

To: Public Comment File – Docket No. OCC–2023–0008

From: Carl Kaminski, Assistant Director, Bank Advisory

Date: January 30, 2024

Subject: Meeting with Representatives from the International Swaps and Derivatives Association (“ISDA”), Securities Industry and Financial Markets Association (“SIFMA”), Bank of America, State Street, BNY Mellon, Morgan Stanley, Goldman Sachs, Citi, JPMC, and Wells Fargo to discuss: Notice of Proposed Rulemaking: “Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity”

Staffs of the Federal Deposit Insurance Corporation, Federal Reserve System, and Office of the Comptroller of the Currency (collectively, the “agencies”) met with representatives from the International Swaps and Derivatives Association (“ISDA”) and Securities Industry and Financial Markets Association (“SIFMA”) and their member banks (collectively, the “ISDA and SIFMA representatives”) regarding the agencies’ Notice of Proposed Rulemaking on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (the “NPR”), which was published in the Federal Register on September 18, 2023 (88 FR 64028). The ISDA and SIFMA representatives discussed the quantitative impact study results described in the attached slide deck, which they provided to the agencies.

Attendees

OCC

Margot Schwadron
Benjamin Pegg
Diana Wei
Venus Fan
Amit Sekhon
Kevin Korzeniewski
Carl Kaminski

FDIC

Benedetto Bosco
Catherine Wood
Ernest Barkett
Irina Leonova
Brian Cox
Bob Charurat

David Riley
Meraj Allahrakha
Benjamin Klein
Huiyang Zhou
Keith Bergstresser
Michael Maloney
Iris Li
Olga Lionakis
Richard Smith
Lauren Brown

Federal Reserve Board

Brian Chernoff
Sarah Dunning
Anna Lee Hewko
David Lynch
Victoria Maizenberg
Michael Pykhtin
Cecily Boggs
Vikram Ramnarain
Lesley Chao
Hulusi Inanoglu
David Imhoff
Chris Anderson
Gillian Burgess
David Alexander
Katherine Arnold
Nadya Zeltser
David McArthur
Isabel Echarte
Diana Iercosan

ISDA

Lisa Galletta
Marc Tourangeau
Panayiotis Dionysopoulos
Mark Gheerbrant

SIFMA

Carter McDowell
Guowei Zhang
Joseph Seidel
Quianying Li
Peter Ryan

Bank of America

Bengt Redlinger

Damian Kudelka
Ed Kutin

Sullivan and Cromwell

Benjamin Weiner
Dan Wolf

State Street

Fabrice Dumont
Robert McKeon

Morgan Stanley

Matt Lovett
Charuhas Pandit
Andrew Nash

BNY Mellon

Manoo Halati

Goldman Sachs

Joseph Hwang
Cristina Patron
Alysa Shcherbakova

Citi

Jonathan Silverstone
Ann McKeehan
Atreya Chatterjee

JPMC

Debbie Toennies
Amol Tandon
Bruce Broder

Wells Fargo

Tim Becker
Roger Rice
Mike Treidga

U.S. Basel III Endgame NPR Quantitative Impact Study KEY MESSAGES

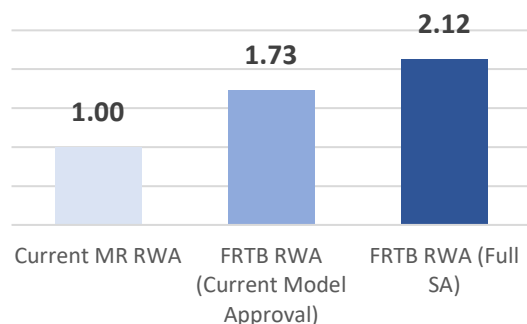
January 30th 2024

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Introduction

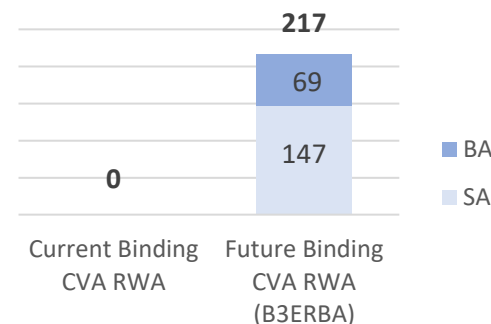
- The capital markets in the U.S. are the largest in the world and continue to be the deepest, most liquid, and most efficient.
- Trading book activities are critical to the ability of US business to raise financing and manage risk. **Debt capital markets account for 75% of total financing in the U.S.** Banks play a critical role in providing intermediation and risk management services that enable US capital markets to function efficiently and cost effectively.
- ISDA and SIFMA ran an industry QIS to gauge the impact of the US Basel III NPR on bank trading book activities, based on input from the **8 U.S. G-SIBs**.
- Results from the QIS show **market risk capital will increase by between 73% and 112%**, depending on the extent to which banks use internal models.
- Capital for **securities financing transactions (SFTs) will increase by 18%**.
- **For clearing, \$7.2 billion of additional capital (representing an increase of 80%)** will be required due to changes introduced by the NPR and the G-SIB surcharge.
- The expanded risk-based approach (ERBA) is expected to generally replace the Current U.S. Standardized Approach as the binding capital constraint for large banking organizations with significant trading activities. Capital under the **credit valuation adjustment (CVA) framework will be fully additive** with ERBA as the binding capital constraint.
- Increases of this magnitude would make it **more costly for banks to provide intermediation, risk management and client clearing services in future**, which could reduce the liquidity of U.S. capital markets and make it harder and more expensive for U.S. businesses to raise funding.
- This could **hamper the ability to achieve other policy objectives**, including efforts to encourage central clearing and regulatory initiatives to resolve liquidity issues and capacity constraints in US Treasury markets.
- ISDA and SIFMA have proposed calibration changes to ensure the rules are more appropriate and risk sensitive.

FRTB Impact



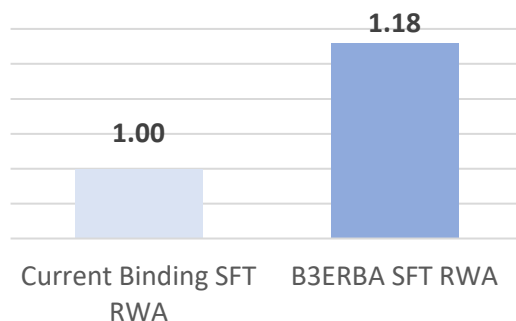
- Market Risk changes will result in a **73% - 112% (\$278 Bn - \$428 Bn) increase in RWA**. The 73% assumes current model approval, but there is risk the internal models scope will reduce, hence increasing the impact.

CVA Impact



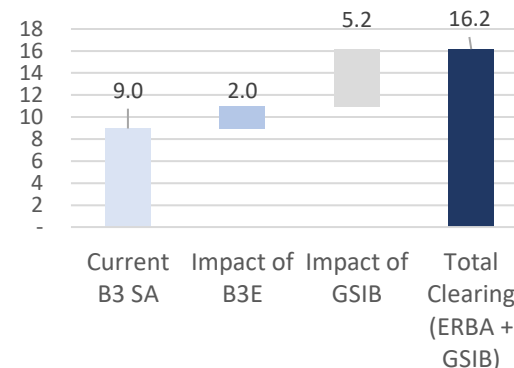
- CVA will be fully additive under ERBA which we expect to become the binding constraint. We estimate this structural change to add **\$217 Bn of RWAs**.

SFTs Impact



- The proposed changes for SFTs **would increase RWAs by 18% (\$87 Bn)**.

