February 20, 2026

Via Electronic Mail

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

Re: Notice of Proposed Rulemaking regarding Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL (Docket No. R-1873; RIN 7100-AH05)

Ladies and Gentlemen:

The Bank Policy Institute, the American Bankers Association, the Financial Services Forum, the Securities Industry and Financial Markets Association, the International Swaps and Derivatives Association, Inc., and the U.S. Chamber of Commerce (the "Associations") submit this letter in response to the Board of Governors of the Federal Reserve System's Notice of Proposed Rulemaking regarding Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL[1] including the data and model documentation associated with the proposal posted on the Federal Reserve's website. The Associations submitted a separate comment letter on the proposed scenarios for the Federal Reserve's 2026 supervisory stress test on December 1, 2025 (the "Proposed 2026 Scenarios" and "2026 Scenarios Letter").[2]

I. Executive Summary

As noted in the 2026 Scenarios Letter, we welcome the Federal Reserve's efforts to provide additional transparency and opportunities for public feedback on its supervisory stress testing process, which is critical for the Federal Reserve to comply with its obligations under the Administrative Procedure

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1 Federal Reserve, *Notice of Proposed Rulemaking regarding Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL*, 90 Fed. Reg. 51,856 (Nov. 18, 2025) (hereinafter, the "Proposal").

2 Federal Reserve, *Request for Comment on Scenarios for the Board's 2026 Supervisory Stress Test*, 90 Fed. Reg. 51,762 (Nov. 18, 2025); Bank Policy Institute, 2026 Stress Test Scenarios Comment Letter (Dec. 1, 2025), *available at* https://bpi.com/wp-content/uploads/2025/12/BPI-2026-Stress-Test-Scenarios-Comment-Letter-2025.12.01.pdf.

Act ("APA"). Both the APA[3] and the Due Process Clause[4] require the Federal Reserve to disclose to the public and request comment on the models and scenarios used in its supervisory stress test. As described in the 2026 Scenarios Letter, the stress test models and scenarios are used to impose binding capital requirements and have the force and effect of law. The annual stress tests also implement express statutory delegations.[5] These foundational legal principles underpin our recommendations in this letter regarding enhancements to the stress testing framework to increase transparency and public involvement in the stress testing process.[6]

In particular, we highlight several key points made in Section II of this letter. First, the Federal Reserve should retain the December 31 jump-off date for the supervisory and company-run stress tests to avoid increasing volatility into the stress testing projections, and creating significant operational challenges for firms. Second, the Federal Reserve should propose all model changes for public comment instead of only "material model changes" (as defined in the proposal)[7] to provide sufficient transparency and a meaningful opportunity for public comment. Finally, the Federal Reserve should commit to ongoing transparency by firming up discretionary language in the proposal and codifying substantive reforms in regulatory text, including the requirement to provide firms with firm-specific disclosures of stress test results each year.

More broadly, as described in Section III of this letter, it will be critical for the Federal Reserve, OCC, and FDIC to consider the overall calibration of bank regulatory capital requirements based on all aspects of the framework, including in the context of implementing the final Basel III standards, modifying the GSIB surcharge, and reforming the tailoring framework for large firms. The stress tests and the effects of the proposed changes must be considered against the backdrop of the broader capital framework.

Our model-specific recommendations—detailed in Section IV of this letter—reflect a few key themes that the Federal Reserve should consider across all the proposed models to improve risk capture, transparency, and integration with the broader regulatory capital framework. In considering the more detailed comments on each model, we recommend more broadly that the Federal Reserve:

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3 *See Azar v. Allina Health Servs.*, 587 U.S. 566, 582 (2019) ("Notice and comment gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes—and it affords the agency a chance to avoid errors and make a more informed decision.").

4 *See FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) ("[T]he void for vagueness doctrine addresses at least two connected but discrete due process concerns: first, that regulated parties should know what is required of them so they may act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way.").

5 *See* 12 U.S.C. § 5365(i), § 1844(b), (c).

6 The legal vulnerabilities of the Federal Reserve's current stress test process have been explained at length in the plaintiffs' complaint and brief in *Bank Policy Institute et al. v. Board of Governors of the Federal Reserve Systems*, Case No. 2:24-cv-04300, (S.D. Ohio), which has been temporarily stayed in light of the Federal Reserve's commitments to implement reforms to the stress tests. Plaintiffs' complaint and brief are incorporated by reference in this letter.

7 Proposed §§ 252.44(e); 238.132(e).

- *Increase risk-sensitivity by reducing over-aggregation and using greater segmentation:* Targeted enhancements to individual credit, market, operational risk, and pre-provision net revenue ("PPNR") models would enable projected stress losses to better reflect product structures, collateral, guarantors, and rating/industry differentiation, thereby reducing misstatement of risk. In our recommendations, we identify instances where current or proposed models are overly aggregated and recommend additional segmentation to improve risk sensitivity. Although these types of changes would make the models marginally more complex, they would lead to results that are better calibrated to firms' risk profiles, which, in turn, would promote consistent treatment across firms. We believe these substantial benefits outweigh the incremental costs of increased granularity.

- *Avoid internal inconsistencies and double counting across components:* The Federal Reserve should resolve internal inconsistencies across the models and overlaps where losses (or valuation changes) can be captured in more than one place. Examples include the reinvestment assumption for certain securities (which should be extended to other securities and to the calculation of risk-weighted assets ("RWAs") for those securities), trading issuer default losses versus trading mark-to-market interactions, the PPNR framework treatment for Trading income and expenses, and the PPNR treatment of held-for-sale ("HFS")/fair value option ("FVO")/private equity ("PE") exposures.

- *Align supervisory stress test modeling more closely with the existing regulatory capital framework:* The Federal Reserve should align the stress test models with the approaches in the existing regulatory capital framework in additional areas. Examples include using the existing capital rules to determine when held-for-investment loans qualify for securitization treatment, applying the capital rules' approach of probability of default ("PD")/loss given default ("LGD") substitution for guaranteed exposures, and using the capital deductions for DTAs from timing differences without layering on a Basel I-based valuation allowance construct.

- *Incorporate economically meaningful mitigants and risk management actions:* Models should recognize mitigants and hedging effects in ways that are aligned with the risk-reducing characteristics of the transactions and consistent with valuation methodologies. Examples include incorporating guarantor/recourse in the Corporate, FVO, and commercial real estate ("CRE") Models, using a discounted cash flow/full revaluation approach for interest-rate hedges in the Securities Model, revising the treatment of hedge adjustments and amortization in PPNR, and recognizing economically effective hedges that do not qualify for accounting hedge treatment.

- *Use existing supervisory data collected on the FR Y-14 reports more effectively, with targeted additions only where necessary:* Many of our recommendations for improving the models would use data from current fields; where new data elements are recommended, we have narrowly tailored them to support specific model improvements with an emphasis on materiality thresholds and alignment with firms' current risk management practices and regulatory reporting.

- *Strengthen methodological transparency and governance around key modeling choices:* The Federal Reserve should disclose additional detail on assumptions and adjustments to adhere to the requirements of the APA and Due Process Clause and to support transparency, consistent interpretation, and accountability, as discussed in greater detail in Section IV of this letter.[8]

We recognize that certain of our model recommendations may take time to fully implement that extends beyond the 2027 stress test cycle. In those cases, we have provided practical recommendations for how the Federal Reserve could improve the models, on an interim basis, for the 2027 stress testing cycle while complying with its obligations under the APA and pursuing more complete, longer-term improvements to the models in future years.

Our comments regarding scenario design, which are included in Section IV.W of this letter, build on our comments provided in the 2026 Scenarios Letter and reflect the need for the Federal Reserve to construct a coherent and well-justified scenario that appropriately considers market structure developments.

Section II of this letter provides recommendations regarding the proposed changes to enhance the transparency and public accountability of the Federal Reserve's stress testing framework. Section III provides comments on other aspects of the stress test and capital framework on which the Federal Reserve has requested comment in connection with the proposal. Section IV of this letter includes detailed comments on the stress test models and the proposed scenario design guides. Appendix I includes granular, technical comments on FR Y-14 reporting, including with respect to the Federal Reserve's proposed changes.

II. Comments Related to Enhanced Transparency and Public Accountability

A. The Federal Reserve should retain the December 31 jump-off date.

The proposal to move the jump-off date for the Federal Reserve's supervisory and company-run stress tests from December 31 to September 30 would create additional risks and challenges for firms.[9] First, moving the jump-off date to September 30 could introduce more variability and estimation uncertainty into the stress testing projections, as September 30 is an interim period and there are regulatory and financial reporting items that, for interim periods, are based on estimates (*e.g.*, tax and compensation accruals). Conversely, for year-end periods, these items are final. In addition, December 31 coincides with the year-end for regulatory reporting purposes (*e.g.*, FR Y-9C) and, for many firms, for financial reporting purposes, making it a more natural jump-off date than September 30.

