June 18, 2026

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Board of Governors of the Federal Reserve
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Docket Nos. 1887, R-1888
RINs 7100-AH20, 7100-AH21

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RINs 3064-AF29, 3064-AG23

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Docket IDs OCC-2026-0265, OCC-2026-0034
RINs 1557-AF52, 1557-AF49

Re: Notice of Proposed Rulemaking on the Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets (the "Standardized Proposal")

Notice of Proposed Rulemaking on the Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations (the "ERBA Proposal", and together with the Standardized Proposal, the "Proposals")

Ladies and Gentlemen:

The International Association of Credit Portfolio Managers ("**IACPM**") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively, the "**Agencies**") on the above-referenced Proposals.

The IACPM is a global industry association established in 2001 to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on

topics of common interest. The IACPM's institutional member firms comprise the world's largest financial institutions, and as such, overlap with the membership of several other financial industry associations.

Our perspective is unique, however, in that the IACPM represents the teams within those financial institutions who have responsibility for the prudential management of such institutions' credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio's components relative to their risk, and allocating capital to new credit exposures. In addition, our members also include investors, insurers, and reinsurers, which participate in risk sharing transactions as sellers of credit protection.

1. Introduction

The IACPM previously submitted a comment letter[1] in response to the Agencies' prior notice of proposed rulemaking revising the capital requirements for large banking organizations (the "**2023 Proposal**").[2] We appreciate the Agencies' careful consideration of the views expressed in that submission, including recognition of the risk-mitigating benefits of credit-linked notes and the maintenance of the supervisory calibration parameter *p* for securitization exposures under the Securitization Standardized Approach (SEC-SA) at its current 0.5. The IACPM also commends the Agencies for the bottom-up, analytical rigor with which they have calibrated the risk weights for credit exposures based on their observed risk characteristics rather than in pursuit of an *ex ante* capital objective. This approach enhances the coherence, transparency and credibility of the framework.

At the same time, the IACPM remains concerned that certain aspects of the Proposals will require banking organizations to hold regulatory capital against credit exposures that are excessive relative to their underlying risk, and that such changes have either been understated or insufficiently addressed in the Agencies' estimated impact analysis.

We also express our concerns with the Proposals' potential impact on the availability of capital management and credit risk mitigation tools for banks and urge the Agencies to implement targeted revisions that would encourage (or at least not discourage) their usage, both under the credit risk mitigation framework and the securitization framework. The importance of such tools for banks to prudently manage the credit risk of their portfolios and maintain their credit capacity to the broader economy cannot be understated. Banks today maintain a professional network of sellers of credit protection that share risk across the whole credit cycle. Such partners are typically sophisticated

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[1] IACPM, *Comment Letter on Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity* (Jan. 16, 2024), https://iacpm.org/wp-content/uploads/2024/01/2023-IACPM-B3EG-Comment-Letter-Final.pdf.

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

investors or insurers that can underwrite the credit risk on single loans (in the case of credit insurance), single borrowers (in the case of credit default swaps) or whole loan portfolios (in the case of credit risk transfer ("**CRT**") transactions, or synthetic securitizations), and are a vital component of a bank's balance sheet optimization and de-risking strategy. Structured appropriately, these credit risk mitigants can "free up" a banking organization's regulatory capital by reducing the risk-weighted assets ("**RWAs**") associated with the underlying credit exposures, increasing the efficiency of their capital resources and making more credit available to their customers.

We have had the opportunity to review the comment letters submitted by other trade associations, including the comment letter jointly filed by the Bank Policy Institute, American Bankers Association, Financial Services Forum, U.S. Chamber of Commerce and Consumer Bankers Association as well as the comment letter filed by the Structured Finance Association. We echo the suggestions they have raised in their letters, including in respect of the treatment of the Proposals' modifications to the definitions of "commitment" and "unconditionally cancelable" and the addition of the word "solely" in the definitions of "traditional securitization" and "synthetic securitization."

Our recommendations can be summarized as follows:

- **General Credit Risk Weights**
  - The Loan-to-Value (LTV) Ratios used to Determine the Risk-Weights for Residential Mortgage Exposures Should Recognize the Risk Mitigating Benefits of Private Mortgage Insurance
  - The ERBA Proposal Should Clarify that Structural and Other Credit Enhancements may be Considered within the Criteria for Determining Whether a Corporate Exposure Qualifies as an "Investment Grade" Exposure Eligible for a Reduced Risk Weighting
  - The Revised Definition of a "Commitment" Should Not be Adopted
  - The Final Rule Should Revise the Definition of "Subordinated Debt Instrument" to Remove Explicit Reference to Preferred Stock
- **Credit Risk Mitigation Framework**
  - The Outstanding Debt Security Requirement for Guarantors that do not Qualify as per se Eligible Guarantors Should be Modified