Clearing Impact



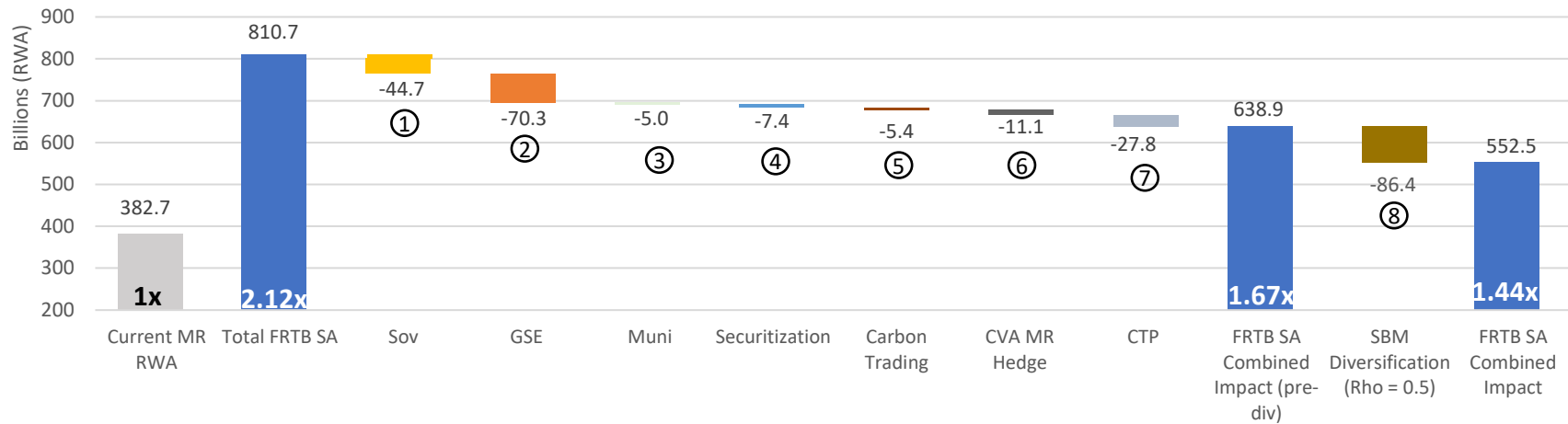
- For the clearing businesses we estimate a **\$5.2 Bn capital requirement increase** and a **\$2 Bn capital requirement increase** from including client clearing activity in the GSIB surcharge and moving from Standardized to ERBA, respectively. This is an **80% increase**.

Key Recommendations

1. **Perform a comprehensive evaluation of how the Proposal would interact with other prudential requirements**, particularly the stress testing framework and the GSIB Surcharge (and related calibration).
2. Allow appropriate time to implement these significant changes to the framework (**at least 18 months from finalization of the final rule**).
3. Incorporate the following **mitigating items** to reduce the potential impacts to U.S. capital markets:

| Capital Markets Impact | Potential Areas for Mitigation |
|---|--|
| Negative effect on the liquidity and vibrancy of capital markets | <ul style="list-style-type: none"> • Improve recognition of diversification in FRTB (in SBM, IMCC, and NMRF) • Remove SFT Minimum Haircut Floor • Remove public listing requirement for collateral |
| Increased capital requirements misaligned to underlying risks in certain markets | <ul style="list-style-type: none"> • Clarify treatment of UMBS TBAs and UMBS eligible pools • Exempt certain sovereign and quasi-sovereign exposures (i.e., MDBs and supranationals) from DRC and SBM • Appropriately calibrate the securitization framework |
| Adverse effect on derivative end-users with downstream impact to investors | <ul style="list-style-type: none"> • Exempt client facing leg of client cleared exposures from CVA • Distinguish between regulated and unregulated financial entities in the CVA framework • Appropriately recognize hedges of CVA exposure |
| Excessive volatility misaligned with underlying risks and disincentivizing FRTB-IMA | <ul style="list-style-type: none"> • Implement the PLA requirement as a qualitative test, avoiding introduction of artificial volatility in capital levels • Cap total FRTB-IMA capital at FRTB-SA to provide appropriate incentives for FRTB-IMA development and recognize the conservatism of FRTB-SA. |

QIS Summary

FRTB SA Impact Summary¹**Impact of Quantified Mitigation Items:**

- 1. Excluding specific sovereign exposures, MDBs and supnationals from SBM and DRC:** \$44.7 Bn RWA reduction (of which, \$35.6 Bn RWA is EM sovereigns).
- 2. Clarifying treatment of TBAs and UMBS pools:** \$70.3 Bn RWA reduction.
- 3. Reducing risk weights and LGD for tax exempt municipal bonds:** \$5.0 Bn RWA reduction.
- 4. Reverting the securitization “p” factor to 0.5:** \$7.4 Bn RWA reduction.
- 5. Reducing carbon trading risk weight to 40 percent:** \$5.4 Bn RWA reduction.
- 6. Exclude ineligible CVA hedges from market risk:** \$11.1 Bn RWA reduction.
- 7. Incorporate CTP decomposition and other CTP changes:** \$27.8 Bn RWA reduction.
- 8. Introduce FRTB-SBM inter risk-class correlation parameter of 0.5 to recognize diversification:** \$86.4 Bn RWA reduction.

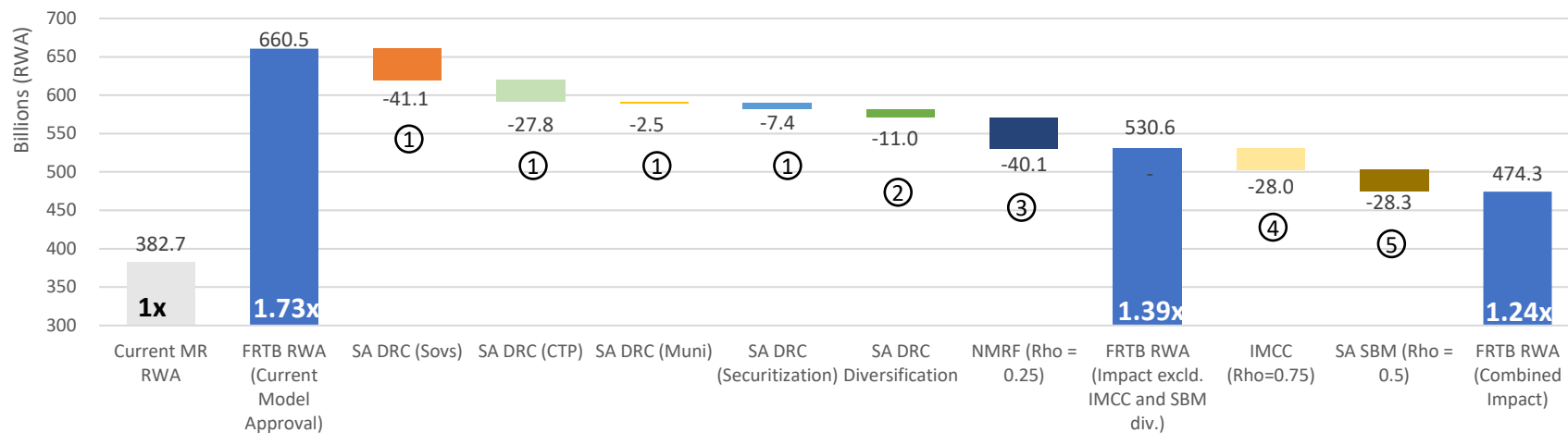
1: Note that the total FRTB SA RWA figure includes \$70.3Bn impact of treating UMBS-eligible pools as exposures to Fannie Mae and Freddie Mac, respectively, and \$11.1 Bn impact of including ineligible CVA hedges. The increase of 112% in market risk RWA under the proposed FRTB-SA in comparison to the current capital rules would reduce to 93% excluding the impact of GSE exposures treatment

