WELLS FARGO

Mike Santomassimo
Chief Financial Officer

30 Hudson Yards
60th Floor
New York, NY 10001
USA

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Via Electronic Submission

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Attn: Docket ID OCC-2023-0008
400 7th Street SW, Suite 3E-218
Washington, D.C. 20219

Ann E. Misback
Secretary
Attn: Docket No. R-1813
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Robert E. Feldman
Executive Secretary
Attn: Comments, RIN 3064-AE29
Federal Deposit Insurance Corporation
550 17th Street, N.W. Washington, D.C. 20429

Re: Notice of Proposed Rulemaking - Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity

Ladies and Gentlemen,

Wells Fargo & Company, together with its affiliates and subsidiaries ("Wells Fargo," "we," "our," or "us"),[1] appreciates the opportunity to comment on the joint notice of proposed rulemaking entitled *Regulatory capital*

[1] Wells Fargo & Company (NYSE: WFC) is a leading financial services company that has approximately $1.9 trillion in assets, proudly serves one in three U.S. households and more than 10 percent of small businesses in the U.S., and is a leading middle market banking provider in the U.S. We provide a diversified set of banking, investment and mortgage products and services, as well as consumer and commercial finance, through our four reportable operating segments: Consumer Banking and Lending, Commercial Banking, Corporate and Investment Banking, and Wealth & Investment Management. Wells Fargo ranked No. 41 on Fortune's 2022 rankings of America's largest corporations. In the communities we serve, we focus our social impact on building a sustainable, inclusive future for all by supporting housing affordability, small business growth, financial health, and a low-carbon economy.

rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity (the "Proposal")[2]. The Proposal represents the U.S. implementation of the 2017 Basel Committee on Banking Supervision's ("Basel Committee" or "BCBS") final Basel III reform package.[3] We appreciate the efforts of the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Federal Deposit Insurance Corporation ("FDIC" and together with the OCC and FRB, the "Agencies") to update the risk-based capital framework.

Wells Fargo believes the Agencies should provide more thorough analysis of the Proposal's economic effects and better calibrate it to reflect the risks of a bank's activities more accurately. Without these important adjustments, the Proposal may contribute to driving banking and financial services outside of the regulated banking sector to less regulated non-bank lenders and financial services providers, which would negatively impact credit availability, increase costs for U.S. households and businesses, undermine reforms to enhance financial stability and, therefore, increase systemic risk. In calibrating capital requirements, the Agencies should holistically consider the cumulative impact of post-crisis reforms, including capital buffers, which are inextricably linked to the requirements in the Proposal.[4]

We have organized our comment letter to highlight seven key recommendations and included an appendix with detailed technical comments on suggested modifications or clarifications to facilitate consistent implementation across banking organizations.

Our key recommendations are:

1. *The operational risk charge should be recalibrated* because it is overly conservative relative to historical operational risk losses, unduly penalizes fee-based businesses, which provide important diversification to banking organizations' revenue, and would increase the cost of credit and other services for all types of customers, including consumers and small businesses.
2. *Risk weights for residential mortgage exposures should be reduced* to reflect the risk of these exposures more accurately and to avoid disincentives for banks to lend to those most in need of affordable credit to finance the purchase of a home, the primary wealth-building asset for many American families.
3. *The securities listing requirement for investment grade corporate exposures should be recast to allow for the use of reliable financial information* instead of a narrower requirement that excludes non-public, small, and middle-market borrowers from investment grade status.
4. *Risk weights for federal tax credit programs should be treated equally and reflect the underlying risk* to align the regulatory capital treatment of national policy priorities.
5. *Hedging of banking book equity exposures should continue to be recognized as risk mitigating activity,* which remains relevant and incentivizes firms to reduce risk through appropriate hedging activity.
6. *The market risk capital treatment of agency residential mortgage-backed securities should better reflect risk* to enable the residential mortgage market to function efficiently.
7. *The collateral haircut floor for securities financing transactions should be removed* to better recognize risk mitigating effects of collateral and avoid cliff effects.

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2 *See* Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, 88 Fed. Reg. 64028 (Sept. 18, 2023).

3 *See* Consolidated Basel Framework, *available at https://www.bis.org/ basel_ framework/* ,(hereinafter "Basel Framework").

4 *See, e.g.*, Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies, 83 Fed. Reg. 17317, 17319 (April 19, 2018) ("Post-crisis regulatory reforms, including the capital rule, the eSLR rule, and the Board's GSIB surcharge rule, were designed to improve the safety and soundness and reduce the probability of failure of banking organizations, as well as to reduce the consequences to the financial system if such a failure were to occur.").

We also support the comment letters on the Proposal submitted by the Financial Services Forum ("FSF"), jointly by the Bank Policy Institute ("BPI") and American Bankers Association ("ABA"), and jointly by the International Swaps and Derivatives Association ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA").

1. Operational Risk Calibration

We recognize that operational risk events[5] can result in material losses and that banks should hold some amount of capital to absorb such losses; however, the Proposal would require excessive operational risk capital relative to such risks. The proposed level of operational risk capital is not adequately analyzed or justified and far exceeds the actual operational risk loss history of large U.S. banking organizations.[6] The overall level of operational risk capital required under the Proposal is a result of the combination of choices made during the development of the Standardized Approach ("SA") at the Basel Committee and the Proposal's approach to adopting the SA into the U.S. regulatory capital framework. The Proposal's approach creates overlap in how potential future operational losses are captured between the SA and the Stress Capital Buffer ("SCB") via Comprehensive Capital Analysis and Review ("CCAR").

Throughout its development, the Basel Committee changed the SA materially. For example:

- While earlier versions of the SA guidance included limits on the amount of fee income used in the operational risk calculation, the final guidance omitted the limiting functions, thereby discouraging scale in fee-based businesses, that can provide stability by diversifying sources of income and have losses that are less correlated to the timing of macroeconomic shocks than traditional credit products.[7] The lack of correlation between operational risk losses and fee income is evidenced in the ORX data, which shows operational risk losses remaining relatively flat since the 2008 global financial crisis, while income has grown steadily over the same period.[8]

- The SA's loss component also evolved during its development.[9] It was initially not included in the 2014 consultation, was subsequently added under a tiered structure that placed increased emphasis on large losses in the 2016 consultation and again adjusted to a flat 15x multiplier in the final guidance. These changes materially impacted required capital and the BCBS did not provide the rationale for the calibration changes.

- The BCBS also adjusted the internal loss multiplier ("ILM") alongside the loss component multiplier ("LCM"), ultimately agreeing to a 1.0 ILM floor and providing local regulators the option to fix the ILM at

[5] The current capital rule defines operational risk as "the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events." 12 C.F.R. §§ 3.101, 217.101(b), 324.101 "Operational risk". Hereinafter, citations to the current capital rule will be to the FRB's regulatory capital rules, as the Agencies' respective regulatory capital rules are substantively identical.

