One Mission. Community Banks.

January 16, 2024

Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

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

Mr. James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity

Dear Sir or Madam:

The Independent Community Bankers of America ("ICBA")[1] appreciates the opportunity to comment on the proposed rule titled "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity" ("Proposal"). The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (together, the "Agencies") are issuing the Proposal to amend the calculation of current risk-based capital requirements for banking organizations

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[1] *The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.*

with total consolidated assets of $100 billion or more and for banking organizations that engage in significant trading activity.

The proposed risk-based capital changes are designed to reflect the international standards developed by the Basel Committee on Banking Supervision with a tailored approach to address specific operations in the U.S. capital markets. The central theme of the Proposal is to remove large banking organization reliance on internal models to set regulatory capital adequacy in favor of a more standardized framework that increases regulatory capital levels for these institutions with the goal of enhancing the safety and soundness of the U.S. banking system. Additionally, where regulators continue to allow the use of internal models for certain risks, the Proposal seeks to improve the internal measure to better capture potential losses. With larger levels of regulatory capital, the largest banking organizations will be able to stabilize lending, better absorb unexpected losses, and decrease the likelihood that an institution with a heightened risk profile could disrupt the overall economy.

Under the Proposal, banks with total consolidated assets of $100 billion and above would calculate risk-weighted assets using the newly developed expanded risk-based approach, which increases the granularity of risk weights for financial assets in a uniform manner across all institutions. The banks would also calculate risk-weighted assets using the standardized approach, which is the risk weight framework currently used by all banks with total consolidated assets below $250 billion. Risk-weighted assets would be calculated using the more punitive of the two measures (i.e., the current standardized approach or the proposed expanded risk-based approach). Large banks would no longer be permitted to use the internal risk ratings approach to calculate risk-weighted assets for credit risk that is currently in use today.

The Proposal also seeks to expand the use of accumulated other comprehensive income (AOCI) as a component of regulatory capital for banking organizations at total consolidated assets of $100 billion and above. Under the Proposal, these institutions would include AOCI in their summation of equity capital when calculating their leverage ratio and their ratio of regulatory capital to risk-weighted assets. AOCI generally captures the unrealized gains and losses on investment securities held available-for-sale, which can be highly sensitive to changes in interest rates across the yield curve spectrum. Today, banking organizations with total consolidated assets below $250 billion are permitted to exclude AOCI when reporting applicable regulatory ratios. In addition, these institutions (i.e., banking organizations with total consolidated assets of $100 billion or more) would be subject to the existing supplementary leverage ratio and the countercyclical capital buffer, safety and soundness metrics that are currently only applicable to much larger institutions.

ICBA generally supports the Proposal, which accurately recognizes the risks present in the financial system and addresses the need to further enhance prudential capital standards for the largest banking organizations in the country. The Proposal effectively distinguishes between those large institutions that subject stakeholders to the most risk on multiple fronts and those community banks that are small, straightforward spread lenders that rely on tailored underwriting and a local presence to provide quality banking services that grow both small and large communities in every corner of the country. ICBA acknowledges that internal models-based approaches for the calculation of credit risk were never going to achieve the risk sensitivity needed to properly capture necessary capital levels for large banks, especially since the models were made to be so complex that achieving transparency in capital adequacy was too difficult. Just as significant, the variability in modeled assumptions across organizations is never justified if the end result is different levels of regulatory capital for the same probability of risk across the banking system.

ICBA is disappointed that the Agencies did not conduct a more thorough investigation of the pro forma impact of the actions described in the Proposal, particularly the impact that higher risk weights on large bank capital calculations could have on smaller banking organizations like community banks and on overall economic conditions. Any increase in levels of regulatory capital that could indirectly pose a threat to stable economic growth, particularly in the residential housing market, should be identified, modeled and mitigated to the greatest extent reasonably possible in order to avoid an unforeseen disruption in home ownership.

ICBA generally supports the inclusion of AOCI in regulatory capital calculations for the largest megabanks and believes that the $100 billion threshold is the right floor for capturing the interest rate volatility for large risk sensitive portfolios. However, due to its small size and noncomplex business model, ICBA strongly believes that a community bank should never have to include AOCI in the calculation of regulatory capital. The $100 billion asset threshold works well to capture the scope of banks that should be subject to AOCI inclusion because these institutions should be expected to be able to implement the hedging and risk mitigation strategies that can provide effective protection from unstable yield curves, as well as the balance sheet management techniques that are available for enterprises that adopt hedge accounting.