Executive Summary – FRTB-SA Issues not included in the SA Impact Summary

- While the industry included the impacts for some key issues in the *Impact Summary*, many other important issues highlighted in the *ISDA-SIFMA Comment Letter (Jan 2024)* were unfortunately not included due to a limited number of submissions from banks (i.e., less than required to publish an impact). This was largely due to resource and timing constraints. These **issues are equally, if not more, critical than those included in the *Impact Summary*.**
- It is critical that the US Agencies fully consider the exhaustive list of issues provided in the ISDA-SIFMA Comment Letter (Jan 2024), before publishing the final US rules to avoid unintended consequences to key US markets, including but not limited to the following:**

| Topic | Key message |
|--|---|
| Treatment of term repos in market risk framework | <ul style="list-style-type: none"> Retain the ability to recognize the risk-mitigating effects of non-investment grade corporate debt securities of term repo-style transactions by not requiring the underlying security collateral in the market risk measure. Should there be a concern with the recognition of non-investment grade collateral, we note that the haircut applicable to non-investment grade collateral is sufficiently conservative. |
| Equity investments in funds | <ul style="list-style-type: none"> Revise available approaches for equity investments in funds under FRTB-SA so that they are implementable and appropriately aligned with inherent risk. The 'fallback method' is too conservative and insufficiently risk sensitive. |
| Securitization framework | <ul style="list-style-type: none"> Improve the calibration of the proposed securitization standardized approach, including through the inclusion of a Simple, Transparent and Comparable securitization framework similar to that set out in the Basel final rule, appropriately adjusted for the operation of the U.S. market. |
| Covered bonds | <ul style="list-style-type: none"> The CSR weight for covered bonds should be reduced from 2.5 percent to 1.5 percent. This approach would be consistent with the underlying risk of these positions given that most covered bonds are highly rated. |
| Equity hedge recognition | <ul style="list-style-type: none"> Enhance the risk sensitivity of equity hedge recognition in DRC for derivatives. Given the inability to use models for calculating DRC, extend the maturity scaling allowed for physical equities to derivatives, as well as "option early termination" clauses in equity derivatives contracts |
| TB / BB Boundary | <ul style="list-style-type: none"> We want to emphasize that the QIS does not reflect certain areas related to the revised trading book / banking book boundary that could potentially have some significant impacts. Some of those areas highlighted in the joint industry letter are: <ol style="list-style-type: none"> Retain market risk covered position eligibility of structured notes Clarify BOLI / COLI descope from market risk covered positions |

FRTB IMA & Selected SA Impact Summary

Impact of Quantified Mitigation Items:

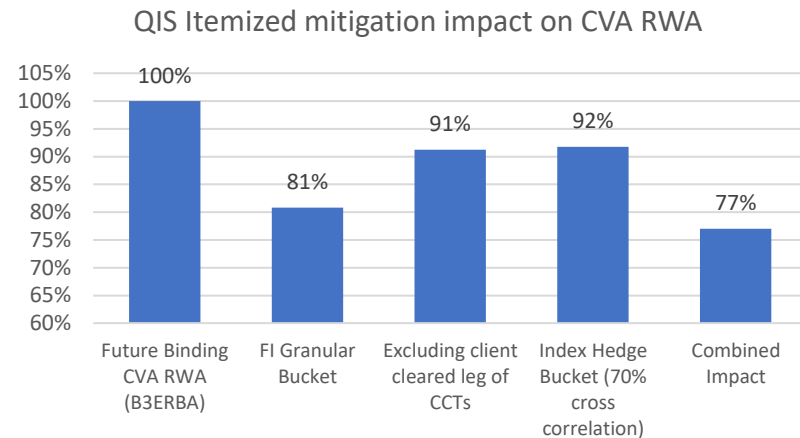
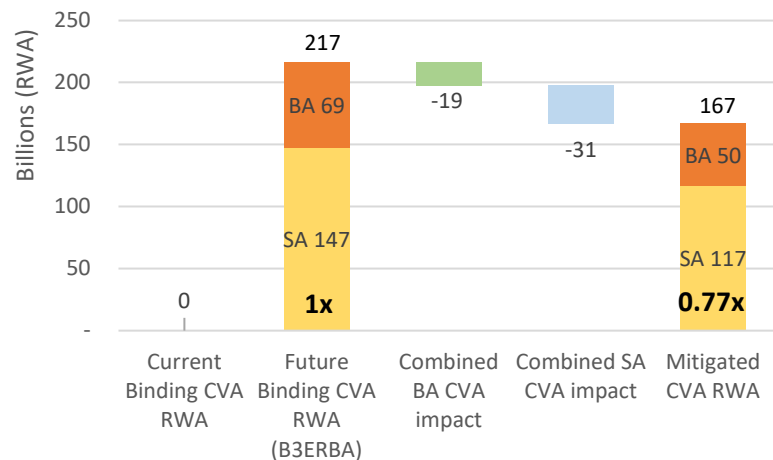
- SA DRC Mitigations** (from previous slide): \$78.8Bn RWA reduction
- Allow combined SA DRC calculation for modelled and non-modelled desks:** \$11.0 Bn RWA.
- Decreasing NMRF rho parameter from 0.6 to 0.25:** \$40.1Bn RWA reduction.
 - Note that an estimate is not yet available for the proposed split between Type A and Type B NMRF
- Increase ES rho parameter from 0.5 to 0.75:** \$28.0Bn RWA reduction.
- SBM inter-risk class correlation parameter for diversification** (from previous slide): \$28.3Bn RWA reduction.

Executive Summary – FRTB-IMA Issues not included in the IMA Impact Summary

- The IMA impacts are incomplete, as only a limited number of member banks can quantify certain impacts. This highlights both:
 - There remain ongoing significant practical challenges in building IMA – banks do not have long history of PLAT metrics
 - There is no significant incentive to overcome these challenges – the large NMRF component remains the unsolved piece of the IMA puzzle
- Lack of supporting data at an aggregate industry level for key recommendations underlines the need for further improvements to IMA to incentivize banks to implement high quality models for market risk management purposes
- **In this light, it is critical that the US Agencies fully consider the exhaustive list of issues provided in the ISDA-SIFMA Comment Letter (Jan 2024), before publishing the final US rules to avoid unintended consequences to key US markets, including but not limited to the following:**

| Topic | Key message |
|-------------|--|
| PLA Test | <ul style="list-style-type: none"> ▪ Convert the profit and loss attribution (“PLA”) test for modelled desks to an entirely qualitative requirement used for supervisory monitoring as this test would otherwise introduce artificial volatility in capital levels that would disincentivize banking organizations from using FRTB-IMA. |
| NMRF | <ul style="list-style-type: none"> ▪ Certain NMRFs should be subject to capital requirements based on the expected shortfall methodology, with revisions to reflect the relatively lower level of liquidity of those NMRFs |
| FRTB-SA cap | <ul style="list-style-type: none"> ▪ Cap the total FRTB-IMA capital at FRTB-SA in order to provide appropriate incentives for banking organizations to build FRTB-IMA and to recognize the conservatism of FRTB-SA |

BA and SA CVA Impact Summary

**Impact of Quantified Mitigation Items:**

- **Implementing all the proposed mitigation items together reduces ERBA CVA RWA by 23% or \$50Bn.** This breaks down as:
 - \$19Bn RWA reduction for BA-CVA²
 - \$31Bn RWA reduction for SA-CVA³
- **Impact of applying the mitigation items independently would be:**
 - **Granular Financials Risk Bucket⁴:** 19% reduction
 - **Excluding client cleared leg of cleared transactions:** 9% reduction
 - **Increasing cross-bucket correlation of 70 percent between bucket 8 and buckets 1-6 in SA- CVA:** 8% reduction