[6] ORX, "Basel III and standardised approaches to capital: Analysis of ORX global banking data in response to regulatory reforms" at 9 (Oct. 2023), available at https://orx.org/resource/basel-iii-and-standardised-approaches-to-capital-2023 (hereinafter, "ORX Study"). Industry research conducted by the Operational Riskdata eXchange Association ("ORX"), which used 21 years of global banking operational risk loss data concludes that annual operational risk losses are typically 6-7% of operational risk capital required under the SA and rarely exceed 15%. This equates to operational risk capital under the SA of approximately 14 years of average annual losses.

[7] *See* Standardised Measurement Approach for operational risk, Bank for International Settlements (BIS), https://www.bis.org/bcbs/publ/d355.htm (final guidance and prior consultations).

[8] *See* ORX Study Section 6.

[9] High-level summary of Basel III reforms (bis.org) at 12, available at https://www.bis.org/bcbs/publ/d424.

1.0.[10] Certain foreign jurisdictions have already elected to use this option as it serves to moderate the overall calibration.[11]

Additionally, as mentioned, the potential future operational losses are also captured through the SCB that is derived via CCAR. According to the FRB's Dodd Frank Act Stress Test (DFAST) disclosures, this has historically amounted to approximately 30% of total pre-provision net revenue ("PPNR") under the FRB's Severely Adverse scenario. [12] Consequently, it is estimated that the industry already holds approximately $138B of capital related to the operational risk calculated as part of the most recent CCAR.[13] Combining the amount of risk weighted assets ("RWA") amount for operational risk with the SCB is unique among jurisdictions implementing the Basel agreement; the effect of this design choice was not considered by the BCBS in setting its SA calibration, and it unnecessarily inflates operational risk capital in the U.S. This unique trait of the U.S. regulatory capital framework, which already accounts for operational risk through the SCB, necessitates careful consideration of how operational risk is measured in the numerator and denominator of required capital ratios and how incurred losses and potential future losses are accounted for in total operational risk capital.

Also, the BCBS's SA formula uses an outdated, fixed multiplier to convert the output of the SA formula, which is measured in dollars of required capital, into RWAs. The formula uses a fixed 12.5x multiplier to convert required operational risk capital into RWA.[14] This fixed 12.5x multiplier is simply the inverse of an assumed 8% minimum total capital requirement, which originated with Basel II,[15] and does not reflect additional capital buffers implemented under Basel III or the SCB. As of October 2023, our minimum common equity tier 1 ("CET1") capital requirement is 8.9%, which equates to a multiplier of 11.2x.[16] Consequently, the higher fixed 12.5x multiplier inflates operational risk RWA contributing to the over-calibration.

To address the over-calibration, we recommend that the Agencies further analyze and reconsider the calibration of both the business indicator and loss components of the operational risk capital SA. Regarding the business indicator component, we suggest the following:

- To address how fee income is incorporated into the formula, we recommend the Agencies consider assigning scaling factors to fee income that reflect actual historical losses associated with that business activity. Currently, each dollar of fee income contributes equally to the business indicator component of the SA, which is not a risk-sensitive approach to measuring operational risk of fee-based businesses. Instead, the Agencies could consider, for example, using industry data published by ORX that includes losses by business activity, which could be used to set the initial scaling factors and then updated on a recurring basis as additional loss information is reported. This approach would address the general lack of correlation between fee income and operational risk losses, provide a more risk-sensitive measure of operational risk capital and reduce the over-calibration of the SA.

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[10] *Id.*

[11] *See* Prudential Regulation Authority, *CP16/22 – Implementation of the Basel 3.1 Standards*, 8.23 (Nov. 30, 2022), https://www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards.

[12] *See generally* FRB 2021 Stress Test Results at 4 (June 2021) *available at* https://www.federalreserve.gov/publications/files/2021-dfast-results-20210624.pdf; FRB 2022 Stress Test Results at 12 (June 2022) *available at* https://www.federalreserve.gov/publications/files/2022-dfast-results-20220623.pdf; FRB, 2023 Stress Test Results at 21 (June 2023), *available at* www.federalreserve.gov/publications/files/2023-dfast-results-20230628.pdf

[13] *See* pages 30 and 44 of the Bank Policy Institute & American Bankers Association Comment Letter re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (filed January 16, 2024).

[14] The Proposal also uses the fixed 12.5x multiplier to convert market and CVA risk into RWA. 88 Fed. Reg. at 64215, 64295.

[15] BIS, International Convergence of Capital Measurement and Capital Standards - A Revised Framework, Part 2: The First Pillar - Minimum Capital Requirements at 1 (June 2004), *available at https://*www.bis.org/publ/bcbs107b.pdf (8% minimum capital requirement).

[16] Wells Fargo, 3Q23 Financial Results at 3, available at https://www.wellsfargo.com/assets/pdf/about/investor-relations/earnings/third-quarter-2023-financial-results.pdf.

- Alternatively, the Agencies could reconsider the netting of expenses associated with fee-based income in the business indicator. There are many businesses that generate fee-based income and have directly attributable expenses that are already reported. The Agencies could allow netting of aggregate fee income and expense as well as operating income and expense using existing regulatory reporting line items.

To address the over-calibration emanating from the loss component, we recommend the following:

- The Agencies should fix the internal loss multiplier at 1.0, which will mitigate the over-calibration but does not fully address the underlying conceptual shortcomings of the SA. This would reduce the duplication that operational risk RWAs have with the SCB and is aligned with Basel Committee's SA guidance and implementation in other jurisdictions.[17]

Alternatively, the loss component in the operational risk RWA calculation could be adjusted from 15x to 10x such that historical operational losses are not inflated up given SCB already accounts for unexpected loss.

- Ultimately, a combination of adjustments to the business indicator and loss component are needed to address the methodological shortcomings of each component and due to the mechanical interaction of both components within the SA formula.

2. Residential Mortgage Risk Weights

The Proposal's risk weights for residential mortgage loans fail to consider actual historic loss data, the impact of the operational risk charge, and SCB. The operational risk charge associated with this business is additive to the credit risk weights and is further increased by the various interest income and fee income generated by the business. The Proposal also does not consider impacts on the mortgage market, including the respective roles of non-banks and government sponsored enterprises ("GSEs"). Differences in capital requirements, and regulation of, banks compared to non-banks, along with disparities between bank and GSE capital requirements have already led to the migration of a significant amount of mortgage activity to less regulated non-bank lenders and the Proposal likely will continue to drive this trend.[18]

The proposed Expanded Risk Based Approach ("ERBA") risk weights should be considered relative to actual historical losses and risk weights under parallel rules promulgated by the Federal Housing Finance Agency ("FHFA"). Those better reflect potential risk and signal how mortgage activity may migrate to the GSEs under the Proposal's risk weights. The recently finalized GSE FHFA requirements use both FICO® score and adjusted mark-to-market loan-to-value ("LTV") to assign risk weights that range from 2-317%.[19] Our own historical loss data, includes 2008 financial crisis data and, shows very low loss rates that would imply far lower risk weights than those proposed for high credit quality borrowers. For example,

- Borrowers with FICO scores over 720 and current LTVs less than 70% have a current one-year loss rate of 0.0% and a peak one-year loss rate of 0.1%.
- Borrowers with FICO scores over 700 and current LTVs less than 80% have peak one-year loss rates of 0.2%.[20]

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[17] *See, e.g.*, Prudential Regulation Authority, *CP16/22 – Implementation of the Basel 3.1 Standards*, 8.23 (Nov. 30, 2022), *available at* https://www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards.
[18] Vol. 13, No. 4, FDIC Quarterly, Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period (2019), *available at* http://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2019-vol13-4/fdic-v13n4-3q2019-article3.pdf,
[19] 12 C.F.R. § 1240.33(c).
[20] Data aligns with methodology for the FRB 's FR Y-14M Schedule data collection.