ICBA appreciates the Agencies using not one but two capital approaches for assessing capital adequacy for banks with total consolidated assets of $100 billion and above. Under the two-prong approach, covered institutions would first calculate risk-weighted assets for credit risk using the expanded risk-based approach, a granular set of risk weights that considers the credit sensitivity of the asset in a uniform fashion that is applicable also to the institution's peers. Additionally, covered institutions would calculate risk-weighted assets for credit risk using the standardized approach, the risk weight framework currently used by smaller banks in established risk-based capital. The measure that produces the lower capital ratio would be used to report risk-based capital ratios. Ensuring that the largest banking organizations are not permitted to maintain capital ratios that are more beneficial than community banks serves as an important reminder that the large megabanks should not operate at a competitive advantage simply because they are larger.

The Proposal

The Agencies are responding to the release of recent changes in international capital standards put forth by the Basel Committee by proposing that banking organizations with total consolidated assets of $100 billion and above adopt a new framework for the calculation of risk-based capital and overall capital adequacy. The Basel Committee's release, better known as the "Basel III Endgame" is the last installment of the Basel III bank capital framework designed to provide harmonization among G-10 peer nations on consistent application of prudential regulatory capital standards by aligning the specifications of calculations used to produce minimum levels of bank capital. The Basel Committee originally issued the Basel III capital accords following the 2008-09 financial crisis as a set of reforms to increase both the quality and quantity of bank capital in an effort to prevent future global financial instability by member countries.

Under the Proposal, risk-weighted assets would be calculated for credit, equity, market risk, operational risk, and valuation risk. Banks subject to the final rule would calculate risk-weighted assets for credit risk coverage using both the standardized approach currently applicable to most banks in the country and the newly defined expanded risk-based approach. Category I and II institutions would no longer be permitted to use the existing internal risk ratings approach. Banks would be required to apply the more punitive of the two calculated risk-based capital ratios when reporting compliance with minimum regulatory capital standards. Current category III and IV banking organizations that apply an AOCI filter in regulatory capital calculations would now be required to include the impact of AOCI, which generally represents unrealized gains and losses on securities held available-for-sale, in the calculation of risk-based capital.

The Proposal standardizes operational risk capital requirements using the bank's own operational loss data. Capturing of operational losses will include an internal loss data program to support reported operational risk capital. Risk-weighted assets under the expanded approach will generally follow the Basel framework. Both residential and commercial exposures will follow an updated loan-to-value ("LTV") framework as exists today with higher risk weights depending on the source of repayment with a focus on cash flow dependencies. Private mortgage insurance would no longer be permitted to be included in the calculation of the LTV ratio. Note that residential mortgage exposures not materially dependent on cash flows with an LTV greater than 100 would only carry a 70% risk weight. Residential mortgage exposures materially dependent on cash flows with an LTV greater than 90% would only carry a 75% risk weight. General corporate exposures would carry a 100% risk weight similar to the existing standardized approach but with a 65% risk weight for general corporate exposures that are considered investment grade.

The Proposal calls for a three-year transition period starting on July 1, 2025, with an 80% phase in of expanded risk based capital ratios. At the start of the transition, 80% of the expanded total risk-weighted assets would be used in the denominator when calculating expanded total risk-weighted assets. The phase in would increase 5% per year until July 1, 2027, when the phase-in would increase to 90%. Starting on July 1, 2028, the transition period would end, and the expanded total risk-weighted assets would be fully adopted. For those banks that are required to report adjusted capital balances including AOCI, a transition amount of 25% would be required on July 1, 2025, with 25% increments each year until fully implemented. Note that once implemented, it is expected that covered institutions will be bound to increased levels of risk-weighted assets thus requiring more regulatory capital to meet minimum regulatory capital standards. The Agencies estimate that the Proposal would increase total risk-weighted assets by 20 percent relative to the current measure of risk-weighted assets.

ICBA's Comments

ICBA fully applauds the efforts of both the Basel Committee and prudential bank regulators in the United States to implement harmonized risk-based capital standards among the largest banks in the country, which although small in number, disproportionately account for an overwhelming level of assets in the banking system. ICBA generally supports the provisions of the Proposal because of the need to ensure some level of uniformity in risk weight calculations across the spectrum of large financial institutions. Regulators have long struggled with the appropriate methodology for capturing credit risk in a bank's asset mix but have fully endorsed a risk-based regulatory capital framework for the majority of banks in the country. It is only prudent that the largest banks be required to abandon the diverse implementation of an internal risk ratings approach that depends largely on the bank's own modeling assumptions in favor of the more standardized approach adopted by the rest of the charters.