CVA Issues not included in the CVA Impact Summary:

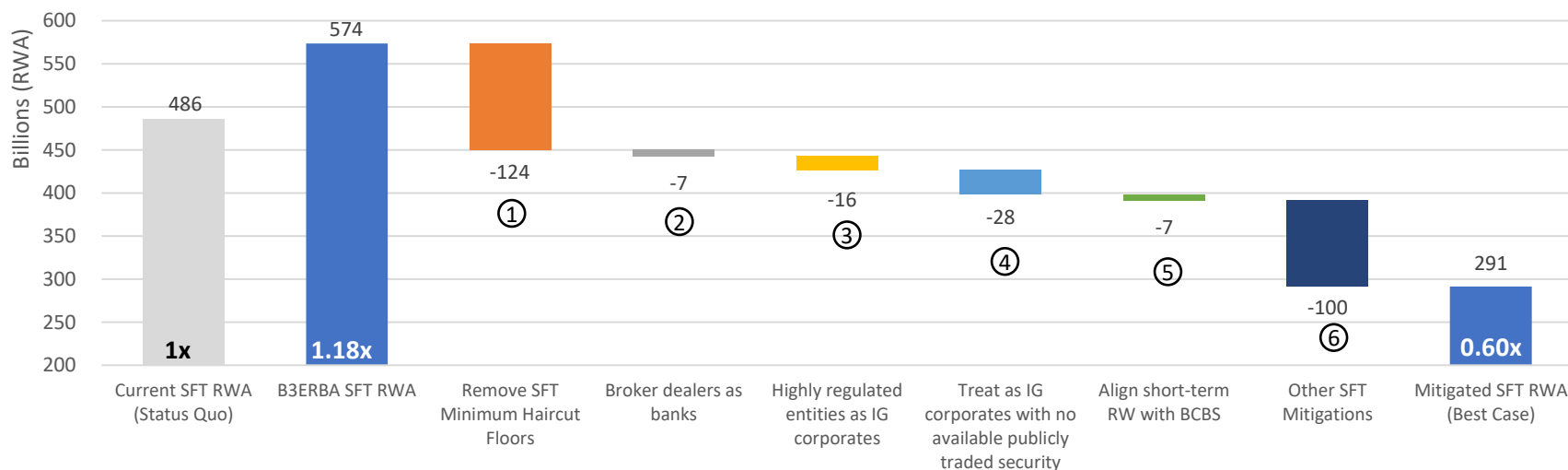
- **Appropriate recognition of hedges for exposures:** Improve recognition of single name and index hedges under both the basic CVA approach (“BA-CVA”) and standardized CVA approach (“SA-CVA”) frameworks.

2: BA CVA impact includes additional FI Bucket, reduced risk weights for carbon trading and excluding client cleared leg of CCTs

3: SA CVA impact includes additional FI Buckets, reduced risk weights for carbon trading, excluding client cleared leg of CCTs and increased cross-bucket correlation of 70% between 8 and 1-6

4: See pages 109-111 of the comment letter for additional empirical data in support of the granular financials risk bucket advocacy

Securities Financing Transactions (SFTs) Impact Summary



Impact of Quantified Mitigation Items:

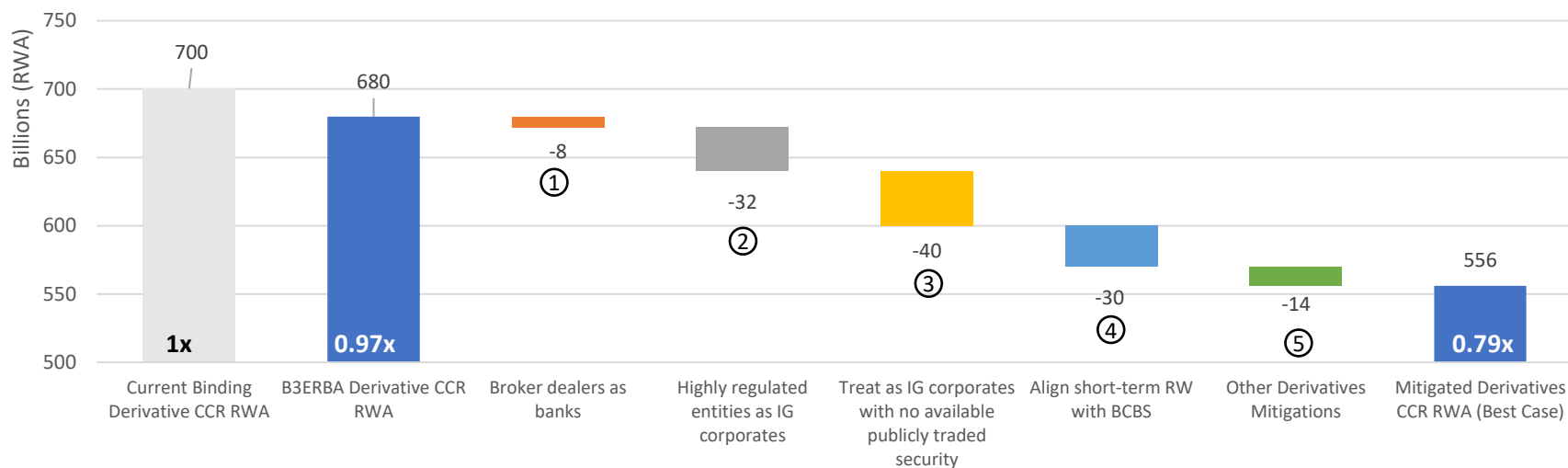
- 1. Removal of SFT Minimum Haircut Floors:** \$124Bn RWA reduction.
- 2. Treat broker dealers as banks:** \$7Bn RWA reduction.
- 3. Assign risk weight of 65% to highly regulated IG corporates even if no publicly traded security:** \$16Bn RWA reduction.
- 4. Assign risk weight of 65% to other IG corporates even if no publicly traded security:** \$28Bn RWA reduction
- 5. Align short-term (less than or equal to 3 months) RW for banks with Basel framework:** \$7Bn RWA reduction
- 6. Mitigation items below would cumulatively lead to an additional \$100Bn RWA reduction:**
 - Allow netting set exposure calculation (with diversification benefit) for single transactions/margin loans.
 - Remove public listing requirement for recognition of investment grade corporate debt.
 - Remove collateral requirement from market risk election.