These metrics indicate materially lower risk than the Proposal's most favorable 40% risk weight available for non-cash flow dependent residential mortgages.[21]

Similarly, the proposed increases in the risk weight percentages for the lowest LTV loans are also inconsistent with the stronger performance of low LTV loans in the annual DFAST exercise. Lower LTV loans have materially lower loan losses than higher LTV loans in the Severely Adverse scenario.[22] The FRB's own observed reduced credit risk for these loans suggests that the lower risk weights used in the Basel standard better align with historical probabilities of default ("PDs") and losses given default ("LGDs").[23]

Mortgages Held for Investment

For held for investment ("HFI") mortgage loans, the business indicator component of the Proposal's operational risk charge is calculated using net interest income, which is the primary source of income associated with these loans and is capped at 2.25% of assets.[24] We estimate the operational risk charge will add approximately five percentage points[25] to risk weights of HFI mortgage loans, driven by the net interest income business indicator charge. Consequently, the effective risk weight for all mortgages with LTVs over 60% will increase relative to the Current U.S. Standardized Approach ("Current SA"). Approximately 89% of the loans in our HFI portfolio have current LTV's below 80%. Despite this low risk profile, we expect approximately 54% of the loans in our portfolio will have an effective risk weight greater than the Current SA.

Mortgages Held for Sale

Mortgage loans we originate to sell (i.e., mortgage loans held for sale ("HFS")) generally have higher LTVs and are often sold to the GSEs. Some of these mortgages that correspond with special GSE programs targeting first-time homeowners or underserved borrowers often have LTVs over 80%, which would receive a 60% risk weight under the Proposal[26] and thus be risk weighted higher than the Current SA 50% risk weight and the Basel Committee 40% risk weight.

The primary sources of income for HFS loans are origination fees, gains on sale, and servicing income after sale, if servicing is retained. These income streams are all captured in the business indicator component of the operational risk capital charge, measured on a gross basis (i.e., not net of any expense), and uncapped.[27] Consequently, the operational risk capital charge attributable to HFS loans is significantly higher than the charge for HFI loans. Using a similar methodology as described above, we estimate the effective risk weight for borrowers with LTVs above 80%, including operational risk, would increase significantly relative to the current flat 50% risk weight.[28] Assuming the loan's rate of return is held constant, and the increased effective risk weight was passed through to the borrower, banks would need to increase mortgage interest rates by up to 100 basis points to cover the higher capital costs.

The Proposal's operational risk charge attributable to mortgage banking activity will be volatile due to the cyclical nature of origination and refinancing. Because the business indicator is based on a three-year look-back,[29] higher capital requirements from periods of high origination and refinance volume will carry forward into lower volume periods and vice versa. The combination of higher risk weights, the operational risk methodology, and capital

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[21] 88 Fed. Reg. at 64048 (proposing risk weights of 40%, 45%, 50%, 60%, 70% and 90% across categories of residential real estate loans based on LTV ratios).
[22] FRB, 2023 Stress Test Methodology at 80-81 (June 2023), *available at* www.federalreserve.gov/publications/files/2023-june-supervisory-stress-test-methodology.pdf.
[23] *Id.* at 80.
[24] *See* 88 Fed. Reg. at 64084 (defining interest-earning assets).
[25] Estimated based on applying the net interest income charge cap of 2.25% in the Business Indicator calculation.
[26] 88 Fed. Reg. at 64191.
[27] 88 Fed. Reg. at 64215-16.
[28] 12 C.F.R. § 217.32(g)(1).
[29] 88 Fed. Reg. 64216.

requirement volatility results in a material increase in capital requirements for banks engaged in mortgage origination with distribution to GSE programs. These impacts will be passed through to borrowers or limit bank activity, including for first time home buyers and underserved borrowers that have lower down payments.

To better align RWAs with the risks inherent in mortgage banking activities, we recommend the Agencies reduce risk weights by LTV band to the Basel Committee levels and address the over-calibration of operational risk. Absent recalibration, we anticipate these numerous over-lapping charges will continue to cause mortgage banking activity to migrate from regulated banks to less regulated non-banks.

3. Wholesale Public Listing Requirement

Under the Proposal, to qualify as "investment grade" (receiving a 65% risk weight), a borrower must meet a two-prong test: (1) have an investment-grade equivalent internal rating and (2) have publicly traded securities outstanding.[30] The second prong of this test is not an economic risk factor and unnecessarily disqualifies many borrowers from the more favorable 65% risk weight. By rendering non-publicly traded entities ineligible for investment grade status, universities, pension funds, endowments, utilities, and similar entities which serve important public functions and high-quality non-public companies, and investment funds will be disadvantaged and likely see their cost of credit be higher than public companies with equivalent risk profiles. Holding a loan rate of return constant, we estimate a 25-50 bps lower borrowing rate for borrowers that qualify as investment grade compared to those that do not. Wells Fargo has approximately 10,000 commercial customers that meet the investment grade test's first prong, yet only approximately 1,800 that meet both prongs. Our customer base is also directionally consistent with independent research,[31] and, therefore, likely reflective of the broader market.

The FRB's stress test model disclosure notes that investment grade borrowers have materially lower loss rates compared to non-investment grade borrowers.[32] The FRB stress test classifies investment grade and non-investment grade based upon the risk characteristics that would be used to satisfy the Proposal's first prong of the investment grade test. The FRB disclosure does not indicate public listing as a factor considered in its stress test model.[33] Based on the FRB's disclosure, the loss rate for investment grade borrowers is 50% lower on average compared to non-investment grade borrowers. Imposing the second prong results in an inconsistent view of risk between the risk-based requirements and stress test for this borrower class.

Non-public borrowers often provide lenders with high quality financial information that can be relied upon to confirm an internal investment grade rating. Our credit review processes for public and non-public companies are largely consistent, including recurring reviews of credit ratings, and we have internal credit underwriting policies requiring high-quality borrower financial information, such as audited financial statements, that are used in the same way as public financial information.

Instead of relying on the public listing requirement, we believe the Agencies should apply the 65% risk weight to firms that provide audited financial statements. Additionally, the 65% risk weight should apply to highly regulated financial institutions given the availability of information in those institutions' public filings that is relevant for credit assessments.[34] The same standard should also apply to eligibility of financial collateral.

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[30] 88 Fed. Reg. at 64054.

