS standard's Corporate SME category, because the Regulatory Retail Exposure category includes a $1 million aggregate exposure limit. Consequently, any loans to small- or medium-sized businesses in excess of $1 million would not qualify for the 85 percent risk weight. Instead, the risk weight would jump to 100 percent for these exposures, creating a cliff effect in their borrowing costs, as depicted in Appendix C. The omission of the Corporate SME category, together with the agencies' 10 percent risk weight penalty on retail exposures relative to the BCBS standard, will significantly increase the capital cost to banks that engage in small business lending. This will increase lending costs for small business clients or potentially reduce small business lending industry-wide.

B. Securities Listing Requirement

The Proposal would unfairly discriminate against small businesses and a variety of other private companies by favoring borrowers that have issued publicly traded securities. In particular, the Agencies have proposed to limit the application of a

[13] The BCBS standard applies an 85 percent risk weight to corporate exposures where the reported annual sales for the consolidated group of which the corporate counterparty is a part is less than or equal to €50 million for the most recent financial year.

preferential 65 percent credit risk weight to corporate exposures to companies that (i) are investment grade and (ii) have securities that are publicly traded or are controlled by a company with securities that are publicly traded (clause (ii), the "securities listing requirement"). Corporate exposures not meeting both requirements would generally receive a 100 percent credit risk weight.

The Agencies assert that these requirements "would serve as a reasonable basis for banking organizations to identify exposures to obligors of sufficient creditworthiness" and that "publicly-traded corporate entities are subject to enhanced transparency and market discipline as a result of being listed publicly on an exchange."[14] However, the Agencies provide no evidence to substantiate their asserted connection between public securities and creditworthiness, and we believe that their reasoning is mistaken. In short, a company's issuance of publicly listed securities is not an effective indicium of creditworthiness. In fact, many key sectors of the U.S. economy operate without publicly traded securities, including small- and medium-sized businesses, institutions of higher education, endowments, and public utilities. These borrowers can be just as creditworthy as publicly listed companies, yet the securities listing requirement would treat them as inherently riskier.

The Agencies also assert that the securities listing requirement would "provide a degree of consistency across banking organizations."[15] However, this assertion overlooks the robust credit underwriting practices of banks, which are all subject to similar supervisory guidance and expectations in evaluating the creditworthiness of borrowers. In proposing the securities listing requirement, the Agencies seem to presume a high degree of variability among banks in assessing the credit risk of nonpublic borrowers, a presumption which the Agencies do not corroborate and that we believe is unwarranted.[16]

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[14] 88 Fed. Reg. 64056.

[15] *Id.*

[16] Furthermore, consistency among banking organizations' internal ratings could more effectively be improved through operational criteria that would complement banking organizations' existing risk management frameworks. Specifically, the Agencies could require a banking organization to annually assess the creditworthiness of obligors and to revalidate an investment grade determination. Such a requirement would complement existing credit administration practices, align to common covenants in loan documentation requiring regular financial statements, and embrace the spirit of the Agencies' reasoning to drive enhanced discipline for borrowers receiving the 65 percent risk-weighting.

C. Recommendations

The Agencies should revise the Proposal to avoid limiting small businesses' access to credit and increasing their borrowing costs. Specifically, the Agencies should conform the Proposal to the BCBS standard by (i) not implementing the proposed 10 percent risk weight penalty on retail exposures relative to the BCBS standard and (ii) incorporating the BCBS standard's Corporate SME category. The Agencies also should not implement the securities listing requirement and should instead apply a 65 percent credit risk weight to any corporate exposure to an obligor that is investment grade. These changes would avoid harm to small businesses while still applying capital requirements to small business lending that are commensurate with the risks involved.

IV. The Proposal Would Curtail Bank Participation in Nationally Legislated Programs Designed to Support Public Policy Goals and Would Inhibit Other Equity Investments that Are Beneficial for Consumers.

Helping people, businesses, and communities thrive is an important part of U.S. Bank's mission, and we are strongly committed to doing business in an environmentally sustainable and socially responsible manner. U.S. Bancorp Impact Finance, a subsidiary of U.S. Bank, is an industry leader in providing financial solutions that help create positive impact for communities and the environment. For 35 years, its tax credit investments and syndications, lending, and other financial solutions have helped create affordable housing, spur economic activity in underserved communities, restore historic buildings, develop renewable sources of energy, and strengthen community development. It also works across the company to facilitate sustainable finance opportunities to meet customer needs.