Executive Summary – SFT Issues not included in the SFT Impact Summary

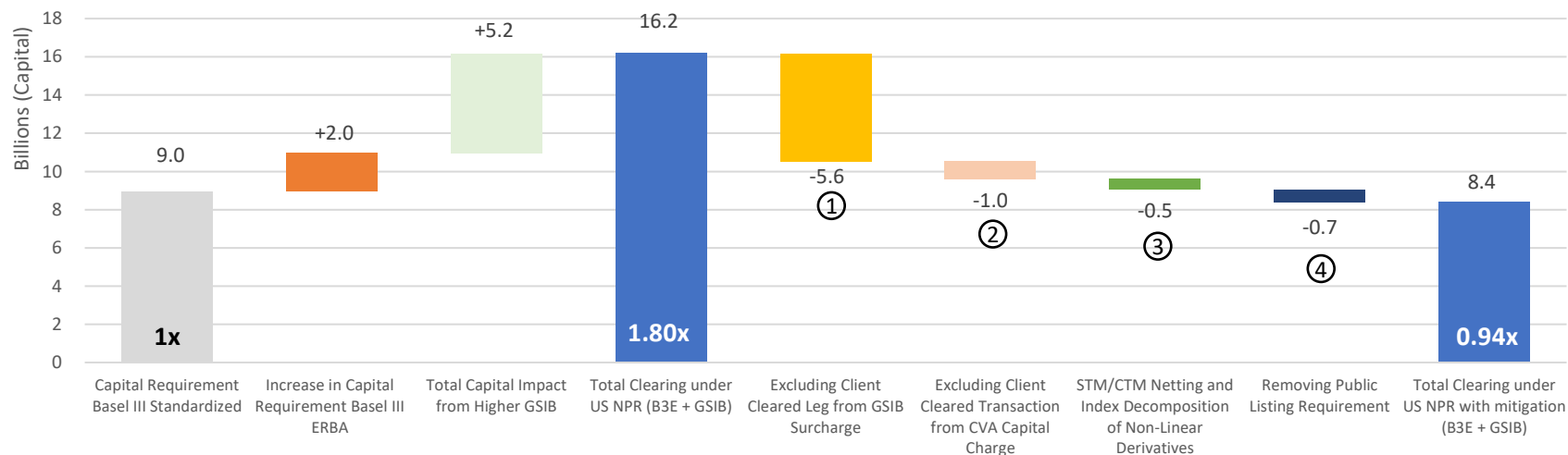
- It is critical that the US Agencies fully consider the exhaustive list of issues provided in the ISDA-SIFMA Comment Letter (Jan 2024), before publishing the final US rules to avoid unintended consequences to key US markets, including but not limited to the following:

| Topic | Key message |
|---|---|
| Volatility haircuts for GSE debt / ETFs | <ul style="list-style-type: none"> Haircut for GSE debt should be lowered from the proposed level applicable to corporate debt. A bank should be permitted to assign haircuts to ETFs based on a look-through approach similar to mutual funds. |
| Definition of IG | <ul style="list-style-type: none"> The current definition of investment grade only applies to certain exposures, i.e., loan or security or the reference entity with respect to a credit derivative. The definition should be expanded in order that it applies to all exposures, including derivatives and repo-style transactions. |

Derivatives CCR Impact Summary

**Impact of Quantified Mitigation Items:**

1. **Treat broker dealers as banks:** \$8Bn RWA reduction.
2. **Assign risk weight of 65% to highly regulated IG corporates even if no publicly traded security:** \$32Bn RWA reduction.
3. **Assign risk weight of 65% to other IG corporates even if no publicly traded security:** \$40Bn RWA reduction.
4. **Align short-term (less than or equal to 3 months) RW for banks with Basel framework:** \$30Bn RWA reduction.
5. **Mitigation items below would cumulatively lead to an additional \$14 billion RWA reduction:**
 - Allow STM trades at netting set level to be treated as CTM for client-cleared / bilateral exposures.
 - Allow decomposition of non-linear derivatives (e.g., options on indices).
 - Introduce lower supervisory factor for developed market equities in alignment with FRTB.

Clearing Businesses Impact Summary⁵**Impact of Quantified Mitigation Items:**

- 1. Exclude agency client-cleared exposures from GSIB surcharge⁶:** \$5.6Bn capital requirement reduction.
- 2. Exclude client-cleared transactions from CVA:** \$1.0Bn capital requirement reduction.
- 3. Net STM transactions with CTM and allow index decomposition of non-linear derivatives in SA-CCR:** \$0.5Bn capital requirement reduction
- 4. Remove public listing requirement for recognition of investment grade corporate debt as collateral:** \$0.7Bn capital requirement reduction.

5: The +\$5.2Bn total capital impact from higher GSIB is based on the following: a) inclusion of notional amounts of client transactions cleared under the agency model in the complexity indicator, b) inclusion of notional amounts of client transactions cleared under the agency model in the interconnectedness indicator, and c) expanding the FI definition and the implementation of SA-CCR.

6: The +\$5.6Bn (i.e., mitigation item 1) is based on excluding client transactions cleared under the agency model from the complexity and interconnectedness indicators (i.e., a. and b. from the previous footnote). Expanding the FI definition (c) is a net benefit and therefore, not included as part of the mitigating items.

Appendix – Key Recommendations

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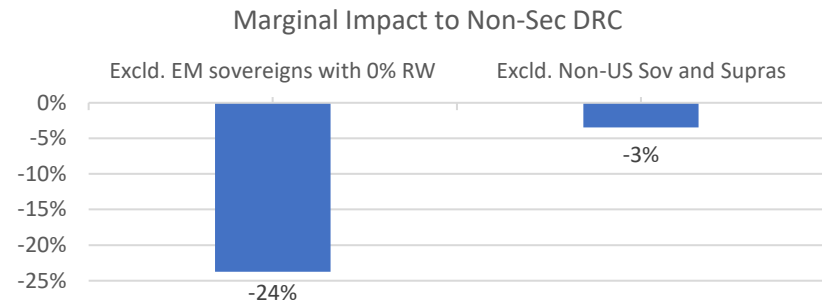
1.a. Sovereigns in SA-DRC

Industry Questions / Issues:

- Under the proposal, all non-US sovereign exposures, and exposures to Supranationals would be subject to a nonzero risk weight under the standardized default risk (SA DRC) capital requirement
- This proposed approach would result in a significant increase in capital requirements for market-making activities and could have negative effects on the liquidity of sovereign debt markets and related markets.

QIS Results:

The marginal impact to non-securitization SA-DRC of excluding EM sovereigns receiving 0% risk weight is a reduction of 24%.
The marginal impact to non-securitization SA-DRC of excluding sovereigns other than U.S. government securities and supranational entities is a reduction of 3% to total SA-DRC.



Industry Recommendations:

- Exposures that would receive a 0 percent risk weight under the proposed ERBA credit risk framework should not be subject to default risk capital requirements, including certain Supranationals and sovereign OECD members with no CRC or sovereigns with CRC between 0-1.
- Positions held in the trading book subject to default risk should not receive a more punitive capital treatment than if the same positions were held in the banking book
- In addition, local currency sovereign exposures that are effectively offset by an equivalent amount of local currency liabilities should be subject to a lower risk weight than the applicable risk weight for DRC
- Finally, for local currency sovereign exposures which do not have an equivalent amount of local currency liabilities, banks should be permitted to assign risk weights based on the credit quality of the non-U.S. sovereign with respect to exposures in the local currency

1.b. Sovereigns in SBM

Industry Questions / Issues:

- Under the proposal, certain sovereign, MDB and Supranational exposures would be subject to a nonzero risk weight for credit spread risk in the Sensitivity Based Method (SBM)
- However, for pricing and risk management purposes, these types of positions are typically not considered “credit risky”, and hence, the requirement to model credit spread risk will result in additional operational challenges and complexity
- The proposed approach introduces inconsistencies between the capital requirements for market risk and credit risk and, by increasing market risk capital requirements, could have adverse effects on the liquidity and functioning of markets for sovereign, supranational and MDB exposures.