[31] Cecilia Caglio, Mathew Darst and Sebnem Kalemli-Ozcan, *Risk-Taking and Monetary Policy Transmission: Evidence from Loans to SMEs and Large Firms*, National Bureau of Economic Research, (Apr. 2021), *available at* https://conference.nber.org/conf_papers/f159755.pdf.]]

[32] FRB, 2023 Stress Test Methodology at 69 (June 2023), *available at* www.federalreserve.gov/publications/files/2023-june-supervisory-stress-test-methodology.pdf.

[33] *See id.*

[34] For these purposes, highly regulated financial entities would include U.S. bank holding companies, investment advisors (and foreign equivalents), funds registered under the Investment Company Act of 1940 ("1940 Act") and business development companies regulated under 1940 Act (and foreign equivalents; *e.g.*, Undertakings for the Collective Investment in Transferable Securities ("UCITS"), pension funds such as employee benefit plans and government plans (as defined in the Employee Retirement Income and Security Act of 1974), broker-dealers, swap dealers and security-based swap dealers (and foreign equivalents), and insurance companies.

4. Federal Tax Credit Programs

Congress created various tax incentives to promote investment in certain tax equity programs (e.g., low-income housing and renewable energy tax credits).[35] The Proposal recognizes the risks associated with these programs inconsistently, by ascribing a 400% risk weight to renewable energy tax credits[36] and a 100% risk weight to low-income housing tax credits,[37] which will disincentivize bank's participation in renewable energy investments. The risk weights for all federal tax credit programs should be consistent at 100%.

In the renewable energy market, banks make certain investments to finance entities that cannot efficiently use the tax benefits of their projects. A market developed for renewable energy project sponsors to partner with banks as tax equity investors and serve as a source of capital that can efficiently realize tax credit benefits. The OCC confirmed national banks' lending authority for such investments in 2021,[38] recognizing that tax equity investments have more loan-like characteristics than other private equity investments. While there are multiple ways to structure a bank's tax equity investment in a renewable energy project, all options require equity capital to realize the tax credit benefits. The tax equity investor has limited downside exposure, unlike typical private equity investments, because the tax equity investment will receive most of its return from predictable tax credits and other tax benefits and has other protective features such as the absence of senior debt in the project and a priority over the project sponsor's return. Thus, as the OCC recognized, tax equity investment risk is not the same as the risk typically associated with a private equity investment. Our loss experience is consistent with this view. Between January 1, 2018, and August 31, 2023, Wells Fargo funded $9.5 billion in renewable tax equity and has only realized negative after-tax returns on one transaction that represented 0.54% of our total investment value and had an after-tax return of -0.22%.

5. Non-Public Equity with a Return Based on Publicly Traded Equity

The Proposal eliminates recognition of effective risk mitigating hedges resulting in a 650% risk weight for certain fully hedged investments. The 650% risk weight does not accurately reflect the risks associated with such transactions and could discourage hedging.

In certain limited circumstances, banks may hold equity for which there are restrictions on tradability but for which the equity risk of such positions is entirely based on changes in the value of publicly traded equity. In such situations, banks can hedge their exposures with a high degree of hedge effectiveness using an offsetting position in the publicly traded equity or swaps that include hedges against any non-equity remaining risks.

Under the Current SA, these combined equity exposures are eligible for hedge pair treatment, resulting in a 100% risk weight for the component of the hedge pair with the greater adjusted carrying value (effectively a 100% risk weight on our holdings).[39] Under the Proposal, this hedge pair treatment would be eliminated. As a result, the equity holdings would receive a 400% risk weight, reflective of a non-publicly traded equity, and the hedge would receive a 250% risk weight, reflective of a publicly traded equity.[40] The effective outcome of the Proposal is therefore a 650% risk weight applied to a position that is based on publicly traded equity and nearly perfectly hedged.

To better reflect the risk of these transactions, the final rule should clarify that a position is eligible for inclusion in the market risk capital framework if the underlying equity risk is entirely based on a publicly traded equity

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[35] An equity exposure that qualifies as a tax equity finance investment under 12 C.F.R. § 7.1025 and earns any of the following clean energy tax credits under sections 45, 45Y, 45Q, 45V, 45X, 45Z, 48, 48D, or 48E of the Internal Revenue Code, or future tax credits.
[36] 88 Fed. Reg. at 64214.
[37] *Id.* at 64077, 64214.
[38] 12 C.F.R. § 7.1025 allows National Banks to engage in tax equity finance transactions and defines the criteria that make these investments the "functional equivalent of a loan."
[39] 12 C.F.R. §§ 217.52(b)3), 217.152(b)(3).
[40] 88 Fed. Reg. at 64076, 64214.

exposure. We believe this is the most logical outcome for a position for which the inherent risk is equity price market risk. Additionally, this outcome would be consistent with our understanding of the interpretations of the market risk boundary taken by other jurisdictions and with the FRB's treatment in its CCAR stress testing exercise.[41]

Alternatively, the over-calibration could be addressed through retaining hedge pair treatment and assigning a 100% risk weight to the effective portion of the hedge. The preamble of the Proposal states that, "The hedge pair treatment under the Current Rule is only available if each of the equity exposures is publicly traded or has a return that is primarily based on a publicly traded equity exposure. As such positions would generally be subject to the proposed market risk capital framework under the Proposal...."[42] In other words, the Agencies argued that hedge pair treatment was being eliminated because positions eligible for hedge pair would generally be included in the Proposal's market risk capital framework. If certain non-public equity holdings that have equity risk entirely based on changes in the value of publicly traded equity cannot be included in the market risk framework due to restrictions on tradability, then hedge pair treatment should be retained to better align the capital required with inherent risk.

6. Credit Spread Risk for Agency Residential Mortgage-Backed Securities

The market risk treatment of Agency Residential Mortgage-Backed Securities ("RMBS") under the Proposal is not clear, does not reflect actual economic risks, and may negatively impact the mortgage finance market if not changed.[43] As the FHFA Single Security Initiative and Common Securitization Platform has homogenized the mortgage pool and security characteristics for Uniform Mortgage-Backed Securities ("UMBS"), banking organizations are currently able to fully offset UMBS To Be Announced ("TBAs") with underlying mortgage pools. Although not specified in the body of the Proposal, the preamble of the Proposal states that netting is not allowed as such positions would be treated as a separate name from Fannie Mae and Freddie Mac.[44] The final rule should clarify that UMBS TBAs and eligible mortgage pools should be considered exposures to the same issuer for both credit spread risk and the default risk charge within the fundamental review of the trading book ("FRTB") SA. Additionally, the Proposal does not specify an intra-bucket correlation factor for RMBS, so a 35% correlation factor would apply when aggregating UMBS, non-UMBS Fannie Mae and non-UMBS Freddie Mac.[45] The final rule should also clarify that GSE mortgage-backed securities should receive between 95-100% correlation factor with respect to the calculation of credit spread risk under the sensitivities-based method.