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[8] For example, to facilitate more accurate and efficient public comment, the Federal Reserve should: (i) provide clearer data definitions and filters across the models; (ii) use consistent notation (*e.g.*, "50%" is varyingly expressed as "0.50" or "50"); (iii) increase coefficient precision (*e.g.*, to two basis points) and include spline and basis descriptions; and (iv) provide validation and back-testing artifacts.

[9] Proposal at 51,872.

As the Federal Reserve noted,[10] a September 30 jump-off date would also result in data that is more stale; that is, a firm's stress capital buffer ("SCB") effective October 1 (under the current framework) or January 1 (under the Federal Reserve's recent SCB averaging proposal)[11] would be based on data that is one quarter older than would otherwise be the case. For example, if the effective date of a new SCB is January 1, that new SCB would be based on data that is one year and one quarter old. This change would undermine the utility of the forward-looking capital planning and stress testing exercise. Given the data delay, the new capital requirement may be inconsistent with the firm's business models and internal capital planning. These challenges and risks support retaining the December 31 jump-off date.

Further, changing the jump-off date would impose significant operational burdens and administrative costs on firms. Firms have extensive internal processes centered around the December 31 jump-off date for capital planning, budgeting and governance purposes, meaning that they have a reliance interest in maintaining the same date going forward. Many firms undertake a comprehensive, multistage process during the fourth quarter of each year to develop, review, and approve strategic plans that align business objectives with prevailing market conditions, risk appetite, and capital and liquidity planning. This process is intentionally structured so that finalized strategic plans can be implemented at the start of the subsequent calendar year. In addition, the OCC and FDIC each specify a December 31 jump-off date in their rules regarding firm-conducted stress tests.[12]

If the Federal Reserve were to shift the supervisory stress test jump-off date to September 30—before firms' strategic plans and business-planning processes have been completed—the resulting projections would no longer align with the forecasting process firms use to set their annual budgets and execute their strategies or with the OCC's and FDIC's stress testing rules. Firms would need to run two different processes, one for purposes of the supervisory stress test that has different periods and uses more stale data based on an interim period, and another with more recent, calendar year-end data for their own internal purposes and to comply with the OCC's and FDIC's rules. This would impose unwarranted financial and administrative burden and costs and draw attention and resources away from other more important risk management work. In addition, firms' resolution plans are generally based on December 31 data, including estimates of the capital and liquidity funding needed in stress. If there is a discrepancy between the stress testing jump-off date and resolution plan as-of date, there would be additional burdens attendant to running separate processes and reconciling or explaining any differences, as may be necessary.

Ultimately, retaining a December 31 jump-off date would use data that is more current, avoid the unnecessary additional burden for firms, and lead to greater efficiency in the stress testing process, while maintaining consistency with the OCC's and FDIC's rules. The December 31 jump-off date would result in SCBs based on more recent and more relevant data and would also align with firms' internal processes organized around the year-end date for capital planning. In addition, the December 31 jump-off date

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10 *See* Proposal at 51,872–3 ("[T]his proposed change would introduce an additional quarter of staleness to the stress test and stress test results.").

11 Federal Reserve, Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, 90 Fed. Reg. 16,843, 16,850 (Apr. 22, 2025) (hereinafter, the "Averaging Proposal").

12 12 C.F.R. § 46.5(a) (OCC); 12 C.F.R. § 325.4(a) (FDIC).

would correspond to the year-end for regulatory reporting and to many firms' fiscal year-ends, when accruals for taxes, discretionary compensation, and other items that are estimated throughout the year for purposes of interim financial statements are finalized. In Section II.B, we propose a timeline for the stress test process that would retain a December 31 jump-off date.

B. The Federal Reserve should revise the proposed timeline for the stress test process.

We propose the following timeline (illustrated in Figure 1), which retains the December 31 jump-off date (the importance of which is discussed in Section II.A above). The timeline below uses 2026 and 2027 illustratively, but it is also intended to apply in future years.

- The Federal Reserve should provide a five-month window for the Global Market Shock ("GMS") as-of date (as discussed in Section II.C below), which would fall between August 1 and December 31.

- The Federal Reserve should publish the supervisory models, including all proposed model changes (as discussed in Section II.D below), for comment by no later than August 31, 2026, with a 60-day comment period ending by October 30, 2026.[13]

- The Federal Reserve should finalize and publish the supervisory models by February 28, 2027, which provides a 120-day period to finalize the supervisory models following the end of the comment period and permits firms to know the final models that will be used to calculate the supervisory stress test results prior to submission of firms' capital plans. Informing firms in advance of the models that will be used to determine their capital requirements is also consistent with the Federal Reserve's transparency objective and its obligations under the APA and the Due Process Clause. If the Federal Reserve does not finalize and publish the supervisory models by that date, it should not use them when conducting that year's stress tests or determining firms' SCBs for that year.

- The Federal Reserve should publish the 2027 proposed scenarios shortly after the December 31, 2026 jump-off date, by January 5, 2027. In general, the scenario publication should be followed by at least a 15-day public comment period (see below regarding the consistency of this recommendation with the requirements of the APA), such that comments would be due by January 20, 2027. The Federal Reserve would then have 40 days to respond to comments and finalize the scenarios, which should be published by February 28, 2027.

- Firms' capital plans should be due by April 30, 2027. This timeline slightly extends the current timeframe between publication of the final scenarios and firms' capital plan

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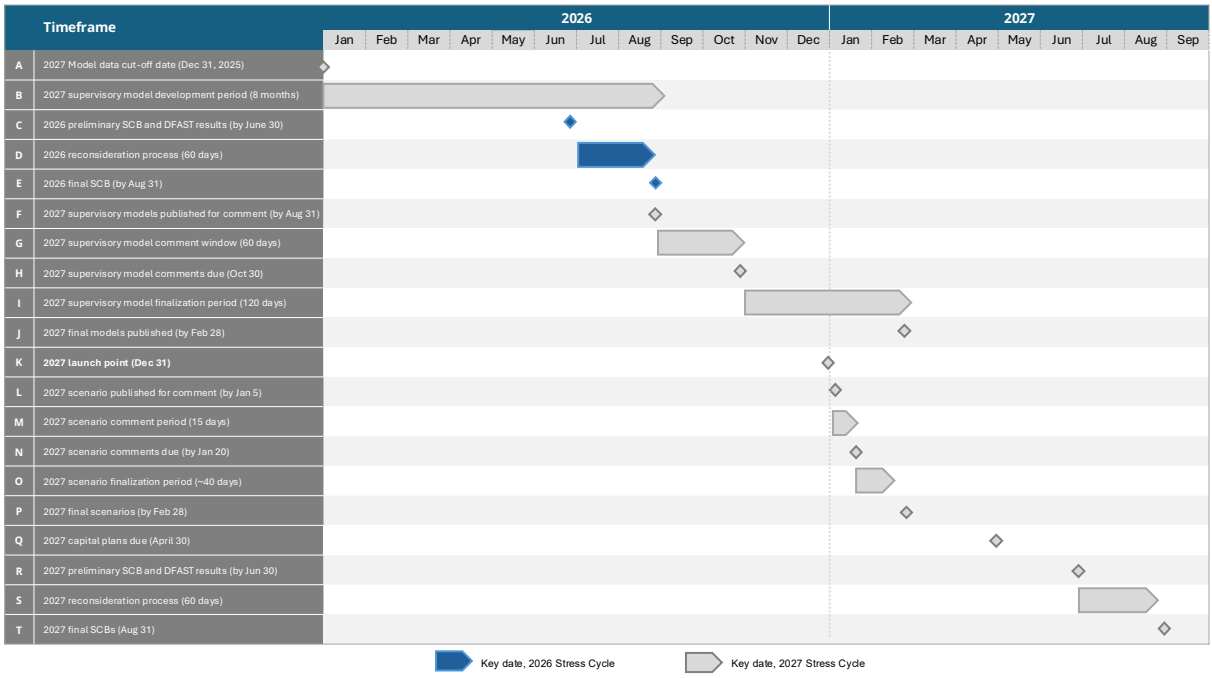
[13] In future years, a 60-day public comment period will likely be sufficient for public comment on the models as we anticipate that the volume of model changes in most years will tend to be lower compared to 2025, when the Federal Reserve disclosed the models in full for the first time. However, in years when the Federal Reserve makes major changes to the models, either in the number of changes or the types of changes, it should publish the models sooner to allow adequate time for public review and comment.

submissions from 50 days to 60 days, which would allow firms more time to conduct their capital planning and associated governance processes following the finalization and publication of the severely adverse scenario.

- The Federal Reserve should continue to publish firms' preliminary SCB and stress test results, including enhanced disclosures (as discussed in further detail in Section II.E below), by June 30, 2027. This would give the Federal Reserve a 60-day window to finalize results after receiving all of the data necessary to perform these calculations.