QIS Results:

- The marginal impact to SA-SBM of excluding exposures to sovereigns, MDB and Supranationals receiving a 0 percent risk weight is a reduction of 3%

Industry Recommendations:

- Exposures to certain sovereigns as defined below, MDBs, and Supranationals should be exempted from credit spread SBM capital requirements:
 - All exposures that currently receive a 0 percent risk weight under
 - the proposed new standardized approach for credit risk under Subpart E (in particular, under Section 111(a)(1), 111(a)(2), 111(a)(5) and 111(b) of the Proposal)
 - or under Subpart D of the current U.S. capital rules (in particular, under Section 32(a)(1), 32(a)(2), 32(a)(5) and 32(b) of the current U.S. capital rules)
 - This would include exposures to OECD sovereigns with no CRC or a CRC between 0-1.
 - Sovereign exposures denominated in a local currency

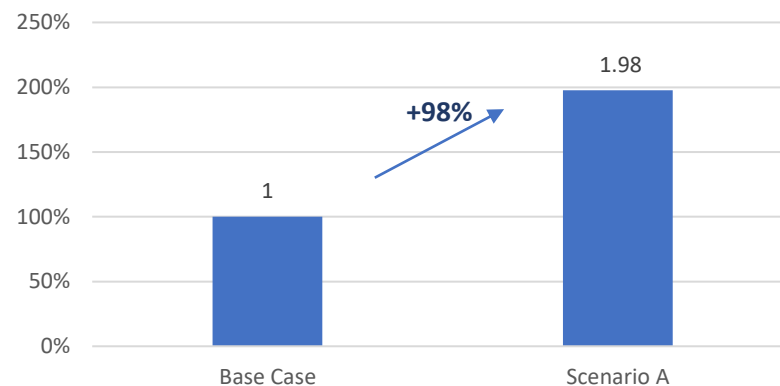
2. Credit Spread Risk for Government Sponsored Entities (GSEs)

Industry Questions / Issues:

- TBAs and deliverable pools are interchangeable exposures and each of TBAs and pools are, therefore, generally used by market participants to hedge positions in one another. Treating TBAs and UMBS-eligible deliverable pools as the same obligor would be consistent with the treatment of mortgage pools that are UMBS-eligible and TBAs under the proposed DRC framework.
- If this recommendation is not implemented, GSE exposures involving UMBS and deliverable pools would be subject to higher capital requirements that do not reflect the underlying risks of these transactions, which would have adverse effects on the depth and liquidity of the RMBS markets.
- This would undermine the implementation of the UMBS market that was intended to increase liquidity by creating a combined market for Fannie Mae and Freddie Mac securities.

QIS Results:

If the recommendation to treat TBAs and UMBS-eligible deliverable pools as the same obligor is not implemented, then FRTB SA capital for GSE exposures will increase by 98%



| Scenario | TBA & UMBS | UMBS-eligible pools | UMBS-ineligible pools |
|----------|------------|---------------------|-----------------------|
| A | UMBS | FN & FH | |
| Base | UMBS | | FN&FH |

Industry Recommendations:

- TBAs and deliverable pools that are eligible as UMBS would be treated as the same obligor under SBM and DRC.

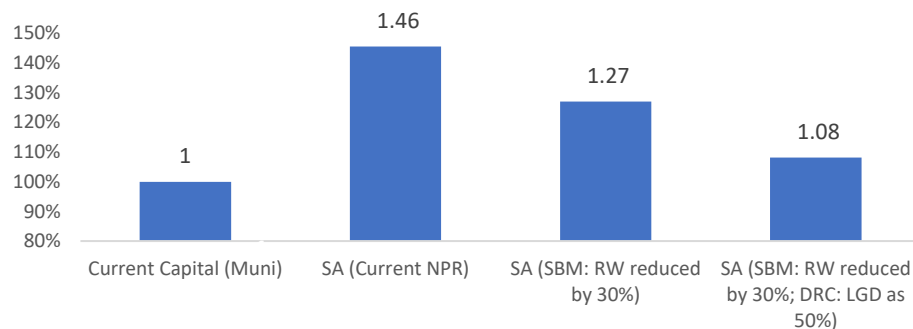
3. Municipal bonds in SA-SBM and SA-DRC

Industry Questions / Issues:

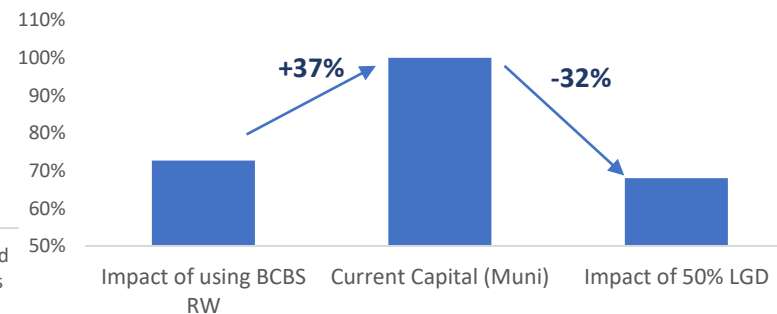
- In general, the Proposal does not take into account the tax-exempt treatment of municipal bonds, including that a banking organization will reflect the tax-exempt status of municipal bonds in devising its hedging strategy as an economic and risk management matter. As a result, under the Proposal, even a fully hedged position in a municipal bond will appear to have a residual sensitivity with respect to interest rate risk that would incur a capital charge under SBM. This proposed treatment would have adverse effects on the liquidity of municipal bond markets.
- Under the proposal, most PSEs would receive a 75 percent LGD because most PSE exposures are senior debt instruments. Under a recent study regarding the empirical default recovery rates of municipal bonds, the average issuer-weighted LGD have been approximately 34%.

QIS Results:

QIS Capital Impact on Books containing PSE exposure



QIS Capital Impact on PSE only exposure



Industry Recommendations:

- The final rule should consider the tax-exempt treatment of municipal bonds, e.g., applying scaling factor to risk weights in SA SBM to recognize the tax-exempt status of municipal bonds
- A 50% LGD should be used for U.S. PSE debt.

4. Carbon Trading in SA SBM

Industry Questions / Issues:

- The proposed 60 percent risk weight that would apply to carbon trading under the Proposal is not sufficiently risk sensitive or reflective of the economics of these arrangements.
- A lower risk weight also would be consistent with broader public policy objectives to promote liquidity in the markets for carbon certificates and consistent with proposed implementation in the EU.

QIS Results:

- The proposed risk weight will reduce the FRTB SA capital requirement for Carbon Trading by 52%, and the overall SA capital requirement for the Commodities asset class by 16%.

Industry Recommendations:

- As an empirical matter, in light of the historical volatility of these instruments, the Associations believe a 40 percent risk weight would be more appropriate.

5. CVA Market Risk Hedges

Industry Questions / Issues:

- The definition of a market risk covered position would include ineligible CVA hedges, i.e., the CVA segment of an internal risk transfer that is not an eligible CVA hedge, or a CVA hedge with an external party that is not an eligible CVA hedge.
- Ineligible CVA hedges reduce the economic risk of the banking organization and are an element of sound risk management practices. However, the Proposal would in fact add these positions to market risk capital requirements, such that the capital outcome would diverge from the economics of the arrangement and prudent risk management.
- Under the proposal, CVA risk managed by a banking organization's CVA desk would be subject to market risk capital requirements if the hedge is considered ineligible, which diverges from the current U.S. capital rules.
- The limited set of instruments that would be eligible CVA hedges under BA-CVA is unduly restrictive and would not reflect either current risk management practices or techniques with respect to CVA risk as currently applied under the existing regulatory capital rules.

QIS Results:

- Including ineligible CVA hedges in market risk would increase FRTB SBM capital requirements by 3%.