7. Minimum Haircut Floor for Securities Financing Transactions

The Proposal introduces minimum haircut floors for certain eligible margin loans and repo-style transactions.[46] The proposed haircut floor requirement would create unwarranted cliff effects that do not reflect the underlying counterparty credit risk of such transactions. The measurement of the haircut floor requirement would also be subject to the volatility of the underlying collateral valuations, and when combined with the cliff effects of the application, would make for unpredictable results. Other jurisdictions, including the European Union and United Kingdom, have recognized this misalignment with the underlying risks and have not adopted minimum haircut floor requirements as a part of their Basel implementations. The specific issues with the Proposal include:

- Although the Proposal provides a scope exemption for transactions involving exclusively non-defaulted sovereign exposures, U.S. Treasuries could be disallowed when included as part of a pool of collateral

[41] Renewable energy investments are excluded from FR Y-14 A Schedule F.
[42] 88 Fed. Reg. at 64077.
[43] 88 Fed. Reg. at 64120-21.
[44] 88 Fed. Reg. at 64123.
[45] *Id.*
[46] 88 Fed. Reg. at 64063-67.

containing non-sovereign exposures,[47] which could have unintended consequences on the U.S. Treasury market.

- The haircut floor requirements for RMBS are equivalent to that of corporate and other issuers,[48] which does not accurately reflect the credit and liquidity characteristics of such collateral.
- The proposed mechanics and documentation requirements of the minimum haircut floor implementation are unclear and would lead to the de-recognition of collateral for exempt transactions.

As such, we respectfully request the Agencies remove the minimum haircut floor standard in the Proposal.

Conclusion

Wells Fargo appreciates the opportunity to comment on the Proposal. Our comments are focused on changes to the Proposal to avoid negative impacts, including on pricing and availability of credit. We are also concerned that the Proposal, if finalized without significant recalibration, will result in activity shifting outside of the regulated sector and will have negative impacts to the economy. We believe our recommendations would ensure the U.S. regulatory capital framework is more appropriately calibrated and fit for purpose.

If you have any questions, please contact Tim Becker, Wells Fargo Public Policy, at timothy.a.becker@wellsfargo.com.

Sincerely,

[47] 88 Fed. Reg. at 64064.
[48] 88 Fed. Reg. at 64064-65.

APPENDIX

Suggested Modifications in Calculating RWA

Consistent Inputs Across Current SA and the Proposed Expanded Risk-based Approach ("ERBA")
Description: The Proposal has minor differences for parameters of the securitization calculations between the Current SA (i.e., Simplified Supervisory Formula Approach ("SSFA")) and ERBA (i.e., Securitization Standardized Approach ("SEC-SA")), including A (attachment point), Kg (weighted-average capital requirements) and W (non-performing ratio).[49] The calculation in the Current Rule does not permit a banking organization to recognize noncash assets in a reserve account in the calculation of parameter A.[50] In contrast, the Proposal would permit a banking organization to recognize all assets, cash or noncash, that are included in a reserve account in the calculation of parameter A.[51] The Proposal would modify the definition of attachment point so that it refers to the outstanding balance of the underlying assets in the pool rather than the current dollar value of the underlying exposures.[52]

The Proposal would apply a similar definition of parameter W from the Current SA for subpart E, but clarify that for re-securitization exposures, any underlying exposure that is a securitization exposure would only be included in the denominator of the ratio and would be excluded from the numerator of the ratio. That is, for re-securitization exposures, parameter W would be the ratio of the sum of the outstanding balance of any underlying exposures of the securitization that meet any of the criteria in paragraphs §___.133(b)(1)(i)-(vi) of the Proposal that are not securitization exposures to the outstanding balance of all underlying exposures.[53]

Additionally, the Proposal makes two modifications to the Kg input in the SEC-SA calculation that are different from the Current SA calculation. First, for interest rate derivative contracts and exchange rate derivative contracts, the positive current exposure would be included in the numerator of Kg but excluded from the denominator of Kg[54] in contrast to the Current SA where the positive current exposure is not included[55]. Second, if a banking organization transfers credit risk via a synthetic securitization to a securitization Special Purpose Entity ("SPE") and that securitization SPE issues funded obligations to investors, the banking organization would include the total capital requirement of any collateral held by the securitization SPE in the numerator of Kg. The denominator of Kg would be calculated without recognition of the collateral.[56]

Furthermore, the "financial collateral" definition under the ERBA for all collateralized transactions would require that the corporate issuer have an outstanding publicly traded security, or the corporate issuer be controlled by a company that has an outstanding publicly traded security to be recognized, while the Current SA does not have this requirement.[57] Finally, the Proposal's calculation for Securities Financing Transaction ("SFTs") would have two different sets of formulas for the exact same pieces of collateral.[58]

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[49] 88 Fed. Reg. at 64069-70.
[50] 12 C.F.R. § 217.43(b)(3).
[51] 88 Fed. Reg. at 64069.
[52] *Id.*
[53] *Id.*
[54] *Id.* at 64070.
[55] 12 C.F.R. § 217.43(b)(1).
[56] 88 Fed. Reg. at 64070.
[57] *Id.* at 64060.
[58] *Id.* at 64307.

Impact: The inputs for SEC-SA and SSFA and the definition of financial collateral, and calculation for SFTs are so similar that it leads to confusion, potential errors, and significant operational burden, without adding significant value in terms of capturing additional risks.
Potential Solution: The Agencies should make inputs and calculations consistent across the Current SA and the ERBA to avoid unnecessary complication in the regulatory capital framework. The Agencies could simply replace the SSFA with the SEC-SA for consistent treatment of securitizations, apply a consistent SFT calculation, and conform the definition of financial collateral to be the same under both Current SA and ERBA.

Look-through Approach
Description: Early buy-out transactions are securitizations where the underlying residential mortgages are delinquent but have U.S. government or agency guarantees (government guarantees). Under the ERBA, where the bank's exposure is senior, the look-through approach specifies that the RWA calculation is the greater of the 15% floor and Kg, which incorporates the government guarantee.[59]
Impact: Under the Current SA, although the SSFA calculation incorporates the government guarantee in Kg, it does not explicitly allow the benefit of the government guarantee to be reflected in the W calculation.[60] This could result in extremely high-risk weights for government guaranteed positions.
Potential Solution: We recommend that the look-through approach for SSFA calculation that is reflected in the Proposal's ERBA also be allowed in the Current SA.

Defaulted Exposure
Description: The Proposal states that, "the proposed definition of defaulted exposure would look to the performance of the borrower with respect to credit obligations to any creditor."[61]
Impact: Not all credit transactions are publicly available; thus, determining a default for all credit obligations would be impractical. In addition, the lack of materiality exceptions can produce unintended results – an investment grade borrower with $100 million in exposure would be in default if a $27 payment for an office equipment lease is more than 90 days past due for non-credit reasons.
Potential Solution: The final rule should eliminate this requirement or use the definition of default found in the current Advanced Approach, which includes the criteria "The obligor is past due more than 90 days on any material credit obligation(s) to the national bank or Federal savings association."[62]

Re-securitization Servicer Cash Advances ("SCAs")
Description: Under the Proposal, firms would be unable to apply the look-through approach to re-securitization exposures.[63]
Impact: The 100% risk-weight floor on re-securitization exposures is punitive for securitization exposures with Servicer Cash Advances ("SCAs") as the risk weight for the underlying assets would move from approximately 20% today to 100% under the Proposal.[64]
Potential Solution: Financing facilities of SCAs should be allowed to apply the look-through approach because SCAs are repaid at the top of the cash waterfall, all but guaranteeing repayment.