- The Federal Reserve should extend the current window in which to submit a reconsideration request from 15 calendar days to 15 business days (as discussed in Section II.H below). Final SCBs would be published on August 31, 2027.[14]

Figure 1



The timeline described above would incorporate a 15-day comment period following the release of the proposed scenarios. Although a 15-day comment period would ordinarily be too short to allow the

14 This proposed timeline should be extended by at least 30 days if the SCB effective date is moved from October 1 to January 1, as is contemplated by the pending Averaging Proposal.

public a meaningful opportunity to comment,[15] we anticipate that in most years it would be reasonable in the narrow and specific context at issue here to facilitate retaining a December 31 jump-off date and to reduce the potential impact on the remaining steps of the stress test cycle.

As a general matter, the APA requires that agencies "give interested persons an opportunity to participate in the rule making,"[16] though it does not prescribe a minimum comment period length to meet that requirement. Courts have interpreted this to mean a *reasonably meaningful* opportunity to comment.[17] Under the facts and circumstances of this specific and narrow context, and, moreover, if the proposed changes to the scenario design framework and our related recommendations to improve transparency and reduce volatility of the scenarios are implemented, we anticipate that in most years a comment period of 15 days could provide a reasonable and adequate opportunity for public review and comment. The release of the models used in the supervisory stress test, as well as the proposed guides for the variables in the scenarios, should improve understanding of the supervisory stress test and should result in scenario design choices that are more coherent and transparent. We therefore expect that comments generally would be limited to general scenario incoherence and variables with paths outside of the boundaries set by the guides and other suggestions for scenario improvement, although of course all aspects of the scenarios would be subject to comment, even those variable paths that are within the guides. Accordingly, a shorter comment period should be sufficient in most years for the public to evaluate and provide informed comment on the proposed scenarios each year.

However, 15 days is the minimum acceptable time period: a comment period that is any shorter than that would not provide a sufficiently meaningful opportunity for public comment and in most other contexts a 15-day period would be insufficient. And, depending on the specific scenario proposal, the public could request a longer time period if necessary. For instance, if the Federal Reserve were to propose a scenario with a significant number of variables outside the ranges specified by the guides, once codified, it would likely need to publish those scenarios earlier to allow for a longer comment period or make corresponding adjustments to allow the public a meaningful opportunity to comment.

C. The Federal Reserve should specify a window for the GMS as-of date that appropriately balances the dynamism of the stress test and the operational burden that firms would face.

To address concerns regarding trading book window-dressing and retain the dynamism of the supervisory stress test, the Federal Reserve has proposed to extend the window for the GMS as-of date to one year.[18] This proposed approach would require firms to calculate and maintain records of daily

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15 *See, e.g.*, *Nat'l Lifeline Ass'n v. Fed. Commc'ns Comm'n*, 921 F.3d 1102, 1117 (D.C. Cir. 2019) ("When substantial rule changes are proposed, a 30-day comment period is generally the shortest time period sufficient for interested persons to meaningfully review a proposed rule and provide informed comment.").

16 5 U.S.C. § 553(c).

17 *See, e.g.*, *Prometheus Radio Project v. FCC*, 652 F.3d 431, 450 (3d Cir. 2011); *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1101 (D.C. Cir. 2009).

18 Proposal at 51,873. In addition, the proposal would neither codify nor specify the maximum time period between selection and notification of the as-of date.

portfolio compositions and price sensitivities to applicable risk factors over an entire year, resulting in significant operational complexity and burden. Extending the time between the GMS as-of date and scenario execution would materially increase operational, data, and model risk. Further, extending the window to one year does not add value to the Federal Reserve so long as the window used is broad enough to account for trading book fluctuations. Because relative GMS shocks are calibrated to market levels on the as-of date and applied to a fixed portfolio snapshot, firms must reliably reconstruct historical positions, reference data, and risk factor mappings long after systems, models, and infrastructure have evolved. Extending the GMS as-of date as proposed would increase reliance on manual controls, complicate model governance, and may introduce non-economic volatility into results, reducing both accuracy and interpretability. To alleviate these risks and operational challenges, the Federal Reserve could consider either (i) selecting one as-of date within a five-month window during the second half of the year and applying a single GMS scenario, or (ii) selecting one as-of date within a two-month window in the second half of the year and applying two GMS scenarios.

We firmly believe that a five-month as-of date window with one GMS scenario would allow the supervisory stress test to adequately reflect the dynamics of firms' trading books. Further, the Federal Reserve would achieve its objectives of transparency and consistency, while reducing operational complexity and improving the risk relevance of results. This alternative therefore balances supervisory rigor with safe and sound implementation.

However, should the Federal Reserve finalize the proposal with multiple GMS scenarios, as suggested by a question in the proposal,[19] we recommend a single as-of date, two scenarios, and a two-month as-of date window. Additionally, to offset the operational burden of producing an additional scenario as part of supervisory stress testing, we recommend eliminating additional exploratory scenarios and reducing data requests in first-day letters and special collections.

Prescribing two GMS scenarios for one as-of date with a two-month window would enable the supervisory stress test to capture trading book dynamics sufficiently while minimizing undue operational burden for GMS firms that implementing two as-of dates would introduce. It also aligns with the principle of simplicity. Accordingly, we believe a two-scenario GMS, with both scenarios run as of the same date, would best advance supervisory objectives and minimize operational costs and administrative burdens for the Federal Reserve and for firms if the Federal Reserve prefers a two-scenario approach. In support of the feasibility of using two GMS scenarios on a single as-of date, we note the following:

- Any perceived limitation in the ability of a single scenario to capture a firm's trading book exposures on a single date could be corrected through a second scenario with different variable assumptions. For example, the Federal Reserve could test separate "rates up" and "rates down" scenarios as of the same date to capture interest rate directionality risk embedded in a trading portfolio. While interest rate directionality is a simple illustrative example, the same principle could be applied to various shocks to other asset classes.

- A two-scenario, single-date GMS would still achieve the Federal Reserve's objective of improving risk capture. For example, the directionality of a particular firm's rates position

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[19] *See id.* at 51,927 (Question 44).

in the trading book, would not lead to potential changes each stress test cycle regarding whether the portfolio will realize gains or losses; there would be improved risk capture results due to the use of shocks that test its portfolio in both directions on the same date.

- Operational burdens associated with any multiple-scenario GMS would be substantially mitigated by conducting the two-scenario GMS as of a single date. The same data would support each of the two scenarios, reducing data collection and preservation burdens.

- Two different scenarios on a single date would also support more accurate risk capture inherent in a firm's trading portfolio—since directionality could be tested—whereas different scenarios on different days would raise the risk that even distinct scenarios designed to test different vulnerabilities would fail to capture risks because of portfolio evolution. For example, a firm's portfolio might be exposed to a "rates up" scenario on the first GMS date and exposed to a "rates down" scenario on the second GMS date; in theory, a firm could avoid significant GMS losses if its portfolio evolved in a manner that coincidentally aligned with changes in GMS stress assumptions.

We recognize that adopting a multiple-scenario GMS—even a two-scenario, single-date GMS—would result in incremental costs and complexity in administering the stress test process. Accordingly, to reduce cost and preserve simplicity, our primary recommendation is to retain the single-scenario, single-date GMS with revised liquidity horizons. If, however, the Federal Reserve alternatively adopts a two-scenario, single-date GMS, it should be paired with streamlined operational processes to reduce the resulting burden on the Federal Reserve and firms.

If the Federal Reserve elects to implement a two-scenario, one-date GMS, two constraints should be adopted, through an APA rulemaking, to provide certainty on managing the operational burden. First, the Federal Reserve should commit to relieving firms of the requirement to participate in trading and counterparty exploratory scenarios. The supervisory benefit of these exploratory scenarios would be substantially reduced in a two-scenario GMS, and eliminating additional exploratory scenarios would allow firms to manage processes efficiently. Second, taking into account the additional data and risk analysis inherent in a two-scenario GMS, the Federal Reserve should also reduce data requests in first-day letters and special collections, for the same reasons exploratory scenarios should be eliminated.

D. The Federal Reserve should propose all model changes for comment.

Under the proposal's enhanced disclosure process, the Federal Reserve would disclose the full supervisory stress test models but would request public comment only for "material model changes."[20] Any revisions to the models that are not considered a "model change" or any "model change" that is not considered "material," as defined in the proposal, would not be subject to public comment before implementation in a stress test. In addition to the ambiguity of this approach and the administrative burdens it would impose both on firms and the Federal Reserve, this approach violates the APA and Due Process Clause and would not provide an adequate opportunity for firms and other interested parties to comment on model changes that may have significant effects on binding capital requirements. Instead,

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[20] Proposed §§ 252.44(e); 238.132(e).

consistent with the Federal Reserve's legal obligations, it should publish all model changes accompanied by impact analyses to facilitate public review and comment.