- The Requirements for Recognizing Eligible Prepaid Credit Protection Arrangements Should be Revised
- The Exception from the 40% Haircut for Credit Derivatives without "Restructuring" as a Credit Event Should be Revised

- **Securitization Framework**
  - The Conditions for Recognizing a "Regulatory" Clean-Up Call Should be Expanded
  - The Inclusion of the word "Solely" to the Performance Requirement for Traditional Securitization and Synthetic Securitization Should Not be Adopted

- **Other Recommendations**
  - The Agencies Should Recognize Synthetic Securitizations in its 2006 Interagency Guidance on Concentrations in Commercial Real Estate (CRE) Lending

2. Recommendations to the General Credit Risk Framework

*A. The Loan-to-Value (LTV) Ratio used to Determine the Risk-Weights for Residential Mortgage Exposures Should Recognize the Risk Mitigating Benefits of Private Mortgage Insurance ("**PMI**")*

In Question 8 of the Standardized Proposal and Question 21 of the ERBA Proposal, the Agencies ask:

> *What would be the pros and cons of providing explicit recognition of private mortgage insurance in the calculation of LTV ratios for purposes of determining the risk weights for residential exposures? What, if any, increases in procyclicality and incentives for increased risk-taking by covered banking organizations might such recognition create? What conditions could the agencies impose on such recognition to mitigate concerns about the wrong-way risk of monoline credit insurance? In recognition that private mortgage insurance may not provide protection under all relevant stress events, what are the advantages and disadvantages of recognizing a portion (such as 50 percent) of the value of the private mortgage insurance in determining the total outstanding amount of*

the loan in the calculation of the LTV ratio? Please provide any data and analysis supporting alternative approaches.[3]

The IACPM acknowledges the benefits of greater risk sensitivity in using LTV ratios to assign risk weights to first-lien residential mortgage exposures under the Proposals. However, like the 2023 Proposal, the Proposals would continue to exclude the recognition of PMI in determining the LTV ratios for residential mortgage exposures, despite PMI being a long-standing feature of prudent lending for high-LTV mortgages.

As noted by Vice Chair Bowman, fewer banks today are engaged in mortgage origination and servicing activities, reducing consumer choice and limiting the cost-reducing benefits of competition.[4] While the overall reductions in risk weights for residential mortgage exposures may incentivize more residential mortgage origination by banks relative to the 2023 Proposal, the non-recognition of PMI will continue to act as a significant deterrent to mortgage lending to all but the most creditworthy of borrowers, particularly for low-to moderate-income (LMI) and minority homebuyers who often purchase homes with low down payments and therefore rely on higher-LTV mortgages. The non-recognition of PMI will ultimately impede the Agencies' objective in slowing or reversing the flight of residential mortgage origination out of the regulated bank perimeter and into the private and non-bank lending system.[5] We also note the incongruity in recognizing PMI for purposes of determining whether residential mortgages have been originated in accordance with prudent underwriting standards but not in the calculation of loan-level capital requirements.

The Agencies contend that providers of PMI would not ordinarily qualify as "eligible guarantors" as their creditworthiness would be positively correlated with the credit risk of the underlying exposures (i.e., wrong-way risk). Furthermore, the Agencies state, during the 2007-2009 housing market crisis, the performance of private mortgage insurance deteriorated at the same time as the underlying residential mortgage exposures.[6] As noted in the comment letter filed by the U.S. Mortgage Insurers ("**USMI**") in response to the 2023 Proposal, the private mortgage insurance industry continued to pay claims through the 2008 crisis, including for the three firms that were placed into receivership.[7] There is ample data to suggest that PMI policies underwritten during the crisis period

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[3] Standardized Proposal, 15340; ERBA Proposal, 14971.

[4] Michelle W. Bowman, *Revitalizing Bank Mortgage Lending, One Step with Basel*, Speech at the Bank for International Settlements (Mar. 2, 2026), https://www.bis.org/review/r260224b.htm.

[5] Standardized Proposal, at 15387 ("The share of bank activity in the residential real estate lending market has decreased substantially since the 2008 financial crisis; the increased competitiveness brought about by the proposal may slow or even partially reverse the migration of activity to the nonbank sector, particularly in residential mortgage markets.")

[6] Standardized Proposal, at 15339; ERBA Proposal, at 14970.

[7] U.S. Mortg. Insurers, *Comment Letter on Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity (Basel III Endgame)* (Jan. 16, 2024), *USMI Basel III Endgame Comment Letter*, at 3.

have overwhelmingly resulted in paid claims.[8] Any concerns with respect to potential wrong-way risk can also be addressed through the application of appropriate haircuts, as noted in our proposal below.