P-factor for SEC-SA
Description: The Proposal would increase the P-factor for SEC-SA from 0.5 under Current SA to 1.0.[65]

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[59] *Id.* at 64212.
[60] 12 C.F.R. §§ 217.43, 217.144, 217.211.
[61] 88 Fed. Reg. at 64039.
[62] 12 C.F.R. § 217.101 "Default" at (2)(b) (defining wholesale obligor default).
[63] *Id.* at 64072, 64212.
[64] *Id.* at 64070, 64212.
[65] *Id.* at 64070.

Impact: The SEC-SA calculation becomes extremely sensitive to the A and W parameters used for the calculation. As a result, the Proposal would significantly increase capital requirements for high credit quality facilities with low attachment points (e.g., prime auto).
Potential Solution: The final rule should maintain the P-factor at 0.5. Alternatively, the Agencies should adopt the BPI and SFA recommendation to reduce the P-factor under the Simple, Transparent, and Comparable ("STC") criteria.

Junior-lien Exposures
Description: The Proposal provides that a junior-lien real estate loan that is not dependent on the property for repayment will have a higher risk weight (150%) than an unsecured loan to the same borrower (85% or 110%).[66]
Impact: The Proposal would incentivize banks to provide unsecured loans rather than loans secured by junior liens on the property.
Potential Solution: The final rule should lower the risk weights for junior-lien real estate loans that are not dependent on the property for repayment to align with unsecured exposures to the borrower.

Affiliates for Regulatory Retail Aggregation
Description: The Proposal states "the regulatory retail exposure category would exclude any retail exposure to a single obligor and its affiliates that, in the aggregate with any other retail exposures to that obligor or its affiliates, including both on- and off-balance sheet exposures, exceeds a combined total of $1 million (aggregate limit)."[67]
Impact: Aggregating non-public data, such as percentage of ownership of a small-to-medium sized enterprise ("SME"), would be difficult and would not capture additional risk that would require additional capital.
Potential Solution: The final rule should narrow the scope of exposures to be aggregated to only include credits that are secured by the same collateral or have cross-default provisions that could result in acceleration and immediate repayment. Additionally, SME exposures should not be aggregated with other retail exposures.

110% Risk Weight Bucket for Aggregate Exposures Above $1MM
Description: The Proposal would require banks to look across lending agreements for consumers (e.g., mortgage) to determine if aggregate exposures are above $1MM. Aggregate exposures would include securities-based lending, which comprise very low risk, secured loans. Business loans guaranteed by the owner, which generally are not high-risk exposures relative to normal small business loans (except with an additional guarantee), also would be included in the definition of aggregate exposures.[68]
Impact: It is a tremendous data burden with little basis in risk assessment to include this additional test.
Potential Solution: The final rule should reduce the risk-weight to 100% to align with current treatment.

Unconditionally Cancellable Calculation for Transactor[69] Accounts
Description: Super-prime borrowers are generally transactors with high credit lines. The Proposal would have a large impact on the amount of capital held against credits to customers with high unused credit limits that are subject to the new 10% conversion factor on unconditionally cancellable commitments, which previously was 0%.[70]
Impact: The Proposal would increase capital requirements for exposures to high credit quality customers that have large unused balances. The proposed treatment is inconsistent with the general principle that applies higher-capital charges to higher risk assets and, as a result, incentivizes firms to make riskier lending arrangements without contractual limits to achieve lower capital requirements.

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[66] 88 Fed. Reg. at 64189, 64191.
[67] *Id.* at 64051.
[68] *Id.* at 64051-52.
[69] *Id.* at 64187 (*Transactor exposure* means a regulatory retail exposure that is a credit facility where the balance has been repaid in full at each scheduled repayment date for the previous 12 months or an overdraft facility where there has been no drawdown over the previous 12 months.
[70] *Id.* at 64056.

Potential Solution: To better align capital treatment with general risk management guidelines of stated credit limits, the final rule should have the unused commitment exposure amounts for transactors be the lower of: 1) the Proposal's credit conversion factor of 10% of the unused line; and 2) the amount that would apply utilizing the proxy methodology for a commitment that does not have an express contractual maximum amount.

Simple Approach

Description: Under the Proposal, banks could only apply the Simple Approach if a loan is subject to a "collateral agreement" for the life of the exposure.[71] An agreement cannot qualify as a "collateral agreement" if a bank's exercise of rights under the agreement may be stayed or avoided under applicable law, including insolvency law (subject to certain exceptions for stays under special resolution regimes).[72] The Agencies developed the definition of "collateral agreement" with respect to internal models methodology requirements for certain stay-exempt products.[73] Subsequently, without explanation, the Agencies adopted the term collateral agreement, including the stay exempt requirement, in the current rule's Simple Approach.[74] The possibility that a stay might delay a bank's ability to exercise its rights with regard to collateral does not mean that the collateral provides no risk mitigation. The Basel framework recognizes this and permits recognition of collateral where the collateral agreement provides that "the bank has the right to liquidate or take legal possession of [the collateral], in a timely manner, in the event of the default, insolvency or bankruptcy . . . of the counterparty."[75]

Impact: The definition of collateral agreement, together with limited exceptions to the broad application of stays under insolvency law, including the U.S. Bankruptcy Code,[76] generally prevents banks from realizing the risk mitigating benefits of collateral securing loans, even if a bank has a first-priority, perfected security interest in collateral. As a practical matter, only certain types of financial contracts, such as commodity contracts, forward contracts, securities contracts, swap agreements, and repurchase and reverse repurchase agreements, could qualify as "collateral agreements."[77]

Potential Solution: The credit risk mitigation benefits of collateral should be recognized when a bank may exercise its rights to the collateral in a timely manner, even if it might be subject to a stay. This would improve the risk-sensitivity of the capital rules, consistent with the stated goal of the Proposal.[78]

Insurance

Description: Post Basel III, the Financial Accounting Standards Board ("FASB") issued ASU 2018-12 (adopted January 1, 2023), which requires the reserves for almost the entire variable annuity ("VA") business to be fair valued and marked-to-market ("MTM") through earnings. Prior to 2023, most VA reserves were traditional insurance reserves and not MTM. The fair valued VA reserve is sensitive to equity levels and interest rates, both of which are hedged to limit volatility. The reserve results in "long" equity risk that is hedged by selling equity index futures through an exchange ("short" positions). However, the bank is already required to deduct insurance underwriting risks in the numerator.

