May 3, 2024

Via Electronic Mail

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

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: James P. Sheesley, Assistant Executive Secretary, Comments/Legal OES

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

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008)

Ladies and Gentlemen:

The Bank Policy Institute[1] and the American Bankers Association[2] appreciated the opportunity to meet with you on April 3 and April 5, 2024, to discuss the joint notice of proposed rulemaking that would amend the capital requirements applicable to large banks and those with significant trading activity.

Attached as **Annex 1** hereto please find responses to several questions raised by the agencies during the course of those meetings.

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1 BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks and major foreign banks doing business in the United States. Collectively, they employ almost two million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 The American Bankers Association is the voice of the nation's $23.5 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $18.6 trillion in deposits and extend $12.3 trillion in loans.

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If you have any questions, please contact Francisco Covas, Executive Vice President and Head of Research, Bank Policy Institute by email at Francisco.Covas@BPI.com or Hu Benton, Senior Vice President and Policy Counsel, American Bankers Association by email at hbenton@aba.com.

May 3, 2024

Annex 1

Responses to Questions Raised in Interagency Meetings to Discuss Basel III Proposal

- **Question:** The comment letter describes overdrafts over 90-days in the non-retail space. Are 90-day+ overdrafts only an issue in the non-retail space or are there issues in the retail space as well?

  - **ABA/BPI Response**: The 90-day overdraft issue cited at the top of p. 83 of the comment letter relates to only the non-retail space.

- **Question:** What is the concern with the one-to-two month extensions for borrowers experiencing hardship falling under the definition of defaulted exposure, given that clause (i) of the definition provides for a 90-day past due period?

  - **ABA/BPI Response**: The proposal provides that for retail exposures, a credit obligation would be considered a "defaulted exposure" if any of the following has occurred: "(1) the exposure is 90 days past due or in nonaccrual status; (2) the [banking organization] has taken a partial charg-eoff, write-down of principal, or negative fair value adjustment on the exposure for credit-related reasons, until the banking organization has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure; or (3) a distressed restructuring of the exposure was agreed to by the [banking organization], until the [banking organization] has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure as demonstrated by a sustained period of repayment performance, provided that a distressed restructuring includes the following made for credit-related reasons: forgiveness or postponement of principal, interest, or fees, term extension, or an interest rate reduction."

    While clause (1) of the definition explicitly includes a 90-day grace period, the concern is that the definition of distressed restructuring in clause (3) of the definition would pick up the short-term extensions less than 90 days because the extension could entail a postponement of principal, interest or fees or extension of the term of the loan, in each case for credit-related reasons. Clause (3) is a bright-line test that does not contemplate any grace or similar period for short-term postponements or extensions.

    By way of example, clause (1) of the definition of "defaulted exposure" does not impose a heightened risk weight on loans that are less than 90 days past due. This clause, on its own, would not result in short-term auto loan term extensions (typically a grace period of one or two months) being considered "defaulted exposures."

    However, the definition of "distressed restructuring" in clause (3) would result in short-term auto loan extensions being considered "defaulted exposures." Under clause (3), a distressed restructuring appears to include *any* "forgiveness or postponement of principal, interest, or fees, term extension, or an interest rate reduction," which does not contemplate any grace period for short-term auto loan term postponements or extensions. The requirement that a "sustained period of repayment performance by the borrower is generally a minimum of six months" also does not have any accommodation for short-term postponements or extensions. Put differently, under clause (3), an auto loan would be deemed a "defaulted exposure" immediately upon the issuance of a short-term

loan extension–resulting in a 150% risk-weighting until the borrower has met the requirement for "a sustained period of repayment performance" (a minimum of six months after the term extension is issued).

- **Question:** Are investments in financial market infrastructure made pursuant to a CCP requirement or are they at the banks' discretion? Do equity investments in financial market infrastructure include default fund contributions?

  - **ABA/BPI Response:** Financial market infrastructures (FMIs) encompass a broad range of entities, including payment systems, securities settlement systems, central securities depositories, central counterparties (CCP) and trade repositories. Equity investment requirements vary on an entity-by-entity basis and are often a condition for participating banks or at a minimum a requirement to participate fully in the facilities of the FMI. As such these types of investments are generally not financial investments but made in the context of the bank engaging in clearing related activities. The investments provide support for entities that play a critical role in the U.S. and global financial system by providing the infrastructure for payment, clearing, and settlement activities across a wide range of financial products, transactions, and instruments.