A. 400 Percent Risk Weight

We are concerned that the Proposal, if finalized, would critically inhibit some of the important environmental and social causes that U.S. Bancorp Impact Finance supports. In particular, the Agencies have proposed to apply a 400 percent risk weight to most non-publicly traded equity exposures, including exposures arising from tax equity financing investments.[17] This treatment would effectively quadruple the associated capital

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[17] Under the Proposal, an equity exposure arising from a tax equity financing investment would be eligible for a 100 percent risk weight only if it qualifies as (i) a community development investment under section 24 (Eleventh) of the National Bank Act or (ii) an equity exposure to an unconsolidated small business investment company or held through a consolidated small business investment company, as described in section 302 of the Small Business Investment Act. 88 Fed. Reg. 64214.

requirement from the 100 percent risk weight that generally applies today. The Agencies have proposed this treatment despite the BCBS standard providing for the application of a 100 percent risk weight to nationally legislated programs that provide significant tax subsidies to encourage investments.

A 400 percent risk weight would make it prohibitively expensive for banks to participate in tax equity financing activities that support many important causes. For example, although the Inflation Reduction Act ("IRA")[18] extended and expanded the use of federal tax incentives for various renewable and carbon emission reduction technologies and the domestic manufacturing of advanced energy equipment, many of these projects would be rendered uneconomical by the increase in pricing that banks would need to accommodate the proposed 400 percent risk weight. Without bank financing for these projects, they would not be completed, thereby frustrating the policies underlying the IRA and inhibiting the country's transition to clean energy. Additionally, we believe the risk of these investments is commensurate with that of existing tax equity financing arrangements, such as low-income housing tax credits ("LIHTC"), which receive a 100 percent risk weight today. We would welcome further discussion with the Agencies to articulate how these tax equity investment structures have similar investment milestones and risk profiles and therefore should be treated equitably in risk-weighting. Similarly, a 400 percent risk weight would make it prohibitively expensive for banks to participate in many investments in the rehabilitation and re-use of historic buildings. These projects can be an important source of revitalization for underserved communities, and the Proposal would risk their future viability.

Outside of the tax equity financing context, additional important public policy initiatives could be frustrated by the Proposal's 400 percent risk weight for most non-publicly traded equity exposures. For example, in 2022 U.S. Bank partnered with First Independence Bank, a minority-owned depository institution ("MDI"), to help it establish its first branch outside of Detroit.[19] This partnership entailed an equity investment to which the proposed 400 percent risk weight would apply. Many other banking organizations have made similar equity investments designed to support MDIs, which would be similarly impacted. The Agencies are statutorily responsible for promoting, assisting, and preserving MDIs, but their efforts to fulfill these responsibilities would likely be undermined by the proposed higher risk weight.

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[18] Pub. L. No. 117-169, 135 Stat. 1818.

[19] *See* https://www.usbank.com/about-us-bank/company-blog/article-library/supporting-mdis-partnering-with-first-idependence-bank.html.

In addition, many banks make equity investments in industry consortia that are designed to address financial infrastructure, risk management, compliance, strategic, or other issues affecting the entire banking industry. These investments are often small and economically insignificant relative to the banking organization as a whole—and therefore unlikely to give rise to safety and soundness risks—but the consortia are necessary to achieve important industry-wide objectives that no bank could achieve acting alone. They can create new products that benefit consumers, enhance competition, and result in lower transaction costs, expedited workflows, and greater liquidity for various asset classes.[20] We believe that bank support for these types of investments is critical to achieving their underlying goals, but the Proposal's punitive treatment of equity exposures may discourage the banking industry from investing in them.

Finally, banks often make small equity investments in projects that are designed to help their customers solve financial problems. As with consortia investments, these types of investments are generally economically insignificant relative to a banking organization as a whole, but they are nonetheless important to serving bank customers and could be rendered uneconomical by the proposed 400 percent risk weight. We urge the Agencies to ensure that the final rule is flexible enough to allow banks to continue to engage in these types of equity investments that help customers.