Industry Recommendations:

- CVA hedges that do not qualify as eligible CVA hedges should not be automatically included in market risk capital requirements

6. Correlation Trading Portfolio (CTP) Decomposition

Industry Questions / Issues

- Although the Associations appreciate that the Proposal would permit the decomposition of multi-underlying instruments under the SBM, there remains a lack of clarity regarding the implementation of decomposition under DRC.
- **Calculation of decomposed single name default JTDs exposures:**
 - Issue 1: Page 64127 of the U.S. NPR says that the “*decomposition into single-name equivalent exposures account for the effect of marginal defaults of the single names in the tranching correlation trading position, where ... the sum of the decomposed single name amounts would be required to be consistent with the undecomposed value of the tranching correlation trading position*”. It is unclear how to interpret the underlined requirement given that the sum of the decomposed single name based on marginal defaults of the tranche is different compared to the undecomposed value of the tranche position
 - Issue 2: As per section 210(b)(1)(iv) a bank must assign zero recovery when calculating the decomposed JTDs of multi-underlying instruments. This is inconsistent with single-underlying instruments and leads as such to incorrect net JTD results
 - Issue 3: Single name CDS also should be included in the net default exposure calculation in §_.210(d)(2)(iii) to reflect more appropriately the economics of these positions.
- **Risk weighting / bucketing of decomposed single name exposures:** The rule does not provide any method regarding the risk weight to assign to the net JTDs obtained via decomposition. The industry would like to confirm that banks can assign the non-securitization risk weights in Table 1 to §_.210 to net JTDs by decomposed underlying name. Furthermore, the Industry wants to confirm that the bank can use the same buckets for decomposed JTDs as those applicable to non-securitization exposures as per section 210(b)(3)(i) instead of using buckets per index given that an index is not relevant for decomposed JTDs.
- **Residual Component:** The netting of decomposed single name exposures is allowed “*when the long and short gross default exposures are otherwise equivalent except for a residual component.*” The “except for residual component” language should not impose any restriction as to when a long and a short decomposed JTD of the same obligor can be netted and, instead, any remaining decomposed net JTD should be capitalized along the lines outlined above

6. Correlation Trading Portfolio (CTP) Decomposition (Cont.)

QIS Results:

- If decomposition is not permitted, capital requirements for CTPs would increase by 195% percent over current Basel 3 capital, driven largely by DRC. If decomposition is permitted and non-securitization risk weights are applied to the decomposed single name net default exposures, capital requirements will be lower, though would still result in a 33% increase over current Basel 3 capital.

Industry Recommendations:

- **Calculation of decomposed single name default JTDs exposures:**
 - Requirement to scale the sum of the decomposed JTDs to the undecomposed JTD of the tranche should be removed
 - A bank should be able to use LGD assumptions defined in §_.210(b)(1)(v) in calculating net default exposure of multi-underlying instruments, including tranches, under §_.210(d)(2)(iii).
 - Single name CDS also should be included in the net default exposure calculation
- **Risk weighting / bucketing of decomposed single name exposures:**
 - Allow banks to assign non-securitization risk weights to decomposed JTDs as per table 1 to section 210 and use the non-securitization buckets for aggregation purposes
- **Residual Component:**
 - Allow banks to use the same buckets for decomposed single name net default exposures calculated under §_.210(d)(iii) as those applicable to non-securitization exposures under §_.210(b)(3)(i), not the index buckets in §_.210(d)(3)(i)

7. SA SBM Diversification

Industry Questions / Issues:

- FRTB SA's SBM, by design, does not recognize any diversification between asset classes (risk class-levels).
- As a point of comparison, using quarterly data publicly reported by the 8 U.S. GSIBs in Pillar III disclosures between Q1 2020 through Q1 2023, applying a correlation parameter of 0.5 across VaR for each asset would have resulted in an aggregate VaR number that would have been 45 percent higher on average than the fully diversified VaR
- Even during the COVID-19 stress periods in Q1 and Q2 2020, a 0.5 correlation parameter would have resulted in approximately 30 percent higher total VaR

QIS Results

- A correlation parameter of 0.5 would result in a 10.7% reduction in overall FRTB-SA capital

Industry Recommendations:

- A correlation parameter across risk class-levels within SBM should be introduced, using similar mathematical forms as existing aggregations within asset classes:

$$\text{capital requirement} = \sqrt{\sum_b SBM_b^2 + \sum_b \sum_{c \neq b} \rho_{bc} SBM_b SBM_c} + DRC + RRAO$$

- SBM_b is the risk class-level capital requirement for each of the 7 asset classes: GIRR, Equity, FX, Commodities, Credit (non-sec, non-CTP), Credit (sec, non-CTP), and credit (CTP)
- ρ_{bc} is a new inter asset correlation parameter or parameter set (effectively set to 100% in BCBS and NPR)
- A value of 0.5 for this new correlation parameter is recommended

8. IMA Diversification

Industry Questions / Issues:

- The SES formula would include a rho parameter equal to 0.6 in the SES calculation. This calibration of the rho parameter is too conservative and does not properly take into account the benefits of diversification of systematic components of NMRF. The proposed calibration would not accurately reflect the economics of transactions and would significantly limit the utility of the FRTB-IMA.
- In addition, a rho parameter of 0.5 under the ES calculation for modellable risk factors would be too conservative and would not sufficiently take into consideration the benefits of diversification.
 - Using data between December 2019 and June 2023 (excluding collection from the March 2020 COVID-19 stress period), a rho parameter of 0.5 results in a total FRTB-IMA figure that is on average approximately 65 percent higher than the fully diversified ES measure, whereas adjusting the rho parameter to 0.75 would result in a total FRTB-IMA figure that would still be 33 percent higher on average than the fully diversified ES measure.

QIS Results

- Decreasing NMRF rho parameter from 0.6 to 0.25 would result in \$40.1 Bn RWA reduction for modelled desks
- Increasing the ES rho parameter from 0.5 to 0.75 would result in \$28 Bn RWA reduction for modelled desks

Industry Recommendations:

- The calibration of the rho parameter under the SES calculation should be decreased from 0.6 to 0.25
- The calibration of the rho parameter under the ES calculation should be increased from 0.5 to 0.75

9. Modelled Capital Formula Changes - Split of DRC

Industry Questions / Issues :

- The FRTB capital formula at firm level splits the default risk charge into separate computations for modelled desks and non-modelled desks. This split is unnecessary and uneconomic for modelled scope (vs standardized scope) since there is only a single default risk charge methodology available under the U.S. rules.

QIS Results:

- Calculating a single DRC for all desks would result in \$11.0 Bn reduction as opposed to the case where DRC is calculated separately for modelled desks and non-modelled desks.

Industry Recommendations:

- The requirement to split the default risk charge computation under modelled scope should be removed.
- Hence, the industry proposes the following updated capital formula post removal of the 2nd term $\max((IMA_{G,A} - SA_{G,A}), 0)$, for computation of FRTB capital for the global portfolio:

$$IMA_{total} = \min \left((IMA_{G,A} + PLA \text{ addon} + SA_U), SA_{all desks} \right) + fallback \text{ capital} + capital \text{ addons} + DRC_{all desks}$$

Where,

$IMA_{G,A}$ is the non-default risk IMA capital requirement for modelled desks;

SA_U is the non-default risk SA capital requirement for the non-modelled desks;

$SA_{all desks}$ is the non-default risk SA capital requirement for the global portfolio;

$DRC_{all desks}$ is the standardized default risk charge for the global portfolio.