    It should be noted that banks would not directly invest in CCPs but rather in parent entities or related group entities. As such, these investments are not part of the waterfall that the CCP can draw upon in the case of any shortfalls. Therefore, these equity investments are distinctly different compared to default fund contributions which are financial resources available to CCPs and the basis for the risk weight associated with default fund contributions is not relevant for these type of equity investments.

- **Question:** Is the issue with the definition of "other operating income" not being limited to income associated with financial services only a problem for IHCs of foreign banking organizations being reimbursed for shared services? Can you quantify the impact of excluding so-called recharge income from the IHCs of foreign banking organizations?

  - **ABA/BPI Response:** The proposed inclusion of income received from affiliates in connection with corporate or shared services, such as those relating to information technology or human resources, in the definition of "other operating income" is focused on IHCs of foreign banking organizations, where shared services income would not be eliminated in consolidation with the foreign parent. In addition, unlike U.S. BHCs, IHCs often have service company subsidiaries that provide these services to affiliates outside the U.S.

  - We conducted an extended Quantitative Impact Study on the Services Component as of June 30, 2023, to analyze the potential impact of excluding recharge income from the calculation of risk-weighted assets for operational risk. The results shown below are based on data provided by seven IHCs.[3] In the study, six out of seven participating IHCs subtracted recharge income from "other operating income," while one firm deducted recharge income from "Fee Income".

[3] This includes all IHCs with total assets greater than $100 billion.

- **Figure 1** summarizes the changes to the services component when recharge income is excluded under two scenarios: (1) Baseline; and (2) Netting in the Services Component.[4] In the baseline case, the services component is set to an index value of 100.

Figure 1

QIS on the Services Component as of 06/30/2023

	Effect on Services Component			
	Baseline [(1)]	Removing Recharge Income	Netting Fee Income and Expenses Option 1	Netting Option 1 and Removing Recharge Income
	100	89	72	66

(1) Services Component under Baseline is set to 100.

  - Excluding recharge income reduces the services component by 11 percent. Netting Fee income with fee expenses results in a 28 percent decrease in the services component compared to the baseline case. When recharge income is also removed under this scenario, the services component experiences a more significant decrease of 34 percent.

  - However, the netting formula used in **Figure 1** can lead to increases in the services component when most of the other operating income consists of recharge income. This occurs because the formula deducts recharge income from other operating income. To address this issue, we have calculated an alternative netting approach. In this approach, we first combine fee income with other operating income. Then, we net the sum of fee expenses with other operating expenses. This alternative calculation helps to avoid the potential distortion caused by the presence of significant recharge income in other operating income.

- **Figure 2** summarizes the changes to the services component when recharge income is excluded under two scenarios: (1) Baseline; and (2) a second option of Netting in the Services Component.[5] In the baseline case, the services component is set to an index value of 100.

[4] The formula for offsetting fee income with fee expenses is as follows:

$$SC = |Avg_{3y}(\text{fee income}) - Avg_{3y}(\text{fee expense})| + |Avg_{3y}(oth\ oper\ inc) - Avg_{3y}(oth\ oper\ exp)|$$

[5] The formula for offsetting fee income with fee expenses under Option 2 is as follows:

$$SC = \left|\left(Avg_{3y}(\text{fee income}) + Avg_{3y}(oth\ oper\ inc)\right) - (Avg_{3y}(\text{fee expense}) + Avg_{3y}(oth\ oper\ exp))\right|$$

Figure 2

QIS on the Services Component as of 06/30/2023	Effect on Services Component			
	Baseline [1]	**Removing Recharge Income**	**Netting Fee Income and Expenses Option 2**	**Netting Option 2 and Removing Recharge Income**
	100	89	60	44

(1) Services Component under Baseline is set to 100.

- Netting Fee income with fee expenses under Option 2 results in a 40 percent decrease in the services component compared to the baseline case. When recharge income is also removed under this scenario, the services component experiences a more significant decrease of 56 percent.

- In addition to removing recharge income, we strongly recommend using an alternative definition of netting as defined in footnote 5.