The proposal would define a "model change" as "the introduction of a new model or a conceptual change to an existing model."[21] A "material model change" would be defined as a model change that, based on Federal Reserve estimates, would result in either (i) a 20-basis-point or more change in the projected CET1 ratio of any firm participating in that year's stress test or (ii) a 10-basis-point or more change in the average of the absolute change to the projected CET1 ratios of all firms subject to that year's stress test.[22] Fundamentally, these definitions do not capture the suite of potential changes that could result in significant effects on stress test results and, therefore, significant effects on a firm's capital requirements. The proposed definition of "material model change" would not capture changes to the models that are significant in the aggregate for one year or over multiple stress testing cycles. For example, model changes across several models that, individually, do not exceed the 10- or 20-basis-point thresholds for any one model in a given year would not satisfy the "materiality" standard even if the model changes in the aggregate would result in changes to CET1 ratios well above the proposed 10- or 20-basis-point thresholds. The definition of "model change" itself also is unduly narrow. For example, a re-estimation of stress test models based on updated data would not be considered a "model change" under the proposed definition notwithstanding that the re-estimation could result in significant changes to stress test results or raise questions about the design, methodology and conceptual underpinnings of the model. Moreover, there could be changes that are below these overall capital materiality thresholds but that have a substantial effect on the stress losses associated with a particular asset or exposure type in the stress test. Those changes could result in affected products becoming uneconomic or otherwise disincentivize bank participation in affected markets.

Because the stress test results are used to set firms' binding capital requirements, the APA and principles of due process require that firms and other interested parties be informed of, and provided the opportunity to comment on, any changes to the models.[23] The models themselves are legislative rules, and as such can be amended only by another legislative rule, whether the amendment is "material" or not.[24] The APA's requirement of notice and comment does not have an exception for regulations that an agency deems not "material."[25] Accordingly, the Federal Reserve should disclose each year the suite of models to be used in that stress test and request comment on any changes to the models (with "model change" defined more broadly, as we propose below). This approach would increase the transparency of the stress test, abide by the Federal Reserve's obligations under the APA and principles of due process, and, ultimately, improve the efficacy of the models. In proposing the model changes, however, the Federal Reserve should still specify the changes made and the impact from each change, thus facilitating

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21 Proposed §§ 252.42; 239.130.

22 *Id.*

23 *See Azar*, 587 U.S. at 582; *Fox*, 567 U.S. at 253.

24 *See Sprint Corp*. v. *FCC*, 315 F.3d 369, 374 (D.C. Cir. 2003) ("an amendment to a legislative rule must itself be legislative") (quoting *Nat'l Family Planning & Reproductive Health Ass'n v. Sullivan*, 979 F.2d 227, 235 (D.C. Cir. 1992)) (internal quotations omitted).

25 *See* 5 U.S.C.A. § 553(b).

meaningful public comment. Moreover, because the models are legislative rules, they should be incorporated by reference into the Federal Reserve's Federal Register releases relating to the models[26] and its supervisory stress test rules in Regulation YY.

Disclosing and requesting comment on all model changes also would simplify the process and reduce administrative burdens. Under the approach outlined in the proposal, the Federal Reserve would need to determine and explain the scope of "model changes" and "material model changes."[27] Firms and other interested parties also would evaluate whether the Federal Reserve appropriately requested comment on all "material model changes." In contrast, under our recommended process, the public would analyze the significance of all proposed changes and determine whether a change warrants comment. Because of the different interests among commenters, a "materiality" threshold for requesting comment is inconsistent with the letter and spirit of the APA. The interests and perspectives of commenters will not always align—what is considered "material" to one commenter (or to the Federal Reserve) may not be "material" to another. Moreover, if model changes are truly immaterial, they are unlikely to generate significant comment and the Federal Reserve can proceed quickly to finalize those model changes following the end of a comment period. On the other hand, if the Federal Reserve receives comments, that is a powerful indication that a change is material and that regulated entities and other members of the public should not be deprived of the ability to comment. Providing the public an opportunity to comment on all changes also would alleviate the administrative burdens of conducting, effectively, two separate model comment processes. Specifically, under the proposal, one comment period would occur with respect to material model changes, whereas the public could seek to comment on other changes that are disclosed by May 15.[28] Our recommended process would streamline this process and result in one comment period per year that covers all proposed model changes.

We understand that, in exceptional circumstances, the Federal Reserve may need to implement changes on an urgent basis. These changes may be technical in nature (*e.g.*, adjustments once jump-off point data is available), or based on market conditions (*e.g.*, due to interest rate changes or exigent events such as the COVID-19 pandemic). To the extent a full notice-and-comment process might be impracticable, instead of unduly delaying implementation of these or similar justified changes, the APA provides procedures intended to avoid those problems. For example, to the extent consistent with the APA, the Federal Reserve could issue an interim final rule that implements these changes for the relevant stress testing cycle and provides appropriate notice and comment. This expedited approach would allow flexibility for the Federal Reserve to make necessary changes more quickly than would be possible under a full notice-and-comment process. Consistent with the APA, the Federal Reserve would be able to use this process whenever it finds that a full notice-and-comment process would be "impracticable, unnecessary, or contrary to the public interest."[29] Any changes made under this framework should apply only for the relevant stress test cycle and should be subject to full notice-and-comment if they are to persist in

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[26] *See* 1 C.F.R. Part 51.

[27] *See* Proposal at 51,869–71.

[28] Even though the Federal Reserve has indicated that it would not formally request comment on the comprehensive model documentation released by May 15, it has indicated that it would "welcome[] public feedback on" the comprehensive model documentation once published. Proposal at 51,870.

[29] 5 U.S.C. § 553(b)(4)(B).

subsequent years. Alternatively, to the extent consistent with the APA, the Federal Reserve could use the process of "direct final rulemaking" where the agency "publishes a proposed rule in the Federal Register along with an announcement that the rule will become effective on a certain date unless the agency receives adverse comment."[30] "If adverse comment is received," then the Federal Reserve would "withdraw[] the rule, and, if it still wishes to promulgate the rule, begin the usual notice-and-comment process."[31] This would permit the Federal Reserve to "issue noncontroversial rules with minimum procedures"[32] and make changes in exigent circumstances promptly, while complying with the APA and due process principles requiring adequate notice and opportunity for comment.

We reiterate that the proposed material model change process is both needlessly complex and inconsistent with the APA, Due Process Clause, and other requirements applicable to the stress testing framework. However, if the Federal Reserve nonetheless decides to finalize its proposed process for material model changes, we recommend several revisions to enhance transparency and public participation in the process.

First, the definitions of "model change" and "material model change" should be amended to afford a more meaningful opportunity for public comment on important changes. As proposed, a change must meet the definition of "model change" *and* the "materiality" threshold to be proposed for comment. For example, the "model change" definition would not capture the removal of a firm from the sample due to a merger, even if the effects of that removal would satisfy the materiality threshold. To resolve this gap and permit public comment on possibly significant changes, the Federal Reserve should revise the definition of "model change" to capture any change to the modeling process that affects stress test results compared to the previous year, including changes that alter the model methodology (*e.g.*, modeling technique, assumptions, model parameters, and calibration approach), result in removal of a firm's data, or lead to re-estimating models based on updated data. The definition of "model change" should also include changes to the scope of a model's use (*e.g.*, new or expanded businesses, products, or exposures).

Second, the definition of "materiality" with respect to model changes should be revised to reflect the effects of individual model changes that, when aggregated, become material. Under the proposal, for purposes of assessing the materiality of a model change, the Federal Reserve does not aggregate the effects of changes across or within component models. As proposed, this framework would not provide for public comment for changes to the models that individually do not cross the proposed 10-basis-point or 20-basis-point thresholds but in the aggregate would result in CET1 ratio changes in excess of those thresholds. This could also allow the Federal Reserve to influence what is proposed as a "material" model change based on its definition of an "individual" change. Amending the definition to include changes in the aggregate is critical to provide an appropriate opportunity for public comment. In addition, that aggregation should be based on the absolute value of all changes, rather than the net impact, to capture the significance of changes and provide a more meaningful opportunity for public comment. Accordingly,

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30 Wright & Miller, *Interim Final and Direct Final Rulemaking*, 32 Fed. Prac. & Proc. Judicial Review § 8189 (2d ed.)

31 *Id.*

32 *Id.*

we recommend that the Federal Reserve set a materiality threshold of a 10-basis-point change in the aggregated impact of the absolute value of changes for any particular firm.

Third, the Federal Reserve should clarify that model changes will be evaluated for materiality with respect to Category IV firms, even if one or more Category IV firms are not participating in the stress test for that cycle. The proposal does not specify how the "materiality" standard would be applied in these circumstances. In particular, a "material" model change would be defined as "a model change that could have, in the Board's estimation, an impact on the post-stress common equity tier 1 capital ratio of any firm, or on the average post-stress common equity tier 1 capital ratios *of all firms required to participate in the upcoming stress test cycle*."[33] Category IV firms are required to participate in the supervisory stress test in even-numbered years.[34] It is unclear whether, under the proposed standard, Category IV firms that do not participate in a given year would be included in the materiality calculation. It is critical that every firm, including Category IV firms that do not participate in an upcoming cycle, are included in the "materiality" assessments. This would ensure that timing under the tailoring framework does not eliminate the opportunity for public comment on a change that could be significant to Category IV firms as a group or a particular Category IV firm that is not required to participate in an upcoming cycle.