The continued non-recognition of PMI also significantly understates the myriad reforms that have taken place since the 2008 financial crisis, including through the implementation of private mortgage insurer eligibility requirements ("**PMIERs**") imposed by the GSEs in 2015 and overseen by the Federal Housing Finance Agency ("**FHFA**") as well as the adoption by the FHFA of the Enterprise Regulatory Capital Framework ("**ERCF**"), which imposes a "bank-like" capital approach to the GSEs and recognizes the credit risk mitigating benefits of private mortgage insurance through the application of "credit enhancement multipliers."[9]

We endorse the recommendations offered by the USMI in their comment letter and urge the Agencies to adopt an approach that provides for the recognition of PMI in a manner similar to that implemented by the FHFA under the ERCF, whereby the effective LTV of a mortgage may be reduced by the dollar amount of PMI coverage purchased, subject to a 15% haircut to the amount of PMI coverage for any potential wrong-way risk. As noted in the USMI letter, the 15% haircut is within the range of haircuts that would be imposed under the ERCF through the application of "asset value correlation multipliers" under the stress probability of default formula.

B. *The ERBA Proposal Should Clarify that Structural and Other Credit Enhancements may be Considered within the Criteria for Determining Whether a Corporate Exposure Qualifies as an "Investment Grade" Exposure Eligible for a Reduced Risk Weighting*

The ERBA Proposal allows for in-scope banking organizations to recognize a reduced 65% risk-weighting in respect of corporate exposures that are "investment grade" based on an internal credit risk rating system that is subject to various requirements.[10] In Question 26 of the ERBA Proposal, the Agencies request feedback on this proposed treatment. Under the current capital framework, an "investment grade" determination is contingent upon a bank's determination that the obligor has adequate capacity to meet its financial commitments "for the projected life of the asset or exposure."[11]

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[8] Andrew Netter & Jonathan Glowacki, *Calculating the Historical Benefit of Private Mortgage Insurance: An Empirical Assessment of Realized GSE Mortgage Losses Across LTV Cohorts from 2000 Through 2025* (May 20, 2026), Calculating the historical benefit of private mortgage insurance, at 4 ("The crisis-vintage period (2005–2009) experienced the most severe modern mortgage credit stress and the highest concentration of MI claim activity in the dataset. Realization rates of 97% on a UPB-weighted basis indicate that a substantial majority of contractual MI coverage associated with credit-event loans identified as having MI translated into paid claims.")

[9] *See* 12 C.F.R. §1240.33(e).

[10] ERBA Proposal, §__.111(h)(1).

[11] 12 C.F.R. §__.2 (definition of "Investment grade").

Importantly, the ERBA Proposal would require banking organizations to determine the treatment of "investment grade" exposures that would be eligible for a reduced 65% risk weighting at the level of the obligor, to the exclusion of "exposure level loss given default factors, such as credit enhancements, transaction structure, and collateral."[12] The internal credit risk rating system itself must assign an "accurate and timely obligor rating grade[ ] based on clearly defined criteria".[13]

While we do not disagree with the simplicity of an obligor-level approach, we urge the Agencies to reconsider the strict requirement that no structural features can be taken into account, given that in certain instances an obligor-level risk rating without consideration of such features would not be reflective of the actual credit risk.

The exclusion of "exposure level loss given default factors, such as credit enhancements, transaction structure, and collateral" rests on a premise that holds for an operating company but not for a non-operating company; namely, that an obligor has a probability of default based on its own financial condition, to which collateral and structure add only post-default recovery value. That premise does not hold for a non-operating company like an SPV or investment fund. Such an entity's capacity to meet its financial obligations "for the projected life of the asset or exposure" is defined by, and inseparable from, the assets pledged, the security interest received, and the cash-flow structure. For such an obligor, those features are not enhancements layered on top of an independently measurable default risk, but rather the primary source of the default risk. To rate the obligor while excluding such features is to assess its expected credit performance without considering the items that actually give it the capacity to pay.

Take, for example, subscription credit facilities provided to investment funds, which are typically secured by a bespoke collateral package comprised of the uncalled capital commitments of the fund's investors. Prudent underwriting of subscription credit facilities necessitates a proper assessment of the financial strength and creditworthiness of the investment fund's investors, and are typically structured such that the lender has the right to call, receive and enforce upon the underlying capital commitments. However, the Agencies' commentary could be interpreted in such a manner that a banking organization would have to disregard such collateral in determining whether the relevant fund qualifies as "investment grade," despite such collateral serving as the principal means of recourse for the lender.

Permitting banking organizations to take these features into account when assessing the creditworthiness of non-operating companies will not change in any fundamental way the Agencies' obligor-level approach, and would only require a clarification that this is allowed so long as the

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[12] ERBA Proposal, at 14957

[13] ERBA Proposal, at 15162.

resulting obligor risk rating meets all the requirements of Section 111(h)(1) of the ERBA Proposal. Such an approach would be more consistent with how banking organizations currently assess the credit profile of a non-operating company obligor for internal credit risk rating purposes.