B. Recommendations

Given the risks that the Proposal's 400 percent risk weight would carry for the transition to renewable energy, revitalization of historic buildings, and other important public policy initiatives, the Agencies should revisit this treatment in the final rule. We recommend that, at a minimum, a 100 percent risk weight be applied to (i) all tax equity

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[20] For example, U.S. Bank has invested in Akoya, a consortium of 12 financial institutions that enables customers to share their financial data with fintech apps to take advantage of services like budgeting, payments, tax planning, and investment management. Akoya was established to help eliminate the risks associated with screen scraping and give people a safe, secure, and transparent way to provide access to their financial data. Akoya replaces screen scraping with application programming interfaces, enabling individuals to share their data with fintech apps using their financial institution's existing online portal. This is particularly important for banks given their role in both protecting customer information and enabling customers to have access and be empowered. Similarly, U.S. Bank has invested in Early Warning, a consortium of seven bank investors, that provides products to financial institutions such as deposit risk management, new account opening verification, identity risk management, authentication, fraud protection, P2P payments (Zelle), and is developing a bank wallet product (Paze). These products are used by thousands of financial institutions and have benefited millions of consumers.

financing investments[21] and (ii) all investments made to further a public policy program created pursuant to federal statute.[22] These changes to the Proposal would help to ensure that the Agencies do not frustrate policies that Congress has sought to further through tax subsidies or other statutory programs.

Further, to allow for *de minimis* investments in industry consortia and other equity investments that would benefit bank customers, the agencies should create an additional, separate category that applies a 100 percent risk weight to any other nonpublic equity exposures to the extent that the aggregate adjusted carrying value of the other exposures does not exceed 1.0 percent of the institution's total capital. By limiting the category to 1.0 percent of an institution's total capital (only a tenth of the related category under the current standardized approach), the Agencies could appropriately balance safety and soundness with the benefits that bank equity investments can produce for customers and the financial system generally.

V. The Proposal's Operational Risk Framework Would Amplify Harm to Borrowers and Create Competitive Inequity Across Jurisdictions

A. Cost of Operational Risk Requirements

The Proposal includes the BCBS standard's Standardized Measurement Approach for operational risk ("SMA"), with certain changes. Consistent with the SMA, the Proposal's operational risk capital requirements would be a function of a banking organization's business indicator component and internal loss multiplier. The business indicator component would serve as a proxy for a banking organization's business volume—as a banking organization's business volume increases, so too would its business indicator component and its operational risk capital requirements. For every new transaction that contributes to a banking organization's revenue, it would be required to set aside more capital for operational risk, in addition to that which is required to meet

[21] The term "tax equity financing investment" should be defined as "an equity exposure that (1) qualifies as a tax equity finance transaction under 12 CFR 7.2015 or (2) meets the criteria to be accounted for under the proportional amortization method as described in ASC 323 of the Financial Accounting Standards Board's Accounting Standards Codification."

[22] To carry out this provision, the Agencies could include in the final rule a reservation of authority for the Agencies to identify types of eligible investments in public policy programs created pursuant to federal statute. Such a reservation of authority would allow the capital framework to remain flexible and up to date as national legislation evolves. In connection with the issuance of the final rule, the Agencies should identify investments in MDIs as eligible investments in public policy programs created pursuant to federal statute.

applicable credit risk capital requirements. In this way, the Proposal's operational risk capital requirements would impose an additional cost on all areas of a banking organization's business, which will ultimately drive pricing for customers.

B. Internal Loss Multiplier

The internal loss multiplier would be based on the ratio of a banking organization's historical operational losses to its business indicator component and would increase the operational risk capital requirement as historical operational losses increase. Although the internal loss multiplier is derived from the SMA, the Agencies have proposed to modify it in a way that significantly departs from the SMA and its implementation in other jurisdictions. In particular, the Proposal provides that a banking organization's internal loss multiplier can be no less than one (the "ILM floor").[23] Thus, although a banking organization's track record for managing operational risk and avoiding operational losses can increase its operational risk capital costs, it cannot similarly decrease those capital costs below the level that applies in other jurisdictions. As a result, the Proposal would disadvantage U.S. banking organizations relative to their international competitors in the European Union and United Kingdom, whose capital frameworks will incorporate an internal loss multiplier that is equal to one and that does not fluctuate based on historical operational losses.

The Agencies' decision to include the ILM floor will complicate capital planning for U.S. banking organizations by introducing unnecessary upside volatility to operational risk capital requirements, which may further compound the negative effects of the Proposal on the cost and availability of credit to customers. For example, to manage capital levels, firms may need to act conservatively and reduce credit availability due to actual or potential variations in their internal loss multipliers and operational risk capital requirements. Conversely, firms would not be able to pass along reduced costs of capital to customers when their effective risk management results in historical losses that would warrant an internal loss multiplier below one, if not for the ILM floor.