Fourth, the Federal Reserve should codify the timing for proposing material model changes and disclosing all other changes. Other than committing to disclose the models by May 15, the proposal otherwise does not include a timeline for these important processes.[35] Notably, the proposed May 15 disclosure date would occur after a firm submits its capital plan on April 5 in accordance with the current due date and the proposal otherwise would not alter the capital plan submission date.[36] Given the importance of understanding the models to be used in the stress test for firms' capital planning, disclosure after the submission deadline would lead to greater uncertainty and variability in the capital planning process, and it would not comply with the Federal Reserve's obligations under the APA and Due Process Clause. Accordingly, the timeline that the Federal Reserve codifies should result in publication of the models sufficiently in advance of the capital plan submission date to allow firms to consider the models in their capital planning processes.

Fifth, we recommend that the Federal Reserve consider the materiality of changes, under the determined thresholds, based on two years of stress test data. Changes that may not be material in a given stress testing cycle could become material under a different scenario or with different jump-off point data. Accordingly, the Federal Reserve should test the materiality of changes against a broader sample rather than based only on effects in the current cycle. Evaluating effects across multiple historical cycles reduces the risk that meaningful changes are overlooked simply because the current year's scenario happens to mask their significance. Alternatively, the Federal Reserve could periodically conduct and publish sensitivity analysis on the materiality of changes to help inform firms and general public.

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33 Proposal at 51,870 (emphasis added).

34 12 C.F.R. §§ 252.44(d)(1); 238.132(c)(1).

35 Proposed §§ 252.44(e); 238.132(e).

36 Proposal at 51,936.

In general, if the Federal Reserve retains the material model change process, it should define materiality in accordance with the following principles:

- In aggregate, immaterial changes should not materially affect a firm's capital requirements.
- Immaterial changes should not change the incentives that firms have to enter or exit a particular business.
- The materiality analysis should be robust to different scenarios and jump-off data.

E. The discretionary language in the proposal on the Federal Reserve's commitment to disclosure and transparency should be replaced with non-discretionary requirements.

The proposal would significantly enhance the transparency of the stress testing process. However, we are concerned that the proposal often uses language such as "will endeavor," "expects to," and similar formulations that allow for significant discretion, without firm commitment from the Federal Reserve.[37] This would increase the volatility of stress test outcomes and diminish the transparency of the overall process and associated rationale for design choices. To meet the stated objectives of increased transparency and accountability and ensure compliance with the APA, Due Process Clause, and other applicable law, the Federal Reserve should be affirmatively required to undertake specific actions.

As an example, the proposal provides that the Federal Reserve "will generally disclose information directly to a firm about the firm's supervisory stress test results that is not available to the broader public."[38] The Federal Reserve, instead, should codify the requirement to provide these disclosures and commit to making these disclosures by June 30, on the same day public results would be released under the timeline described in Section II.B, to provide planning certainty to firms and allow firms to use that additional information in evaluating whether to make a reconsideration request. In addition, the Federal Reserve should codify the type of information the Federal Reserve provides to firms. In particular, the Federal Reserve should provide a more granular breakdown of projections and a quarter-by-quarter view of results, rather than a single aggregated result across all nine quarters of the planning horizon. At a minimum, the firm-specific breakdown should be at a level of granularity consistent with the data that the Federal Reserve recently disclosed publicly on an aggregate basis.[39] In the firm-specific disclosures, the Federal Reserve should also include the model-level impact to the firm resulting from any model changes that are significant to the firm, along with any model adjustments such as overlays. These disclosures would help firms to understand better how their activities and exposures are modeled in the stress test,

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37 *See, e.g.*, Proposal at 51,879, 51,883, 51,887, 51, 889, 51,891.

38 *Id.* at 51,872.

39 *See* Federal Reserve, 2025 Detailed Nine Quarter Paths, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm; *see also* Federal Reserve, 2025 Detailed Hypothetical Nine Quarter Paths Under Proposed Models, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm.

which would further support firms' capital planning, as they would be better able to evaluate the regulatory consequences of their business decisions.

Discretionary language appears throughout the scenario design framework, effectively undermining the reduced volatility and increased transparency otherwise afforded by the guides. For example, the proposal states that the Federal Reserve "will endeavor to disclose and explain" its reasoning for selecting the variable paths and potentially deviating from the guides.[40] Coupled with similar discretionary language found in the guides throughout the proposed Scenario Design Policy Statement,[41] these statements do not provide sufficient accountability and transparency regarding the paths of variables in a given scenario. As we noted in the 2026 Scenarios Letter, "endeavoring" to explain deviations from the guides is not sufficient. The ranges and values provided in the guides should be binding, with deviations occurring only if they have been thoroughly described and explained in the proposed scenarios and the public is provided a meaningful opportunity to provide comments on the proposed scenarios, including the rationale for any deviation.

In general, more concrete commitments would serve the goals of transparency and accountability in the stress test process and compliance with federal law. Although we recognize the Federal Reserve's desire for flexibility, the Federal Reserve broadly should memorialize and hold itself to firm public commitments with specific deadlines—whether written in codified regulatory text or policy statements that are legislative rules—that comply with the law and would reinforce accountability for the Federal Reserve making non-arbitrary decisions concerning the stress tests. This principle is fully consistent with administrative law expectations articulated by Administrative Conference of the United States guidance,[42] which emphasizes that agencies should establish clear timelines to avoid undue delay. In the rare circumstances that the Federal Reserve believes deviations from those commitments are needed, the Federal Reserve should publicly explain its rationale and justify those deviations. As noted in the 2026 Scenarios Letter, the Federal Reserve's legal obligations under the APA and principles of due process require that the Federal Reserve fully explain its choices when exercising discretion to allow a meaningful opportunity for public comment.

F. The substantive reforms in the proposal should be codified in regulatory text.

Given the stated objectives of the proposal to create transparency and accountability and reduce volatility in the stress testing process from year to year, the proposal's substantive changes, including the variable guides, timeline, and SCB reconsideration process, should be codified in regulatory text. In many

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40 Proposal at 51,879.

41 *Id.* at 51,947 ("The Board *expects to specify* that inflation will decline by 3 percentage points."; "The Board *anticipates* . . . an unemployment rate peak value that increases between 3 to 5 percentage points . . . ."; "The Board *expe*cts to specify that the U.S. dollar will appreciate against the euro by approximately 15 percent from its jump-off value at its peak"; "The Board *anticipates that* the severely adverse scenario will feature a CRE price value that falls between 30 and 45 percent from its jump-off value." (emphases added)).

42 *See* Recommendations of the Administrative Conference of the United States, Recommendation 78-3: Time Limits on Agency Action, 43 Fed. Reg. 27,507, 27,509 (June 26, 1978) (proposed 1 C.F.R. § 305.78-3 (recommending that agencies adopt timelines, whether or not required by statute)).

cases, the proposal would amend existing policy statements (Stress Testing Policy Statement and Scenario Design Policy Statement) to implement substantive reforms, rather than codifying changes in regulatory text. This approach could undermine the transparency objectives of the proposal and result in future deviations from the framework that are implemented without the public accountability and transparency required by administrative law and due process principles. (Importantly, the Federal Reserve's characterization of these policy statements does not mean that they are not legislative rules within the meaning of the APA.[43])

Accordingly, and to avoid confusion, the Federal Reserve should codify the variable guides in regulatory text instead of the Scenario Design Policy Statement. In addition, the Federal Reserve should specify in rules text that the Federal Reserve will not depart from these guides when determining the paths for these variables unless it provides an explanation and reasoned analysis in the proposed scenario release. This construct would help clarify how the revised stress testing framework has been designed to comply with the Federal Reserve's obligations under the APA, which requires agency disclosure and analysis of changes to its regulations.[44] The supervisory scenarios and models are equivalent to the RWA calculation methodologies in terms of determining regulatory capital requirements. Accordingly, the scenarios and models should be treated the same procedurally, by undergoing the notice-and-comment process when changes are proposed. Formalizing the Federal Reserve's obligations in regulatory text rather than ambiguously labeled "Policy Statements" would improve transparency in the scenario design process and allow for a more streamlined scenario comment period (as discussed above), preserving both agency and industry time and resources. It would also provide consistent and transparent regulatory treatment for revisions that affect firms' capital requirements. Alternatively, at a minimum, the Federal Reserve should make clear that it is required to adhere to these policy statements.

Regardless of the Federal Reserve's approach to codifying the variable guides, the timeline for the stress testing process, discussed above in Section II.A and Section II.B, should be codified in regulatory text to provide planning certainty to firms and increase accountability. The Federal Reserve proposes to publish the proposed scenarios for public comment by October 15 in the year preceding the stress test, publish the final scenarios to be used by February 15 of the year in which the stress test is to be performed, and publish comprehensive documentation on the stress test models by May 15 of that year.[45] The Federal Reserve notes that it would "revise Regulations YY and LL, as well as the Stress Testing Policy Statement" to codify these changes.[46] However, although the proposal would codify the May 15 date for publication of the comprehensive model documentation in the rule text, it does not provide a date by which the Federal Reserve would disclose and invite public comment on material model changes.[47] Even if

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43 *See Safari Club International v. Zinke*, 878 F.3d 316, 332 (D.C. Cir. 2017) ("[a]n agency may not escape the requirements of § 553" through "labeling").