10. CVA Financials Risk Bucket

Industry Questions / Issues:

- Under the Proposal, all financials would be assigned to bucket number 2 and subject to a risk weight of 5% for investment grade and 12% for speculative grade and sub-speculative grade exposures for purposes of the delta counterparty credit spread risk.
- The proposed risk weights for financials under the CVA framework are not appropriately risk sensitive and do not sufficiently recognize differences in risk profile between regulated financial institutions, highly regulated entities, and unregulated financial institutions

QIS Results:

Material reduction under Proposed FI Granular Bucket Ratio

- 14% reduction in BA CVA
- 19% reduction in total CVA

Industry Recommendations:

- Exposures to regulated financial institutions and highly regulated entities should receive a risk weight of 3% for investment grade exposures and 8.5% for non-investment grade exposures. Exposures to unregulated financial institutions should receive a risk weight of 5% for investment grade exposures and 12% for non-investment grade exposures.

| | | Sovereigns | Local Govt. | Financials | | Materials, energy, ... | Consumer goods, ... | Tech, comms, ... | Health, Utilities, ... | Other | Qualified Indices |
|----------|-----------|-------------|-------------|------------|--------|---------------------------|------------------------|---------------------|---------------------------|--------|----------------------|
| B3E NPR | Bucket | 1a | 1b | 2 | | 3 | 4 | 5 | 6 | 7 | 8 |
| | IG | 0.50% | 1.00% | 5.00% | | 3.00% | 3.00% | 2.00% | 1.50% | 5.00% | 1.50% |
| | HY and NR | 3.00%/7.00% | 4.00% | 12.00% | | 7.00% | 8.50% | 5.50% | 5.00% | 12.00% | 5.00% |
| | | | | | | | | | | | |
| Proposed | Bucket | 1a | 1b | 2a | 2b | 3 | 4 | 5 | 6 | 7 | 8 |
| | IG | 0.50% | 1.00% | 3.00% | 5.00% | 3.00% | 3.00% | 2.00% | 1.50% | 5.00% | 1.50% |
| | HY and NR | 3.00%/7.00% | 4.00% | 8.50% | 12.00% | 7.00% | 8.50% | 5.50% | 5.00% | 12.00% | 5.00% |

Regulated Financials /
Highly Regulated Entities

Unregulated Financials

11. CVA Scope - Client Facing Exposure on Cleared Transactions

Industry Questions / Issues:

- The proposal will require Banks to calculate a CVA capital charge for its exposure to client-facing leg of a trade cleared through a CCP where the banking organization is acting as the clearing member.
- While we understand that the Agencies have previously considered this issue, changes in circumstances warrant a reevaluation of the issue in connection with the Proposal for several reasons:
 - The Proposal would include CVA in ERBA which likely will become the binding constraint for most large banking organizations, while currently the CVA framework applies only under the advanced approaches which is not binding constraint
 - These exposures are not subject to CVA under U.S. GAAP as banks do not suffer CVA losses on client facing exposures
 - Other jurisdictions, most notably the EU and the UK, have excluded or proposed to exclude the client-facing leg of cleared derivative transactions from CVA risk capital requirements
 - There is a significant negative aggregate impact on client clearing when viewed together with other features of the Proposal and the separate Federal Reserve proposal regarding the GSIB Surcharge

QIS Results:

- Impact of excluding client cleared transactions leads to 9% reduction in total CVA RWA

Industry Recommendations:

- Client facing exposure on a cleared transaction should be excluded from CVA capital requirements

12. CVA Cross-Sector Index CDS Hedges

Industry Questions / Issues:

- The proposed SA-CVA framework would not sufficiently recognize the risk mitigation of index CDS hedges.
- Cross-sector index CDS hedges and options on index CDS hedges are common risk management tools for hedging CVA counterparty spread risk. This risk management practice would be insufficiently recognized in the proposed SA-CVA in light of the relatively low qualified index cross-bucket correlation treatment. In addition, a bank would enter into index hedging only if the hedge is determined to be effective in managing CVA risk.

QIS Results:

- Increasing the cross-bucket correlation to 0.7 will reduce the SA-CVA capital requirement by 13% over the current proposal.

Industry Recommendations:

- The SA-CVA counterparty credit spread delta cross-bucket correlation between the qualified index bucket and the buckets other than the “Other sector” bucket should be revised to 70%.

13. SFT Minimum Haircut Floor - Rationale for Inclusion

Industry Questions / Issues:

- We do not believe that there are compelling reasons for adopting the SFT Haircut Floor framework in the United States
- Considerations:
 - None of Canada, the EU, UK or Japan have proposed to implement the Floor. It is unclear why U.S. market or regulatory conditions warrant a different regulatory standard.
 - There is no market or supervisory evidence cited in the proposal to justify imposition of the Floor. Other than being an element of the global Basel Accord, there does not appear to be any compelling logic for inclusion of the Floor in the U.S. regulatory capital framework.
 - The Floor does not appear to be well-designed to address potential policy concerns with financing arrangements in U.S. securities markets. As a policy tool there needs to be further consideration on the scope of application .
 - While the securities borrowing exception is helpful and welcomed, the criteria for its application introduce ambiguity risk in practice. Although our comment letter suggests changes to clarify these issues, any residual ambiguity in a final rule would introduce challenges for the efficient operation of this important market.

QIS Results:

- Removing the minimum haircut floor framework would lead to 26% reduction in the RWA for all securities financing transactions with unregulated financial institutions.

Industry Recommendations:

- The minimum haircut floor framework should not be implemented

14. Treat Exposures to Broker-Dealers and Other Financials as Bank Exposures

Industry Questions / Issues:

- Under the Basel framework, an exposure to a securities firm or other financial institution may be treated as an exposure to the bank if the securities firm or other financial institution is subject to prudential standards and supervision equivalent to the standards applicable to banks. The Proposal would not include this aspect of the Basel framework.

QIS Results:

- Treating exposures to Broker-Dealers as exposures to Bank would reduce SFT RWA by \$7 Bn and Derivatives CCR RWA by \$8 Bn.

Industry Recommendations:

- The rules text should incorporate a framework to treat certain exposure to a securities firm or other financial institution as bank exposures qualifying for the lower risk weights applicable to banks, including exposures to:
 - A broker-dealer, swap dealer or foreign equivalent directly subject to Basel-based bank capital requirements
 - Non-bank swap dealers that have elected to apply the bank-based approach for capital requirements
 - Broker-dealers that are subsidiaries of bank holding companies
 - U.S. bank holding companies

15. “Publicly traded” Requirement to Receive 65% Risk Weights for Corporate Exposures

Industry Questions / Issues:

- Investment grade corporate counterparties (as defined under the current U.S. capital rules) should receive a 65 percent risk weight as opposed to 100 percent irrespective of whether the entity (or its parent) has securities listed on a securities exchange.
- The industry, in a comment letter submitted by the American Bankers Association (“ABA”) and the Bank Policy Institute (“BPI”), has prepared detailed recommendations regarding how the Agencies should revise the design of this aspect of the proposed credit risk framework in ERBA.

QIS Results:

- Assigning lower IG corporate risk weight of 65 percent to highly regulated IG entities even if no publicly traded security is issued by the entity or its parent reduces SFT RWA by \$16 Bn and Derivatives CCR RWA by \$32 Bn
- Assigning lower IG corporate risk weight of 65 percent to IG corporates even if no publicly traded security is issued by the entity or its parent (impact does not include highly regulated entities) reduces SFT RWA by \$28 Bn and Derivatives CCR RWA by \$40 Bn

Industry Recommendations:

- The requirement for the issuer or a parent to have a security listed on a public exchange to receive a 65 percent risk weight should be removed.

16. Risk Weight for Short-Term Exposures to Banks

Industry Questions / Issues:

- The Proposal would not include a lower risk weight for certain short-term exposures to banking organizations (such as securities financing transactions) as provided under the Basel framework.
- Differentiating by maturity risk is consistent with the regulatory intent of the Proposal. In particular, the preamble to the Proposal provides that ERBA is intended to be “more risk-sensitive than the current U.S. 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).”

QIS Results:

- Aligning short-term risk weight for banks with that of Basel, i.e., all bank exposures ≤ 3 months subject to lower risk weight in Table 2 (page 54 of 1087 USNPR) would lead to \$7 Bn SFT RWA reduction and \$30 Bn Derivatives CCR RWA reduction.

Industry Recommendations:

- There should be a lower risk weight applicable for short-term exposures to banking organizations as provided under the Basel framework.