> A bank holding company or savings and loan holding company must deduct an amount equal to the regulatory capital requirement for insurance underwriting risks established by the

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[71] The Proposal perpetuates this requirement, which is included in the current rule. *See* 12 C.F.R. § 217.37(b)(1)(ii)(A).

[72] 12 C.F.R. § 217.2.

73 *See* 72 Fed. Reg. 69288, 69349 (Dec. 7, 2007).

74 *See* 77 Fed. Reg. 52792, 52797 (Aug. 30, 2012) ("Under the revised structure, each agency's capital regulations would include definitions in subpart A.").

[75] BIS, CRE - Calculation of RWA for credit risk, Basel Framework, 22.26, *available at* https://www.bis.org/basel_framework/chapter/CRE/22.htm?inforce=20230101&published=20201126.

[76] 11 U.S.C. § 101 *et seq.*

[77] These financial contracts would be exempt from the U.S. Bankruptcy Code's automatic stay. 11 U.S.C. § 362(b)(6); *see also* 11 U.S.C. §§ 555, 556, 741(7) (discussing certain financial contracts).

[78] 88 Fed. Reg. at 64028 ("The revisions set forth in the proposal would improve the calculation of risk-based capital requirements to better reflect the risks of these banks' exposures.").

> regulator of any insurance underwriting activities of the company. The bank holding company or savings and loan holding company must take the deduction 50% from tier 1 capital and 50% from tier 2 capital. If the amount deductible from tier 2 capital exceeds the Board-regulated institution's tier 2 capital, the Board-regulated institution must deduct the excess from tier 1 capital.[79]

Impact: Typically, this reserve is an "other liability," even if the exposure was treated as an equity, the larger side of the hedge pair treatment will always be the hedge. This results in the short equity index being risk-weighted at 250% under the Proposal and is applied in addition to the deduction for the required capital for the insurance underwriting.
Potential Solution: The equity index futures used in hedging insurance risks should receive a 0% risk-weight or, at a minimum, the insurance capital deduction should be allowed to be reduced by an amount that removes the double-count of including these in risk-weighted assets.

Suggested Clarifications to Processes and Criteria

Business Credit Card SME Treatment
Description: The Proposal's preamble indicates that a transactor must be a natural person, but the Proposal otherwise seems to apply all treatments in the retail section to natural persons and SMEs.[80]
Impact: It is unclear how credit cards to SMEs, which would otherwise qualify as a transactor, should be treated. This may result in inconsistent interpretations and practices among firms.
Potential Solution: The final rule should confirm that the transactor risk weight would apply to a SME business credit card that otherwise meets all the requirements of the "transactor" definition. Furthermore, the final rule should confirm that a personal guarantee of a business card would be classified as regulatory retail.

Regulatory Retail Limits
Description: Under the Proposal, banks could apply the regulatory retail risk weight if various criteria are satisfied; however, the interaction between loans originated by a bank and loans purchased through a securitization is not clear.[81]
Impact: The treatment of eligible products is burdensome if banks are required to compare the underlying loans of purchased securitizations against the bank's regulatory retail portfolio to ensure aggregate thresholds are not breached for individual borrowers or SMEs. Furthermore, the 0.2% aggregate retail limit[82] provides no added value as large banks, which are the focus of the Proposal, will always be limited to the $1 million aggregate borrower cap before they would be bound by the 0.2% aggregate limit due to the size of their portfolios. Thus, any calculations that would be required in connection with the 0.2% aggregate limit would increase banks' administrative burden but confer no benefit.
Potential Solution: The final rule should clarify the interaction between the regulatory retail aggregate limit and the treatment of purchased securitizations with underlying exposures that are regulatory retail assets. For example, the regulatory retail definition states that "the sum of the exposure amount and the amounts of all other retail exposures to the obligor and to its affiliates does not exceed $1 million." The final rule should confirm that this is limited to originated credits by the bank and would not include securitizations that are purchased from third parties. Similarly, we propose removing the 0.2% retail limit as the Proposal only applies to the largest banks and as a result, the $1MM limit will only ever be applicable.

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[79] 12 C.F.R. § 217.22(b)(3).
[80] 88 Fed. Reg. at 64053.
[81] *Id.* at 64051-52.
[82] *Id.*

Regulatory Retail Classification for Kg Purposes

Description: Under the Proposal for calculating SEC-SA, a firm would be required to apply a Kg to the underlying exposures as though the underlying assets were held on the bank's books.[83]

Impact: The treatment of eligible products within a securitization is not clear and is burdensome if banks are required to compare the underlying loans in the securitization against the bank's regulatory retail portfolio to ensure aggregate thresholds are not breached for individual borrowers or SMEs.

Potential Solution: The Agencies should confirm that if the underlying assets of a securitization are eligible products and are less than $1MM, then the regulatory retail treatment would apply for purposes of calculating Kg for SEC-SA without having to aggregate with or compare to other exposures in the bank's portfolio.

Inputs for SEC-SA and SSFA for Partially Funded and Fully Unfunded Facilities

Description: The SEC-SA and SSFA are computed from inputs (A, D, W, Kg) derived from the on-balance sheet exposure;[84] however, the Proposal is silent on how to treat partially or entirely unfunded securitization facilities.

Impact: The treatment of the inputs for unfunded portions of securitization facilities is unspecified, which may result in inconsistent interpretations and practices among firms.

Potential Solution: The final rule should confirm that for transactions that are unfunded, and where no collateral has been delivered, industry practice is to conservatively assume that the transaction is funded to the maximum advance rate. Also, the final rule should confirm that for transactions that are partially funded, the bank should apply the risk-weight calculated from the funded portion and apply that to the unfunded amount.

Parameter W- Restructured Reperforming Loans

Description: Under the Proposal, parameter W includes underlying exposures of the securitization "in default."[85] The Proposal's "defaulted exposure" definition specifically includes distressed restructuring of the exposure.[86] However, the requirement for distressed restructuring varies between different asset types.

A defaulted retail exposure includes "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."[87]

Impact: The underlined sentence above is not included in requirements of distressed restructuring for other asset types, namely, defaulted non-retail (excluding real estate), defaulted residential real estate, defaulted real estate (non-residential).

Potential Solution: The Agencies should clarify if restructured loans that return to performing status should be excluded from the W parameter for all exposure types or only retail exposures.

Non-Credit Defaulted Exposures

Description: Under the Proposal, defaulted exposure must be a credit obligation. Credit obligation explicitly scopes out derivatives, repo-style transactions, and other Counterparty Credit Risk ("CCR") exposures.[88]

Impact: The lack of clarity around how to treat non-credit defaulted exposure may lead to inconsistent treatment across the industry.

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[83] *Id.* at 64070.
[84] *Id.* 64210.
[85] *Id.* at 64069-70.
[86] *Id.* at 64184.
[87] *Id.*
[88] *Id.* at 64183-84.

Potential Solution: The Agencies should clarify how to assign a risk weight to a counterparty that has defaulted on a derivative, repo-style transaction, and other CCR exposures.