44 *See Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) (noting that an agency must "supply a reasoned analysis" for a change in regulation).

45 Proposed §§ 238.132(b), (e)(1); 252.44(b), (e)(1).

46 Proposal at 51,868.

47 *See* Proposed §§ 238.132(e)(2), 252.44(e)(2) ("The Board will disclose and invite public input on any material model changes before implementing them in the stress test.")

the Federal Reserve does not adopt our recommendations regarding the jump-off date and stress test timeline, it should codify the date by which it would disclose material model changes for public comment. Changes to the timeline can have significant effects on firms' internal processes, as noted above in Section II.A. Codifying the timeline in rule text would prevent the Federal Reserve from making potentially significant changes without soliciting public input.

Further, the Federal Reserve should codify its usual practice of providing notice of the GMS as-of date within two weeks of that date.[48] The proposal would adopt in rule text the requirement to notify firms of the as-of date by October 15 of the year preceding the stress test, but does not discuss the period of time between the as-of date and the notification.[49] Codifying the typical two-week period would provide certainty regarding the period of time that a firm must retain the relevant data, which is significant in light of the associated data retention costs.

The Federal Reserve should also codify in regulatory text the improved SCB reconsideration process discussed below in Section II.H. Codifying this process, with suggested improvements as described below, would provide concrete steps and standards for firms and the Federal Reserve to follow, improving the consistency of the process.

G. The Federal Reserve should disclose to the public when it applies an overlay to the stress test results.

The current Stress Testing Policy Statement provides that "[t]he Federal Reserve does not make firm-specific overlays to model results used in the supervisory stress test. This policy ensures that the supervisory stress test results are determined solely by the industry-level supervisory models and by firm-specific input data."[50] The proposal would not amend this aspect of the Stress Testing Policy Statement. The Federal Reserve has, however, indicated that it does occasionally use overlays.[51]

To the extent the Federal Reserve uses firm-specific overlays—contrary to the public representations in its Policy Statements—the Federal Reserve should establish a transparent and consistent process for their application. The Federal Reserve should adopt durable criteria for when overlays may be applied, focusing on circumstances such as data gaps, methodological limitations, or lack of intuitiveness in results. Most importantly, the Federal Reserve must disclose the use of any overlays and provide an opportunity for public comment or for firms subject to a firm-specific overlay to share any concerns with the use of the overlay through the reconsideration process. An industry-wide overlay should be treated similarly to a "model change." If, as we recommend, the proposed "material" model

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48 The Federal Reserve should also publish notice of the GMS as-of date more broadly, so other firms that are not required to include the GMS component in stress testing may do so efficiently if they choose.

49 Proposed §§ 238.143(b)(2)(i); 252.14(b)(2)(i).

50 12 C.F.R. Part 252, Appendix B, § 2.8.

51 See Defendant's Cross-Motion for Summary Judgment, *Bank Policy Institute et al. v. Board of Governors of the Federal Reserve Systems*, Case No. 2:24-cv-04300 (S.D. Ohio) (Apr. 29, 2025) ("[T]he Board occasionally exercises case-specific discretion in determining whether to apply overlays to firm-specific data prior to application of the stress test models to produce the firms' final results.").

change process is not implemented, any industry-wide overlay would be necessarily subject to notice and comment. If, however, the Federal Reserve retains some form of "material" model change process, any industry-wide overlay should be subject to notice-and-comment whether or not it crosses the "materiality" threshold otherwise applicable to model changes. If it is impracticable to seek comment on an overlay before implementing it—for example, if the Federal Reserve determines an overlay is, in its view, needed only after receiving data submissions for a given stress testing cycle—the Federal Reserve should disclose the overlay and permit firms to challenge the overlay as part of the reconsideration process. The Federal Reserve should also seek comment on whether to continue the overlay in connection with subsequent stress test cycles. With respect to firm-specific overlays, the Federal Reserve should not publicly disclose these overlays, but should disclose the use of the overlay to the affected firm in its firm-specific results. The Federal Reserve should also disclose to the firm the effect of the overlay on the firm's results, and should allow the firm to respond with any concerns with the use and application of the overlay through the reconsideration process. This would allow affected parties an opportunity to understand and respond to the rationale of an overlay, balancing transparency and due-process protections with supervisory flexibility.

H. The timeline for the SCB reconsideration process should be extended and the process should be enhanced to improve transparency.

The proposal would not change the existing process pursuant to which a firm may request reconsideration of its preliminary SCB,[52] although the proposal requests feedback on the reconsideration process.[53]

Under the current capital plan rule, a firm may request reconsideration of its preliminary SCB by submitting a written request within 15 calendar days of its receipt of a notice of the firm's preliminary SCB.[54] The reconsideration request must include a detailed explanation regarding why reconsideration should be granted, along with an explanation of any new information provided.[55] A reconsideration request may also include a request for an informal hearing.[56] The Federal Reserve has sole discretion regarding whether an informal hearing is considered "appropriate or necessary to resolve disputes regarding material issues of fact."[57] The Federal Reserve retains flexibility in both the availability and

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52 Proposal at 51,872.

53 *See id.* (Question 21).

54 *See* 12 C.F.R. §§ 225.8(h)(2)(i), (i)(1)–(2); 238.170(h)(2)(i), (i)(1)–(2).

55 *See id.* §§ 225.8(i)(3)(i); 238.170(i)(3)(i).

56 *See id.* §§ 225.8(i)(3)(ii); 238.170(i)(3)(ii).

57 *Id.* §§ 225.8(i)(4)(i); 238.170(i)(4)(i).

timing of the hearing.[58] Within 30 days of a request for reconsideration, or within 30 days of a hearing, the Federal Reserve is required to provide notice of its decision.[59]

The current process should be replaced with an enhanced reconsideration process that: (i) extends the 15-calendar day reconsideration window to 15 business days, (ii) starts the reconsideration window only after firm-specific disclosures are provided, (iii) expands the scope of issues that the Federal Reserve may consider in the context of a reconsideration request, and (iv) defines the criteria the Federal Reserve would consider in determining whether to hold an informal hearing.

The 15-calendar day window for firms to submit a reconsideration request does not provide sufficient time given the detailed level of review that a firm must conduct in determining whether to submit a reconsideration request as well as the significant efforts required in preparing the request. The 15-calendar day request window should be extended to 15 business days.[60] In addition, that period should begin only after the Federal Reserve has provided all enhanced disclosures to the firm, including firm-specific disclosures that incorporate at a minimum the data that the Federal Reserve recently disclosed publicly on an aggregate basis.[61] Expanding the existing 15-calendar day window would provide firms important, additional time to verify results, determine whether a reconsideration request is appropriate, and substantiate the reconsideration request.

The factors that the Federal Reserve considers in determining whether to modify SCBs in response to reconsideration requests are not specified in the current capital plan rule and, historically, these requests have almost never been granted.[62] For the two requests that were granted in the last 10 years,

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58 *See id.* §§ 225.8(i)(4)(ii); 238.170(i)(4)(ii) ("An informal hearing shall be held within 30 calendar days of a request, if granted, provided that the Board may extend this period upon notice to the requesting party.").

59 *See id.* §§ 225.8(i)(5); 238.170(i)(5). Along with the timing of the hearing, the Federal Reserve can delay the 30-day period to render a decision if it provides notice of the delay. *See Id*.

60 Under the current timeline, with final SCBs provided by the end of August and SCBs taking effect October 1, the reconsideration timeline could be extended without affecting other aspects of the SCB timeline. *See id.* § 225.8(h)(4). If, as contemplated by the Averaging Proposal, the timeline is revised such that new SCBs take effect January 1, there is even more capacity in the overall SCB timeline to provide a longer window for a firm to submit a request for reconsideration. Averaging Proposal at 16,850.

61 *See* Federal Reserve, 2025 Detailed Nine Quarter Paths, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm; *see also* Federal Reserve, 2025 Detailed Hypothetical Nine Quarter Paths Under Proposed Models, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm.

62 There have been 10 requests between 2020 and 2025. Between 2020 and 2023, eight were made and none were granted. *See* Federal Reserve, *Press* Releases (2020-2025), *available at* https://www.federalreserve.gov/newsevents/pressreleases.htm (each annual Press Release Announcement on Individual Capital Requirements for Large Banks contains discussion of how many reconsideration requests were submitted and how many were granted). In each of 2024 and 2025, one request was made

the rationales for reconsideration focused on correcting errors and evaluating whether the models operated as intended. The Federal Reserve should codify the reasons for which a firm may request a revision to its preliminary SCB, which should include resolving disproportionate or economically irrational outcomes, as well as failing to adhere to the principles reflected in the stress testing rules and policy statements—not merely correcting data input errors or adjusting model outputs that cannot be rationalized. The bases for requesting reconsideration should be expanded to include circumstances in which one or more stress test models result in a manifest error in intended risk capture.