In the Proposal, the Agencies acknowledged the problems with the use of internal models to isolate specific risk sensitivities, particularly credit risk, when applied by the largest banks in the country. Variability across institutional models creates uncertainty among industry peers as one bank may view a specific loan input as being much less susceptible to changes in interest rates when compared to a similar sized institution with the same national presence and the same risk profile. The expanded risk-based approach will greatly reduce and hopefully eliminate such variability so that examiners will be able to assess risk across peers without having to waste countless hours of energy attempting to understand the dynamic nature of a bank's internal model framework.

Adoption of the Basel III Endgame by the largest banking organizations in the United States will require those institutions to overhaul how they assess risk-based capital metrics and suitable levels of regulatory capital to meet supervisory expectations. Risk calculations will become much more precise, forcing these organizations to more frequently and narrowly evaluate capital deployed among different earnings channels with a greater need to efficiently allocate capital resources. Undoubtedly, many of these institutions will be forced to adopt the Proposal by simply carrying higher levels of high-quality common equity tier 1 capital, recognizing the need to maintain proper capital adequacy across all capital metrics and to protect the institution against unforeseen deterioration in appropriate capital levels.

Revolutionary technologies that place account access in the hands of consumers, small business owners, corporate treasurers, and even chief risk officers are the same tools that allowed these banks to become so large so quickly. Without removal of the internal risk ratings approach and adoption of the expanded risk-weighted assets framework, depositors, especially those that hold balances in excess of insured amounts, will be subjected to uncertain risk profiles from the largest banks perceived too-big-to-fail. Creating a more standardized approach to credit risk determination and removing internally driven risk assessment models to drive risk weights will allow those institutions to better manage their credit risk and allow regulators to better determine which institutions among peers are deploying capital most effectively. With this new standardized approach, the internal modeling assumptions of these large institutions will no longer be relied upon to set credit risk. In its place will be an expanded risk-based approach that utilizes similar risk weights for similar financial assets among peers.

ICBA believes that the renewed focus required through the adoption of a new expanded risk-based capital approach will place new operational challenges on the largest financial institutions, particularly those new category III and IV banking organizations that will need to reflect AOCI volatility in their capital framework and will need to enact a dual approach to capital adequacy. However, such challenges are not only warranted under the Basel III Endgame, the large size of these banks makes adoption all that much more important since prudential regulators rely heavily on big bank peers to rescue troubled banks at a moment's notice when depositors flee. Conversely, the agencies' decision to avoid the inclusion of AOCI in community bank capital calculations was critical in recognizing the straightforward balance sheets of these banks. Had the agencies established the AOCI threshold any lower than they did, the resulting impact on community bank operations would have been severely challenged, with the need to institute overarching interest rate risk mitigation practices that would harm earnings, deplete operational efficiencies, and further drive consolidation among small peers.

866-843-4222
icba.org
1615 L Street NW
Suite 900
Washington, DC 20036
518 Lincoln Road
P.O. Box 267
Sauk Centre, MN 56378

ICBA believes the Agencies should have engaged in an effort prior to issuing the Proposal to identify and document any unintended consequences resulting from the implementation of the Basel III Endgame that could disrupt the resiliency of the domestic economy. The resulting rapid increase in the cost of funds for consumers, small businesses, and the nation's largest capital markets participants has placed additional struggles on the ability of these and other enterprises to achieve daily operational efficiencies with regard to cash.

Of particular concern is the impact on the fragile housing market, where recent spikes in long-term rates have already challenged the ability for homebuyers to transact in a market that should never limit access to someone achieving the American dream. ICBA questions whether changes in risk weights on important consumer-sensitive expsoures like mortgage loans have been made with a thorough understanding of their impact on home affordability, especially in low-to-moderate income areas. As the Agencies are well aware, adjustments to these risk weights without paying close attention to first-time homebuyers and other entrants to the housing market that are sensitive to down payment minimums can disincentivize, discourage, and otherwise deter these important homebuyers from participating in one of the most rewarding economic activities in the country. Without a better understanding of the long-term impact of higher risk weights on certain traditional banking exposures like residential and commercial real estate, it is unclear what the long-term implications are for these asset classes when bank capital levels rise across the spectrum of different banks. ICBA recommends that the Agencies conduct futher analysis on the long-term impacts of the Proposal that fully addresses all of our concerns on the potential disruptions surrounding homeownership before finalizing the rule.

ICBA appreciates the opportunity to provide comment on this Proposal and hopes that the banking agencies will consider our observations. If you have any questions or would like additional information, please do not hesitate to contact me at james.kendrick@icba.org.

Sincerely,

/s/

James Kendrick
First Vice President, Accounting & Capital Policy