C. The Revised Definition of a "Commitment" Should Not be Adopted

Under the current capital framework, the definition of a "commitment" requires that a banking organization be subject to a legally binding obligation to extend credit or to purchase assets.[14] The Agencies propose revising that definition to include any "contractual arrangement, under which [the bank] and an obligor agree to terms applicable to one or more extensions of credit, purchases of assets, or issuances of credit substitutes."

The Agencies characterize the revised definition of a "commitment" as a clarification that is intended to "promote comparable treatment across banking organizations."[15] Rather than providing clarity and consistency in interpretation, however, the revised definition would significantly expand the scope of arrangements that would need to be capitalized as off-balance sheet commitments. The Agencies' impact assessment on RWAs for commitments also does not appear to factor in the increase in total commitments arising out of banks reclassifying certain uncommitted arrangements as off-balance sheet commitments, and risks raising procedural considerations under the Administrative Procedure Act.[16]

We urge the Agencies to give proper consideration of the issues raised in Section II(A) of the joint comment letter provided by the Bank Policy Institute, American Bankers Association, Financial Services Forum, U.S. Chamber of Commerce and Consumer Bankers Association, and agree with those trade associations that the current definitions of "commitment" and "unconditionally cancelable" should be retained.

D. The Final Rule Should Revise the Definition of "Subordinated Debt Instrument" to Remove Explicit Reference to Preferred Stock

The ERBA Proposal would define a subordinated exposure as "an exposure that is a corporate exposure, a bank exposure, or an exposure to a GSE that is subordinated by its terms or separate intercreditor agreement to the general creditors of the obligor, *including an exposure to preferred stock that is not an equity exposure*" (emphasis added).[17] As noted in the 2023 Proposal, subordinated debt

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[14] 12 C.F.R. §__.2 (definition of "Commitment").

[15] Standardized Proposal, at 15342; ERBA Proposal, at 14977.

[16] *See* ERBA Proposal, at 15372.

[17] ERBA Proposal, § __.101.

instruments generally have a lower priority of repayment and would therefore be exposed to greater losses in the event of an obligor default.[18]

We urge the Agencies to revise the definition of a "subordinated debt instrument" by striking the reference to preferred stock, as this reference would inadvertently scope in securities that are not subordinated and in fact represent the most senior form of debt. For example, consider preferred securities issued by municipal bond closed-end funds ("**CEFs**") that are investment companies regulated under the 1940 Investment Company Act (the "**1940 Act**"), and that primarily invest in tax-exempt municipal bonds. The preferred stock in such CEFs is actually the most senior security issued, and holders' claims are only subordinated to generally immaterial claims of general creditors, such as the fees charged by service providers to the CEF. Holders of such preferred stock also enjoy special protections under the 1940 Act, as CEFs must have at least 200% asset coverage for any preferred stock at the time of issuance and upon the declaration date of any common share distribution.[19] The ERBA Proposal's definition of "subordinated debt instrument", however, would treat such preferred stock as equivalent to the lowest priority or junior-most debt of an obligor.

This will significantly disincentivize large U.S. banks from purchasing such preferred stock, in which case many CEFs may be forced to seek leverage capital from alternative sources, which likely would be more costly and less stable. Furthermore, the ERBA Proposal would generally result in a risk weight for preferred stock issued by these funds that is much higher than the risk weight applicable to investments in the common stock of such funds, which would be treated as equity exposures to investment funds with risk weights determined under a look-through approach. This would lead to an inconsistent capital outcome where the less risky investment in the form of preferred stock would receive a higher risk weight than the arguably more risky equity share issued by the same fund. This could be avoided by simply striking the explicit reference to preferred stock, i.e., removing "including an exposure to preferred stock that is not an equity exposure" from the definition of a "subordinated debt instrument".

3. Recommendations to the Credit Risk Mitigation Framework

A. The Outstanding Debt Security Requirement for Guarantors that do not Qualify as per se Eligible Guarantors Should be Modified

The Proposals continue to effectively exclude insurance companies from partnering with U.S. banks on credit portfolio management transactions as sellers of credit protection, despite the fact that prudentially regulated, well-capitalized insurance companies generally have a high degree of

[18] 2023 Proposal, at 64043.

[19] 15 U.S.C. § 80a-18(a)(2)(A).

creditworthiness and already participate as investors in the CRT programs of Fannie Mae and Freddie Mac.