Finally, the Federal Reserve should continue to publish when the staff is instructed to explore issues presented in reconsideration requests and institute a process of ongoing transparency as to the status and results of staff review. In the Federal Reserve's responses to reconsideration requests to date, Federal Reserve staff was frequently directed to explore possible model refinements or disclose certain information to firms.[63] However, the Federal Reserve does not provide any follow-up information related to these directives. The Federal Reserve should publish a list of follow-up issues identified via reconsideration requests and the results of the Federal Reserve staff's further analysis of those issues by the next proposed model release. This would increase transparency in the reconsideration and overall stress testing process.

As noted in Section II.F above, each of the following reforms to the reconsideration process should be codified in regulatory text: specifically, (i) the window to submit a reconsideration request begins once the firm-specific disclosures are provided, (ii) the permissible bases for submission of a reconsideration request include resolving disproportionate or economically irrational outcomes or failing to adhere to stress testing principles, and (iii) the Federal Reserve will publish a list of research issues identified in

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and one request was granted, though in each case the request raised numerous grounds for reconsideration and the Federal Reserve made changes in response to a small subset. *See* Federal Reserve, *Response to request for reconsideration of The Goldman Sachs Group, Inc.'s preliminary stress capital buffer requirement, pursuant to the Board's capital plan rules* (Aug. 23, 2024), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20240828a1.pdf (hereinafter, "2024 Reconsideration Request Response"); Federal Reserve, *Response to request for reconsideration of Morgan Stanley's preliminary stress capital buffer requirement, pursuant to the Board's capital plan rules* (Sept. 30, 2025), *available at* https://www.federalreserve.gov/supervisionreg/files/reconsideration-process-response-letter-20250930.pdf.

63 *See, e.g.*, 2024 Reconsideration Request Response at 8 ("The Board has directed Federal Reserve staff to explore possible refinements to the PPNR model components to address possible weaknesses related to the PPNR model components referenced in this request. As noted, the Board also has directed Federal Reserve staff to disclose projected CET1 over the nine-quarter stress testing planning horizon when notifying each firm of its preliminary SCB requirement in the future and to develop a proposal to revise the Board's regulatory reporting forms to collect certain data related to expenses associated with business divestitures and the write-down of consolidated investment entities."); Federal Reserve, *Response to request for reconsideration of Bank of America Corporation's stress capital buffer requirement, pursuant to the Board's capital plan rules* (Aug. 4, 2022) at 6, *available at* https://www.federalreserve.gov/supervisionreg/files/bac-letter-20220804.pdf ("With regard to the arguments raised by [the firm] in the request for reconsideration, the Board has directed Federal Reserve staff to explore possible refinements to the models used to produce the disclosed noninterest expense projections to better reflect the composition of firms' total assets.").

reconsideration request letters and whether changes to models were made in response before finalizing model revisions for the next cycle.

I. The increased transparency in the stress testing process will lower risk in the financial system.

In discussing the potential costs and benefits of the proposal, the Federal Reserve raises the potential risk that disclosure of supervisory models could lead to reduced risk sensitivity of firms' risk models and an overreliance of the financial system on a single modelling framework.[64] The apparent concern is that if firms attempt to more closely mimic the Federal Reserve's publicly disclosed stress test models, a model monoculture could be created in which firms invest less in their own models, reducing their independent ability to measure risks that have not been captured by the public supervisory models. If, in addition, firms seek to "game" the Federal Reserve's stress test models by choosing portfolios to optimize capital requirements, the Federal Reserve's concern is that capital requirements will not reflect risks that are not well-captured by public supervisory models.

This concern assumes that supervisory models are ineffective in measuring risks to the financial system and that disclosure of the models exacerbates the problem by reducing the firms' incentives to develop their own models for risk-management purposes. However, it is the lack of disclosure of supervisory models that has reduced the ability of the models to improve over time and better measure potential risks that may be building in the financial system. Until now, the Federal Reserve's supervisory stress test models were formulated behind closed doors, without the benefit of the review, analysis and suggestions of market observers, the academic community, financial institutions, or policymakers. The result of that non-transparent process has been a concentration of modeling risk within the Federal Reserve itself, with the models being used to set firms' binding capital requirements without external review or public accountability.

Concerns that firms might "game" the models once the details have been disclosed are misplaced. First, this concern ignores the fact that firms have strong and ongoing incentives to measure and manage risk accurately so they can operate profitably and safely. In addition, Category I, II, and III firms are required to develop their own models to run internal stress tests each year that capture their individual idiosyncratic, business-specific risks.[65] For other firms, Federal Reserve guidance also explains that an "effective capital planning process requires a banking organization to assess the risks to which it is exposed and its processes for managing and mitigating those risks, evaluate its capital adequacy relative to its risks, and consider the potential impact on its earnings and capital base from current and prospective economic conditions."[66]

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64 See Proposal at 51,932-33.

65 12 C.F.R. §§ 252.53, 252.54; 12 C.F.R. §§ 238.142, 238.143.

66 Federal Reserve, Supervision and Regulation Letter 09-4, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies" (revised July 24, 2020), *available at* https://www.federalreserve.gov/boarddocs/srletters/2009/sr0904.htm.

Second, "gaming" presupposes that the models are not accurately capturing risk; if the models captured risk, aligning portfolios with the modeled output would enhance, rather than undermine, safety and soundness. Disclosure of supervisory models and the independent vetting that results from public accountability improves the ability of the models to independently measure new and emerging risks, without requiring supervisors to rely solely on firms' own risk models to identify vulnerabilities. A transparent notice-and-comment process will reveal risks that supervisory models may be missing or other flaws in the models, encouraging a dynamic modeling regime that would be more reliable and adjust to changing market circumstances. The risks targeted in each annual scenario can then vary more from year to year, making the stress test more difficult to "game."

Furthermore, the substantial supervisory attention on firms' internal capital planning and stress testing processes effectively eliminates any realistic possibility of "gaming" the models or the scenario risks of the stress test. The supervisory monitoring and review process examines the details of firms' capital calculations, reviews and challenges the models firms use, and sifts through the granular details of trades and positions, raising questions about any practices or positions that could be framed in light of optimizing performance under supervisory models to reduce required capital in a manner that is not reflective of actual risk. Under current supervisory practices, concerns about "gaming" are therefore highly exaggerated.[67]

A rigorous notice-and-comment process for the stress test models does not increase risks in the financial system but rather reduces them, making it more likely that capital levels in the financial system are adequate and reflective of actual risks.

III. Comments Related to Other Aspects of the Stress Test and Capital Frameworks

A. The SCB Averaging Proposal should be finalized with the proposal and applied prospectively after the first year the new models take effect.

The Federal Reserve should finalize the Averaging Proposal together with the broader stress testing revisions addressed in the enhanced transparency proposal. Importantly, the Averaging Proposal should be finalized with asymmetric averaging to avoid locking firms into a higher SCB when the more recent stress test results show lower stress losses. This asymmetric averaging approach is consistent with other aspects of the current capital framework, including the countercyclical buffer and GSIB surcharge,

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[67] We note, moreover, that the concept of "gaming" the stress test models is somewhat of a red herring. Nobody argues that the risk weights established in the Basel standardized approach should be kept secret because firms might rationally adjust their portfolios based on those risk weights to optimize their capital requirements. Indeed, regulatory requirements are intended to affect industry behavior. The key issue is ensuring that the requirements accurately capture risk, and public transparency of the models (like the standardized approach risk weights) helps achieve this outcome.

and with the Federal Reserve's stated goals of the Averaging Proposal, in particular to mitigate the costs of volatility in capital requirements.[68]

When finalized, the Federal Reserve should apply the Averaging Proposal prospectively, only after the first year in which the Federal Reserve uses the revised, publicly-commented-on models to calculate SCBs. Under this approach, if the revised models first apply in 2027, SCB averaging would begin in 2028. By prospectively applying the Averaging Proposal, the Federal Reserve would avoid averaging results based on the new, updated, and transparent models with results based on older models that were never subject to notice and comment. This sequencing would therefore protect firms from blending fundamentally different modeling regimes and support a clearer, more credible transition. It would also preserve the integrity of the revised framework and prevent distorted or transitional SCBs. Moreover, given the recent decision to maintain current SCB requirements until the models can reflect public feedback, prospective application of averaging would avoid averaging subsequent results with either results from many years earlier (*e.g.*, 2025) or results that did not lead to new SCBs (2026).[69]

B. The Federal Reserve should consider the relationship between the supervisory stress test and the finalization of Basel III and calibrate the overall regulatory capital framework accordingly.