C. Recommendation

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[23] As with the operational risk requirements generally, the Agencies provide no empirical justification for the level of the ILM floor. Rather, their explanation for its inclusion in the Proposal is limited to a single sentence stating that the ILM floor would "help ensure the robustness of the operational risk capital requirement." 88 Fed. Reg. 64056. This statement fails to acknowledge that the internal loss multiplier by design already includes a floor of 0.541. This is because the formula for the internal loss multiplier is bounded below by *Ln* (*exp* (1)-1), which equals 0.541. It is arbitrary for the Agencies to determine, without any supporting analysis or data, that the BCBS standard's floor of 0.541 is inadequate to protect against operational losses and that a floor of one is needed instead.

Absent full removal of the operational risk capital requirement in the final rule, we recommend that the Agencies revise the Proposal to set the internal loss multiplier equal to a static value of one. This approach would align implementation with comparable jurisdictions, remove unnecessary volatility from capital planning, and achieve the Agencies' stated objective of ensuring that the operational risk capital requirement is robust.

VI. The Proposal's Transition Provisions Would Cause Cliff Effects that Would Unnecessarily Intensify the Proposal's Adverse Effects on Borrowers

A. Deduction Thresholds

As referenced above, the Agencies have proposed to reverse the changes they made in 2019 as part of their Capital Simplifications Rulemaking[24] to the deduction thresholds for mortgage servicing assets, certain temporary difference deferred tax assets ("DTAs"), and investments in the capital of unconsolidated financial institutions. These changes would effectively unwind a previously successful Agency effort to simplify the capital framework while maintaining robust resiliency. As explained above and more fully addressed in the Regional Bank letter, we oppose the implementation of these changes.

In addition, the Proposal provides no transition period for these changes, even though they would directly and significantly impact the capital positions of many banking organizations. Notably, the Proposal diverges from the transition provisions in the Agencies' 2013 capital reforms, which afforded a five-year transition period for changes to regulatory capital adjustments and deductions, including the treatment of AOCI.[25] Moreover, the Agencies have not addressed the treatment of changes to the deduction thresholds under their annual supervisory stress tests. As a result, it appears that the changes would have immediate effect under both the capital rules and the supervisory stress tests.

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[24] Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35234 (July 22, 2019).

[25] Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62018, 62075 (Oct. 11, 2013).

Given the lack of any transition period for the changes to the deduction thresholds and the abbreviated three-year transition period for the changes to the treatment of AOCI, affected banks would experience a cliff effect requiring significant, sudden changes to capital planning and management. These sudden changes could intensify and exacerbate the Proposal's adverse consequences to borrowers, because affected banks would need to make substantial and abrupt changes to their lending practices to comply with the new requirements on an accelerated basis.

B. Recommendation

If the Agencies implement the proposed changes to the deduction thresholds for mortgage servicing assets, DTAs, and investments in the capital of unconsolidated financial institutions, they should incorporate appropriate transition provisions to avoid amplifying the Proposal's adverse effects on borrowers. Specifically, the Agencies should provide a five-year transition timeline for these changes, along with the proposed changes to the treatment of AOCI, consistent with the Agencies' 2013 capital reforms. Additionally, these transitions should be harmonized within the Agencies' annual supervisory stress tests to reflect the impact in forecast periods in a manner commensurate with the transition provisions' effect.[26]

C. Long-Term Debt Proposal

Shortly after issuing the Proposal, the Agencies issued a separate notice of proposed rulemaking that would require category II, III, and IV banking organizations to issue and maintain outstanding minimum amounts of long-term debt (the "LTD proposal").[27] As the Agencies acknowledge in their Impact Analysis for the LTD proposal, long-term debt is generally more expensive than other types of short-term funding that banking organizations could otherwise use.[28] Consequently, the LTD proposal is likely to raise funding costs for affected banking organizations, which will reduce their ability to accrete capital in preparation for the full implementation of this Proposal.

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[26] Harmonization with annual supervisory stress testing could be effectuated through revisions to the Board's supervisory stress test requirements to define "regulatory capital ratio" by reference to the Agencies' transition provisions of the capital rule, such as that found in 12 CFR 252.42(m) prior to 2019.

[27] Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, 88 Fed. Reg. 64524 (Sept. 19, 2023).

[28] *Id.* at 64552.