In Question 22 of the Standardized Proposal and Question 51 of the ERBA Proposal, the Agencies raise the following question:

> *The agencies seek comment on the requirement that the entity has issued and outstanding an unsecured debt security without credit enhancement that is investment grade to meet the definition of an eligible guarantor. What, if any, alternatives to this requirement should the agencies consider to help ensure that eligible guarantors can be expected to perform on guarantees and what would the pros and cons of those alternatives be?*

The current eligible guarantor requirements effectively preclude recognition of many well-established credit insurance arrangements. As a result, this constrains the use of tools that support sound lending, portfolio diversification, and prudent risk management. Highly rated and prudentially regulated insurance entities should therefore be eligible for recognition where they provide credit protection and demonstrate their financial capacity to perform on their obligations on a stand-alone basis as well as through debt securities issued by their parents or holding companies. Survey results indicate that more than 90% of participating large U.S. and U.S. subsidiary banking institutions would have interest in executing transactions with insurance companies for credit risk mitigation if the eligible guarantor definition were clarified to recognize well-capitalized insurers as eligible guarantors.[20][1]

The IACPM has jointly filed a comment letter with the International Trade and Forfaiting Association[21], and we reiterate the recommendation made in that letter to recognize sellers of credit protection whose direct or indirect *parents* have issued debt securities without credit enhancement that are "investment grade", provided that in all such cases the seller qualifies as "investment grade" as currently defined in the capital framework.[22]

B. The Requirements for Recognizing Eligible Prepaid Credit Protection Arrangement Should be Revised

We commend the Agencies for the recognition of "eligible prepaid credit protection arrangements" as a new form of credit risk mitigant, which bear a similar risk profile to cash-

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[20] IACPM survey of US Banks and US Subsidiary Bank members conducted May 28, 2026; respondents were among the 30 largest U.S. banking institutions.

[21] ITFA & IACPM, *Re: Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-weighted Assets; Response to Question 22* (June 18, 2026).

[22] *Supra* note 11.

collateralized transactions and resolve the technical deficiencies identified by the Federal Reserve Board for credit-linked instruments directly issued by banks, including credit-linked notes ("**CLNs**").[23] As an administrative matter, we request that the Federal Reserve Board withdraw the Fed FAQs, such that banking organizations will no longer be required to request an exercise of the Federal Reserve Board's "reservation of authority" to issue CLNs and qualify for synthetic securitization treatment. We also agree with the recommendation in Section IV(C) of the joint comment letter provided by the Bank Policy Institute, American Bankers Association, Financial Services Forum, U.S. Chamber of Commerce and Consumer Bankers Association that the Agencies should confirm the ability of banking organizations to continue issuing credit-linked notes in reliance on any existing reservations of authority granted to them by the Agencies.[24]

In Question 31 of the Standardized Proposal and Question 58 of the ERBA Proposal, the Agencies ask the following:

> *Under the definition of eligible prepaid credit protection arrangement, the proposal would require that a protection purchaser be able to reduce the outstanding balance due to the protection provider promptly upon realizing or otherwise recognizing a loss on the reference exposure, in the event that the obligor on one or more reference exposures fails to make a contractually required payment, or the occurrence of other credit events as described in the arrangement. What, if any, are the exposure types in respect of which, or circumstances when, a protection purchaser may be exposed to losses before such losses are manifested in a way that would permit a reduction in the protection purchaser's repayment obligation? For example, what would be the instances where nonpayment or other loss on the reference exposure may not always result in an accounting write-down of the eligible prepaid credit protection arrangement at the same time? What, if any, changes to the proposed definitions of prepaid credit protection arrangement and eligible prepaid credit protection arrangement should the agencies consider to further ensure that a protection purchaser would be able to reduce its repayment obligation on a prepaid credit protection arrangement as contemporaneously as possible with the manifestation of losses in respect of a reference exposure?*[25]

Under prong (7) of the proposed definition of an "eligible prepaid credit protection arrangement," a banking organization must be able to "promptly reduce the outstanding balance of the

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[23] Board of Governors of the Federal Reserve System, Frequently Asked Questions about Regulation Q (Sep. 28, 2023), https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm (the "**Fed FAQs**").

[24] *See, e.g.,* Letter from Bd. of Governors of the Fed. Reserve Sys. to Luigi L. De Ghenghi, Esq., Davis Polk & Wardwell LLP (Jan. 9, 2026), https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhc_changeincontrol20260109.pdf. Under this letter, the bank's issuance of CLNs is limited to the lower of $20 Billion and 10% of its Tier 1 capital.

[25] Standardized Proposal, at 15351; ERBA Proposal, at 14992.

initial principal amount…by the loss of the protection purchaser on the reference exposures….” There are many instances in which a banking organization may seek to recover amounts due from a protection seller by deducting the repayment amount of the outstanding CLNs *prior* to the recognition of a charge-off or loss on the underlying reference exposure. Additionally, CLNs are commonly structured such that the banking organization may recognize a conservatively estimated, initial loss upon the occurrence of a credit event with respect to the underlying reference exposure, with a true-up payment occurring once the work-out or recovery process is complete. These terms are often tailored to the specific asset class in which the banking organization is purchasing the credit protection.

In each of these instances, the amount that the banking organization may seek to recover from the CLNs may not be tied to an actual loss that is recorded on its balance sheet. In fact, prong (7) of the proposed definition may be read to prevent banking organizations from claiming protection amounts under the CLNs until such time that the banking organization has experienced a corresponding crystallized loss.