Definition of Timing Events in the Proposal

Description: The Proposal's preamble[89] and FR Y-14Q instructions define a Timing Event as, "an operational loss event that causes a temporary distortion of the institution's financial statements in a particular financial reporting period but that can be fully corrected when later discovered (e.g. revenue overstatement, accounting and mark-to-market errors)."[90] However, the Proposal's updated definition of Operational Loss Event includes a new part to refer to Timing Events as, "restatements or corrections of financial statements that result in a reduction of capital relative to amounts previously reported."[91] It is unclear what is meant by the phrase, "that result in a reduction of capital relative to amounts previously reported." Additionally, the Timing Events definition now includes revenue overstatements, but it is unclear if bank overpayments are Operational Loss Events (i.e., Non-Timing Events).

Impact: The Proposal and FR Y-14Q Operational Loss Event definitions should be consistent to avoid errors and inconsistencies. It is unclear what level of Timing Events should be included and whether bank overpayments are Operational Loss Events, which may result in inconsistent interpretations and practices among firms.

Potential Solution: The final rule should limit Timing Events to those where the error meets a bank's internal threshold for a restatement event. Additionally, the final rule should clarify if revenue overstatements are included in Operational Loss Events.

Timing Events Go-Forward Requirement

Description: Timing Events under the Current Rule and FR Y-14Q instructions are excluded from operational loss events.[92] We recommend the Agencies make this requirement prospective from the effective date of the final rule.

Impact: Some of the required data elements were not tracked prior to the Proposal's publication and will be difficult to obtain.

Potential Solution: The final rule should clarify that the Timing Events would not require looking back because those elements may not be attainable.

Suggested Definitional Clarifications

Liquid and Readily Marketable

Description: The FRB's Regulation YY, Liquidity Coverage Ratio: Liquidity Risk Measurement Standards established criteria to determine whether an instrument is "liquid and readily marketable."[93] This term also is used in § ___.2 of the regulatory capital rules within the definitions of Eligible Margin Loans and Repo-Style Transactions.[94] Unlike in Reg. YY, however, there are no defined criteria for how to determine "liquid and readily marketable."

Impact: The absence of such criteria results in each firm having to develop their own process for determining what securities meet this requirement, which may result in inconsistent practices among firms.

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[89] *See id.* at 64180.

[90] Instructions for the Capital Assessment and Stress Testing information collection (Reporting Form FR Y-14Q Schedule E Operational Risk, E.1—Operational Loss History; Line H-Gross loan amount) at 76-77, available at https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=eba56271-9025-4e55-ae9c-7e0059a92f2a.

[91] 88 Fed. Reg. at 64185.

[92] 12 C.F.R. 217.101 "Operational loss event"; Instructions for the Capital Assessment and Stress Testing information collection (Reporting Form FR Y-14Q, Schedule E Operational Risk, E.1—Operational Loss History; Line H-Gross loan amount) at 76-77, available at https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=eba56271-9025-4e55-ae9c-7e0059a92f2a.

[93] 12 C.F.R. § 249.3.

[94] 12 C.F.R. § 217.2.

Potential Solution: The final rule should define "liquid and readily marketable" consistent with Reg. YY to reduce unnecessary operational burden and facilitate industry consistency.

Common Stock versus Common Equity

Description: The methodology for determining whether an equity investment in an unconsolidated financial institution is significant or non-significant is based on the percentage of issued and outstanding common stock.[95] However, not all firms have outstanding common stock, such as partnerships.

Impact: The lack of clarity around what qualifies as an unconsolidated financial institution may result in inconsistent interpretations and practices among firms.

Potential Solution: The final rule should clarify the methodology for determining whether an investment in an unconsolidated financial institution is significant or non-significant for firms that do not have outstanding common stock but hold other equity interests.

Investment Grade and Eligible Guarantor

Description: It is unclear how an exposure to a subsidiary that is fully guaranteed by an investment grade parent would be treated. Under the Proposal, a banking organization would assign a 65% risk weight to a corporate exposure that is both (1) an exposure to a company that is investment grade, and (2) where that company, or a parent that controls that company, has publicly traded securities outstanding.[96] However, the definition of eligible guarantor states the "creditworthiness is not positively correlated with the credit risk of the exposures for which it has provided guarantees."[97] Thus, the parent may be eligible for the investment grade risk-weight while the exposure subsidiary, even though fully guaranteed by the parent, would receive a 100% corporate risk weight.

Impact: The lack of clarity around the treatment of exposures to subsidiaries that are fully guaranteed by an investment grade parent may result in inconsistent interpretations and practices among firms.

Potential Solution: The definition of investment grade should include exposures to subsidiaries that are fully guaranteed by the parent that meets the definition of investment grade, or the definition of eligible guarantor should remove the requirement that the creditworthiness not be positively correlated.

Timely Repayment of a Guarantee

Description: The definition of eligible guarantee under § ___.2 of the regulatory capital rules states that a guarantee, "requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligated party on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment."[98]

Impact: The timeliness of a repayment is undefined, which may result in inconsistent interpretations and practices among firms.

Potential Solution: The final rule should clarify what "timely manner" means.

Recourse on Securitization Structures

Description: The "traditional securitization" definition under § ___.2 of the regulatory capital rules, states that "performance of the securitization exposures depends upon the performance of the underlying exposures."[99]

Impact: Exposures with partial guarantees may not benefit from collateral if banks are required to disregard the securitization structure because the performance of the securitization exposure is not solely based on the

[95] 88 Fed. Reg. at 64295-96.
[96] *Id.* at 64053-54, 64192.
[97] 12 C.F.R. § 217.2.
[98] *Id.* (emphasis added).
[99] *Id.*

performance of the underlying exposures. This is counter-intuitive to risk-based regulatory capital rules, where higher risk should correspond with higher capital treatment.
Potential Solution: In situations where a sponsor provides a guarantee on the performance of a facility, the final rule should clarify if there is an amount of recourse that would cause the structure to no longer be eligible for securitization treatment.

Unfettered Control Determination for Securitization Structures
Description: The "traditional securitization" definition under § ___.2 of the regulatory capital rules states that the Agencies "may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance."[100]
Impact: The requirement that regulators approve determinations of unfettered control is unnecessary due to the Agencies' general reservation of authority.
Potential Solution: The requirement for the Agencies to determine unfettered control should be removed from the final rule.

Traditional Securitizations to Entities other than an SPE:
Description: It is unclear whether traditional securitization treatment can apply to an entity that is not an SPE, such as a trust, or when the exposures are otherwise bankruptcy remote.[101] Traditional securitization treatment would apply to loans that do not qualify for Eligible Margin Loan treatment but are secured by assets in a brokerage or similar account (1) that are collateralized by liquid and readily marketable debt or equity securities, or gold, (2) where that collateral is marked-to-fair value daily, and (3) where the transaction is subject to daily margin maintenance requirements.
Impact: Lack of clarity may result in inconsistent interpretations and practices among firms.
Potential Solution: The final rule should clarify that such exposures can be treated as traditional securitizations.

[100] *Id.*
[101] *See* 88 Fed. Reg. at 64209.