The Agencies have estimated that the LTD proposal would require $250 billion in total long-term debt, which reflects an incremental $70 billion of long-term debt relative to current levels.[29] However, the Agencies' analysis failed to consider the inflationary effects of the Proposal on risk-weighted assets and the need for category II, III, and IV banking organizations to issue long-term debt in amounts that exceed the regulatory requirement to maintain their current liquidity coverage ratios. Thus, it appears the Agencies have not sufficiently considered the interaction between existing regulations, the Proposal, and other forthcoming rule changes, resulting in an underestimation of the combined impact. Consequently, the banking industry's response to the Proposal and other regulatory changes may be more acute than the Agencies currently anticipate, and the resultant effects on borrowers more severe.

D. Recommendation

The Agencies should coordinate the transition provisions for the Proposal with the transition provisions for the LTD proposal in a way that prioritizes the accretion of common equity tier 1 ("CET1") capital and minimizes detrimental impacts to borrowers. In particular, the transition periods for the proposals should run sequentially, rather than concurrently, to allow banking organizations to prioritize CET1 accretion without the hindrance of increased funding costs related to the issuance of new long-term debt. In other words, the first year of the transition period for any new long-term debt requirements should begin following the end of the transition period provided under this Proposal. This approach would appropriately prioritize the accretion of CET1, given its status as the most loss-absorbing form of capital, while still ensuring that banks meet any new long-term debt requirements in a timely manner.

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U.S. Bank appreciates the opportunity to comment on the Proposal. If you have any questions, please contact the undersigned at John.Stern@USBank.com.

Sincerely,

John Stern
Chief Financial Officer, Senior Executive Vice President

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29 *Id.*

Appendix A: Mortgage Loan Programs

In addition to agency loan programs, U.S. Bank offers the below unique programs to support sustainable homeownership.

- U.S Bank American Dream Home Loan:
  The U.S. Bank American Dream loan provides homebuyers the assistance they need to get over the buying threshold and into their next home. It can be combined with other down payment assistance and grant programs.
  - Down payment as low as 3 percent
  - Mortgage insurance paid by U.S. Bank
  - Assistance funds up to either $5,500 or 3 percent of the purchase price up to $10,000 – whichever is greater. Funds can be used for a down payment, closing costs, required repairs, or improvements.
  - Fixed interest rate for the life of the loan
  - Works with those on income-driven repayment plans
  - Available in 26 states
- U.S Bank Access Home Loan
  The U.S. Bank Access Home Loan aims to address some of the obstacles that minorities face and improve their access to credit, while supporting their wealth building through homeownership and assist in closing the wealth gap and historic lack of access for individuals and communities of color.
  - Down payment as low as 3 percent
  - Up to $12,500 in down payment assistance
  - $5,000 lender credit can be used toward closing costs, including the ability to buy down mortgage interest rate
  - Borrower can combine with other down payment assistance grants and programs
  - $1,000 minimum contribution from borrower's own funds
  - Borrower's income can be up to 100 percent of area median income (AMI)
  - FICO score of 640, nontraditional credit history considered for scores 620+
  - Available initially in Las Vegas, Little Rock, Milwaukee, Minneapolis, St. Louis as well as six California cities including Sacramento, Los Angeles, Oakland, Fresno, San Diego and Riverside/San Bernadino.

Appendix B: “Proxy” Methodology

The Proposal could incentivize banking organizations to remove pre-set spending limits on certain commitments, such as lower utilization consumer credit cards. Specifically, the “proxy” methodology for commitments without pre-set spending limits would provide a meaningful benefit for banking organizations that have customers with low utilization rates.

As illustrated in the example below, the “proxy” methodology results in risk-weighted assets for Customer A that are 53% higher than the risk-weighted assets of Customer B and would thereby incentivize banks to remove card limits to avoid higher capital costs.

	Customer A	Customer B
Exposure Type	Contractually Limited Card	Card with No Explicit Limit
Pre set Credit limit	$20,000	None
Avg. Total Drawn over shorter of 8 quarters or commitment creation date	$1,000	$1,000
Current Drawn amount	$1,000	$1,000
Committed but undrawn amount determined using	Stated Commitment	Proxy Methodology
Committed but undrawn amount calculation	($20,000 $1,000)	($1,000*10) $1,000
Committed but undrawn amount equals	$19,000	$9,000
UCC Exposure at Default	$1,900	$900
Drawn plus credit equivalent undrawn	$2,900	$1,900
RWA as Transactor	$1,595	$1,045

Appendix C: Cliff Effect in SME Lending

The Proposal's requirement for small- or medium-sized enterprises to meet a $1 million aggregate exposure limit to qualify for an 85 percent risk weight creates a cliff effect that would substantially increase borrowing costs for businesses that need to borrow more than one million dollars in aggregate.