We therefore urge the Agencies to align prong (7) with the timing and valuation principles that apply to other credit risk mitigants such as “eligible guarantees”. For example, prong (7) of the definition of an “eligible guarantee” merely requires that the protection provider make a payment to the beneficiary “on the occurrence of a default” and “in a timely manner.”[26] This change to the definition of an “eligible prepaid credit protection arrangement” can be implemented as follows:

> “(7) Upon a failure by the obligor on the one or more reference exposures to make a contractually required payment, or the occurrence of other credit events as described in the arrangement, allows the protection purchaser promptly to reduce the outstanding balance of the initial principal amount due to the protection provider ~~by the loss of the protection purchaser on the reference exposures~~ upon the occurrence of such credit event, without input from the protection provider; and…”

In Question 32 of the Standardized Proposal and Question 59 of the ERBA Proposal, the Agencies also ask the following:

> *Certain credit-linked notes that may qualify as eligible prepaid credit protection under the proposal, are sometimes accounted for on a fair value basis. The fair value of such credit-linked notes may be affected by factors other than losses or credit events (for example, a change in interest rates) in respect of the reference exposure. As a result, at the time that credit losses in respect of the reference exposure are realized, the fair value of the credit-linked note, and the amount by which the banking organization may*

[26] 12 C.F.R. §__.2 (definition of “Eligible guarantee”, prong (7)).

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set off its losses in respect of the reference exposure, may be less than the notional amount of the note. What, if any, modifications to the proposal should the agencies consider to address the risk that a banking organization may not be able to set off losses on a reference exposure against the full notional amount of a prepaid credit protection instrument? What would be the advantages and disadvantages of defining the protection amount of an eligible prepaid credit protection instrument to be the instrument's carrying value (For example, the fair value if the banking organizations elects this accounting treatment)?

As has been highlighted by letters filed by other trade associations, the accounting method under which the banking organization records the instrument at fair value has no bearing on the quantum of credit protection available under the outstanding principal amount of the CLNs. This reflects the prepaid nature of the CLNs, as the cash proceeds received by the bank up front are available to cover losses irrespective of any subsequent fair valuation of the CLNs.

There should therefore not be any situation in which a bank issuer of CLNs would not be able to recognize losses on a reference exposure up to the outstanding principal balance of the CLNs, in which case the protection amount should not be adjusted to reflect the carrying value of the CLNs.

C. The Exception from the 40% Haircut for Credit Derivatives without "Restructuring" as a Credit Event Should be Revised

Consistent with the 2023 Proposal, the Proposals provide an exception to the 40 percent haircut that would apply to the notional value of an eligible credit derivative that does not include "restructuring" of the underlying reference exposures as a credit event. To qualify for this exception, the terms of the reference exposure must not allow the maturity, principal, coupon, currency, or seniority status of the exposure to be amended without "unanimous consent", and the bank must conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that the hedged exposure is subject to the U.S. Bankruptcy Code, the Federal Deposit Insurance Act, or a domestic or foreign insolvency regime that allow for a company to liquidate, reorganize, or restructure and provides for an orderly settlement of creditor claims.[27]

The Agencies have justified the "unanimous consent" requirement on the grounds that a banking organization has little incentive to consent to a restructuring if it cannot reduce any related losses with an offsetting payment under the eligible credit derivative, and would therefore be protected notwithstanding the absence of a "restructuring" credit event. Additionally, the requirement for the bank to have a well-founded basis that the hedged exposure is subject to an insolvency regime on par

[27] *See* Proposals, §__.36(e)(1) and §__.120(e)(1).

with the U.S. Bankruptcy Code is intended to further reduce the risk that a restructuring might occur outside of an orderly insolvency regime.

In Question 23 of the Standardized Proposal and Question 52 of the ERBA Proposal, the Agencies pose the following questions:

> *The agencies seek comment on allowing covered banking organizations to recognize in full the effective notional amount of credit derivatives that do not include restructuring as a credit event, if certain conditions are met. What are the cost and benefits of this approach? What, if any, less restrictive conditions for receiving full recognition should the agencies consider that would more appropriately capture credit derivatives that provide similar protection as those that include restructuring as a credit event receive and why? For example, what would be the advantages and disadvantages of requiring the consent of all parties directly and adversely affected by a restructuring, rather than the unanimous consent of all parties? What would be the advantages and disadvantages of requiring the consent of all parties affected by any change in lien position or priority in the hedged or referenced exposure?*

As we highlighted in our comment letter on the 2023 Proposal, the "unanimous consent" requirement is overly broad relative to the underlying risk and does not reflect current market practice. For example, in the U.S. corporate debt market, For credit facilities originated to obligors outside of the United States, for example, it is commonplace for such loans to include a "majority lender" consent standard as opposed to a "unanimous consent" standard.

The "unanimous consent" standard may also lead, in some situations, to incoherent results. For example, a syndicated credit facility may include both term loans and revolving lines of credit; based on a plain reading of the "unanimous consent" standard, where the term lenders are permitted to grant an adjustment to the interest rate for term loans advanced under the facilities, a 40% haircut may nevertheless need to be applied on the basis that the revolving lenders are not required to agree to such an adjustment.

We reiterate our prior stance that, if the Agencies' principal concern is that a banking organization may be forced into a restructuring without its consent, such concern could just as easily be addressed with a requirement that the maturity, principal, coupon, currency, or seniority status of the exposure cannot be amended without the consent of all lenders *directly or adversely affected* by such amendment. We therefore urge the Agencies to strike the words "by unanimous consent of all parties" and replace with the words "with the consent of all parties directly and adversely affected." Such a revision would be more narrowly tailored to the risk that a banking organization would suffer losses due to a restructuring outside of its control and would also afford the underlying obligor the

flexibility to negotiate with only those lenders affected by any proposed amendment of the sacred rights at issue.

The Proposals also require that a banking organization have a "well-founded basis" supported by sufficient written documentation that the hedged exposure is subject to the U.S. bankruptcy code, FDIA or an insolvency regime that recognizes liquidations, reorganizations and restructuring. This requirement deviates from the Basel III standard, which only requires that the governing law of the underlying exposure is within a jurisdiction that meets the above requirements.[28] Requiring banking organizations to conduct a legal analysis of the applicable insolvency regime for each hedged exposure imposes substantial operational and legal costs with marginal benefit, particularly given the prevalence of well-recognized and well-established insolvency regimes around the world. We therefore recommend that the Agencies eliminate this requirement from any final rulemaking.

4. Recommendations to the Securitization Framework

A. The Conditions for Recognizing a "Regulatory" Clean-Up Call Should be Expanded

We commend the Agencies for providing broader recognition of regulatory and tax clean-up calls within the definition of an "eligible clean-up call". In the Proposals, a banking organization may recognize a regulatory clean-up call that is exercisable "upon the occurrence of a regulatory event that significantly changes the risk-weighted asset amount for the securitization exposure under applicable risk-weighted asset-standards."[29] The Agencies further clarify that a regulatory event must represent a "final action," such as a "final rule adopted by the agencies…or a law enacted by Congress."[30]

A regulatory clean-up call can protect banking institutions that have entered traditional and synthetic securitization transactions from being locked into securitization structures that no longer provide the contemplated economic and credit risk mitigation benefits due to changes in law. We are concerned, however, that the conditions for recognizing a regulatory clean-up call are unnecessarily narrow and provide little practical benefit. Following implementation of the Proposals via a final rulemaking, the circumstances in which a congressional action or regulatory event will "significantly change[ ]" the RWAs associated with a securitization exposure will likely be very rare. In the meantime, a banking organization may be exposed to a myriad of other regulatory events unrelated to the structure of a securitization transaction and the credit quality of the underlying reference pool, including changes to retention obligations, prudential liquidity requirements, etc. To highlight the interpretive complexity, it is unclear whether a final action that modifies the risk-weightings of the underlying assets in the

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[28] *See* Basel Committee on Banking Supervision, *Basel III: Finalising post-crisis reforms* (Dec. 2017) at 49, note 83, https://www.bis.org/bcbs/publ/d424.pdf.

[29] *See* Proposals, §__.2 (Definition of "Eligible clean-up call", prong (3)(iii)).

[30] Standardized Proposal, 15356; ERBA Proposal, 14997.

securitization, as opposed to the securitization formula (i.e., the SEC-SA) used to determine the risk-weights for such "securitization exposures," would trigger the ability to exercise a regulatory clean-up call.

We therefore urge the Agencies to modify the conditions for recognizing a regulatory clean-up call to include any regulatory event that "materially and adversely impacts the bank's ability to recognize the economic benefits from the transaction". Such a change would grant banking organizations the flexibility to unwind securitization transactions that no longer provide the contemplated economic benefits due to changes in law that are wholly unrelated to the performance of the securitization or its underlying exposures.[31]

B. The Inclusion of the word "Solely" to the Performance Requirement for Traditional Securitization and Synthetic Securitization Should Not be Adopted

The Agencies have proposed what they purport to be a "technical modification" to prong (3) of the definition of a traditional securitization and a synthetic securitization by requiring that the performance of the securitization exposure depend "solely" upon the performance of the underlying exposures. The Agencies' stated rationale is that the revision will "clarify the existing scope of exposures subject to the securitization framework".

We strongly disagree with this assertion. Rather than a mere clarification, the introduction of the word "solely" will scope out a significant number of securitization structures from securitization treatment, including warehouse facilities and tranched hedges, in which the performance of the exposure may be linked to factors not "solely" dependent on the underlying assets. The revised definition may also result in a large-scale recharacterizations of existing securitization positions into non-securitization exposures with a drastically higher risk-weighting.

The Agencies themselves acknowledge that "the performance of a securitization exposure depends not only on the *structure of the securitization*, but also on the performance of the underlying exposures *and certain parties to the securitization structure, including the asset servicer and liquidity facility provider*"[32] (emphasis added). Elsewhere, the Agencies state that the performance of a securitization exposure will often depend on "the performance of common supporting transaction participants such as servicers and trustees."[33] However, the introduction of the word "solely" is

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[31] Any exercise of such an "eligible clean-up call" would, in any event, be subject to the ongoing condition that it not be structured so as to "avoid allocating losses to securitization exposures held by investors or otherwise… provide credit enhancement to the securitization." *See* Proposals, §__.2 (Definition of "Eligible clean-up call", prong (2)).

[32] Standardized Proposal, 15353; ERBA Proposal, 14994.

[33] *Id.*

logically inconsistent with the Agencies' own admission that the performance of a securitization exposure will not depend exclusively on the performance of the underlying exposures.

In the original implementation of the securitization framework, the Agencies stated as follows:

> "*Both the designation of exposures as securitization exposures…and the calculation of risk-based capital requirements for securitization exposures…are guided by the economic substance of a transaction rather than its legal form. Provided there is tranching of credit risk, securitization exposures could include, among other things, ABS and MBS, loans, lines of credit, liquidity facilities, financial standby letters of credit, credit derivatives and guarantees, loan servicing assets, servicer cash advance facilities, reserve accounts, credit-enhancing representations and warranties, and CEIOs*."[34]

A common thread underlying the securitization framework is that there is true tranching of credit risk and the performance of the instrument is *primarily* dependent upon cash flows sourced from the underlying exposures. It is not uncommon in each of these structures for there to be recourse outside of the underlying exposures themselves, including seller-provided representations and indemnities. The performance of the pool will also often depend on the performance of other transaction parties to the securitization, including custodians, trustees and services. The introduction of the word "solely" reflects a substantial departure from the current framework in which the designation of an exposure as a securitization exposure is guided by the economic substance of the transaction rather than its form.

The "solely" standard will necessarily be under-inclusive by disqualifying transactions whose economics and cash flows are driven by an underlying pool of financial exposures, but may nevertheless fail to satisfy the proposed standard due to the existence of credit support. This "all-or-nothing" approach may also discourage bank lenders and investors in securitization structures from accepting credit support that would otherwise reduce their overall level of risk. We therefore urge that the insertion of the word "solely" not be adopted as proposed.

We also agree with the suggestions raised in Section I of the comment letter submitted by the Structured Finance Association for the Agencies to work with industry to arrive at a formulation that better addresses their concerns, without unnecessarily invalidating securitization treatment for a wide swath of transactions that otherwise satisfy all of the principal features of a securitization.

5. The Agencies Should Recognize Synthetic Securitizations in its 2006 Interagency Guidance on Concentrations in Commercial Real Estate (CRE) Lending

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[34] 78 FR 62112 (October 11, 2013).

We support the Agencies' objectives to enhance the risk sensitivity of the capital framework, and we encourage the Agencies to carry that same risk sensitivity into the supervisory assessment of commercial real estate (CRE) concentrations under the 2006 Interagency Guidance on Concentrations in Commercial Real Estate (CRE) Lending (the "**CRE Guidance**").[35] Currently, the CRE Guidance does not permit a banking organization to recognize synthetic securitizations in the calculation of its CRE concentration ratio, as the assets would remain on-balance sheet and therefore reflected in the specific Call Report line items comprising the numerator of the ratio.[36]

Just as the risk-based capital rules permit a banking organization to reduce a CRE portfolio's RWAs in proportion to the credit risk transferred through a synthetic securitization, the supervisory measurement of a bank's CRE concentration ratio should reflect that same proportional reduction, rather than continuing to count the full gross balance of CRE exposures as if no protection had been obtained. This would also align the Interagency Guidance with the OCC's Comptroller's Handbook, "Concentrations of Credit" (Oct. 2020), which recognizes the purchase of credit derivative protection as a useful tool for managing CRE concentration risk. This would also encourage more banking organizations, particular community and regional banks that have proportionately higher CRE concentration ratios relative to their larger peers, to rely on CRT transactions as a de-risking tool for their CRE portfolios.

We welcome the opportunity for a constructive dialogue with the Agencies on this topic, including the development of a workable solution that would permit banking organizations to recognize the risk-mitigating benefits of synthetic securitizations, provided a baseline level of credit risk on the underlying CRE portfolio has been transferred.

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We appreciate the opportunity to share our comments on the Proposals. If you have any questions or would like additional information, please contact the undersigned.

Yours sincerely,

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[35] *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, 71 Fed. Reg. 74,580 (Dec. 12, 2006), available at https://www.occ.gov/news-issuances/federal-register/2006/71fr74580.pdf.

[36] CRE Guidance, note 6 at 74584.

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