The Federal Reserve should consider and account for the interplay of the stress testing framework with any proposal relating to the finalization of Basel III to avoid an overcalibration of capital requirements, in particular in respect of trading, credit valuation adjustment ("CVA"), and related capital markets activities and operational risk. In general, each of the updated Fundamental Review of the Trading Book ("FRTB") market risk standard and the GMS was designed broadly to capture market risks arising from market illiquidity and tail events.[70] Each of the FRTB and GMS similarly measures market risk under extreme market conditions and evaluates the effects of market losses on capital positions under these circumstances.[71]

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68 *See* Bank Policy Institute, Letter re Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, at 7–9 (June 23, 2025), *available at* https://bpi.com/wp-content/uploads/2025/06/BPI-SCB-Proposal-Comment-Letter-4897-2200-0451-v.13.pdf.

69 See Federal Reserve, *Federal Reserve Board Finalizes Hypothetical Scenarios for Its Annual Stress Test and Votes to Maintain the Current Stress Test-Related Capital Requirements Until Public Feedback Can Be Considered*, Press Release (Feb. 4, 2026), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20260204a.htm.

70 *See* Basel Committee on Banking Supervision, Explanatory Note on the Minimum Capital Requirements for Market Risk at 4-3 (Jan. 2019), *available at* https://www.bis.org/bcbs/publ/d457_note.pdf (addressing the perceived weaknesses in Basel 2.5, including 10-day liquidity horizons, exclusions of tail risks, and extensive diversification benefits).

71 For a more detailed analysis of how the FRTB captures the same risks as the GMS, see Greg Hopper, Bank Policy Institute, *How Can the Global Market Shock More Effectively Complement the Fundamental Review of the Trading Book?* (May 30, 2023), *available at* https://bpi.com/how-can-the-global-market-shock-moreeffectively-complement-the-fundamental-review-of-the-trading-book/.

Moreover, stress capital requirements have long captured operational risk losses, which are applied in addition to the current standardized approach, which does not have an express operational risk capital charge. Basel III finalization includes a new methodology for calculating RWAs for CVA and operational risk. Adding a capital charge for CVA and operational risk in the calculation of RWAs without analyzing the interaction with corresponding capital requirements through the stress test would result in an overall miscalibration of capital requirements.

Accordingly, the Federal Reserve should consider the interaction of the GMS, CVA, and operational risk models with any proposal relating to the finalization of Basel III to avoid an overcalibration of capital requirements that may impair market liquidity and functioning and the ability of firms to provide credit to the economy.

C. The dividend add-on component of the SCB should be eliminated.

The proposal would revise the dividend add-on component of the SCB requirement to cover dividends in quarters five through eight (rather than four through seven) of the stress test horizon.[72] In the Averaging Proposal, the Federal Reserve requested comment on whether to eliminate the dividend add-on component entirely.[73] As discussed in our letter on that proposal,[74] the dividend add-on component should be eliminated as it is duplicative of other parts of the capital framework. The dividend add-on requires firms to pre-capitalize four quarters of dividends, but if a firm experiencing stress decided to maintain its dividend and draw on the capital resources that it pre-capitalized, the payout ratio and eligible retained income calculations required under 12 C.F.R. § 217.11(c) generally would prevent the firm from doing so.[75]

The prior justifications for the dividend add-on component are no longer relevant. The dividend add-on was "one way of promoting forward-looking dividend planning given historical experience," as in the 2007-2009 financial crisis, "many firms continued to make significant distributions of capital, including through dividends, without due consideration of the effects that a prolonged economic downturn could have on their capital adequacy."[76] However, since the 2007-2009 financial crisis, the Federal Reserve has provided extensive guidance on capital planning expectations for firms subject to the SCB,[77] implemented a

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72 Proposal at 51,874.

73 Averaging Proposal at 16,850 (Question 21).

74 Bank Policy Institute, *supra* note 68.

75 *Id.*

76 Federal Reserve, Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules, 85 Fed. Reg. 15,576, 15,579 (Mar. 18, 2020).

77 *See* Federal Reserve, *Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies*, SR Letter 09-4 (Feb. 24, 2009, revised July 24, 2020); Federal Reserve, *Federal Reserve Supervisory Assessment of Capital Planning and Positions for Firms Subject to Category I Standards*, SR Letter 15-18 (Dec. 18, 2015, revised Jan. 15, 2021); Federal Reserve, *Federal Reserve Supervisory Assessment of Capital Planning and Positions for Firms Subject to Category II or III Standards*, SR Letter 15-19 (Dec. 18, 2015, revised Jan. 15, 2021).

new rating system with a specific focus on capital planning[78] and introduced new requirements—including a buffer framework—that have broadly increased the stringency of capital requirements and directly responded to the stated supervisory concern arising from the 2007-2009 financial crisis. Further, firms maintain management buffers above capital requirements, which reflects that the firms already otherwise engage in the type of forward-looking dividend planning that the dividend add-on component was designed to require.

IV. Model-Specific Comments

The Federal Reserve has provided more detail about its supervisory stress test models than ever before, and that added transparency has allowed for a much more thorough assessment. There is now a clearer understanding of the models the Federal Reserve has chosen to employ. Drawing on that improved understanding, we identify in this section several areas where the models could be strengthened. A key theme is that the Federal Reserve's models can benefit in many areas from added granularity that would improve the risk capture of the models. While these types of changes would make the models marginally more complex, they would lead to results that are better calibrated to firms' risk profiles, which in turn promotes consistent treatment across firms. We believe these benefits outweigh the costs of added complexity. A more granular approach would better balance the Federal Reserve's stress test design principles—consistency, risk sensitivity, and simplicity.

Further, the difference in modeling sophistication across portfolios is significant. For example, the home equity PD models use detailed state-transition frameworks that capture non-linear relationships between borrower characteristics, scenario variables, and outcomes. By contrast, the corporate loan PD model relies on a series of simple linear regressions of a vendor-supplied estimate of PD on scenario variables—an approach that ignores the more complex interactions among borrower characteristics, loan features, and macroeconomic conditions. More granular models are generally better suited to capture the range of risk profiles among the firm portfolios than relatively more aggregated models. The Federal Reserve already collects detailed data on material portfolios and sources of revenues and expenses stemming from business lines. Many of our comments are recommendations for the Federal Reserve to use those data to improve the models for portfolios and business lines that currently rely on highly aggregated modeling approaches. In addition, several models are estimated with data samples truncated before the pandemic. While we recognize that pandemic-period data poses challenges, the affected models should not remain static. Also, where feasible, model sub-components should be estimated over consistent horizons so that parameter estimates are comparable across specifications.

While the documentation provided represents an advancement, there is still room for improvement. A central shortcoming is that the documentation typically reports which specification was selected but provides little or no evidence-based justification for that choice. Genuine transparency would require clearly defining the criteria the Federal Reserve uses to evaluate competing specifications, presenting the performance of each model against those criteria, and illustrating why the chosen model is superior along the dimensions that matter. Many of the comments in this section recommend that the Federal Reserve test alternative specifications that are more widely used in the industry. The Federal Reserve may have already tested similar specifications and decided against incorporating them, but there

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[78] *See, e.g.*, Federal Reserve, *Large Financial Institution (LFI) Rating System*, SR Letter 19-03 (Feb. 26, 2019).

is simply no way to know that from the documentation provided. In addition, there remains room for improvement in the documentation around variable transformations. In some cases, it is difficult to understand how the Federal Reserve transformed variables for use in the models which hinders the ability to evaluate the models. Variables should be scaled so that parameter estimates are economically meaningful—not reported as zero. All variable definitions and scaling conventions should be clearly stated to prevent misinterpretation.

Credit Risk Models

A. Corporate Model

The Federal Reserve would use the Corporate Loss model ("Corporate Model") to estimate losses on corporate loans and leases under a stress scenario.[79] The Corporate Model would project quarterly losses across several loan types[80] by utilizing loan-level inputs from firms' FR Y-14Q "to ensure adequate granularity when assessing risk and projecting losses."[81] The Corporate Model "treats loans to corporate and commercial borrowers similarly and relies on more granular loan-level characteristics to differentiate the risk of loss and the sensitivity to macroeconomic factors" and gives different treatment to "[s]everal loan types [that] have risk characteristics that differ from most corporate loans."[82] However, the Federal Reserve would not collect more granular data "because the burden of collection outweighs the benefit of more sensitive modeling."[83]

Although the Federal Reserve recognizes the importance of differentiating between different loan types depending on their characteristics, the Corporate Model would not be sufficiently granular in several key areas. Importantly, the model would not distinguish loans that have characteristics that make them equivalent to securitized products. Further, the Corporate Model would not consider the impact of loans with guarantors on projected losses. This lack of segmentation would lead to a material miscalculation of aggregate projected losses for corporate loans.

1. The Federal Reserve should apply the proposed credit loss model for AFS and HTM securities for loans that qualify for securitization treatment under the regulatory capital framework.

The model would not account for the lower risk of loss for loans that have structural features that make them equivalent to held-to-maturity ("HTM") securitized products.[84] By treating these exposures the

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79 *See* Federal Reserve, Supervisory Stress Test Model Documentation: Credit Risk Models, at 7 *available at* https://www.federalreserve.gov/supervisionreg/files/credit-risk-models.pdf (hereinafter, "Credit Risk Models Documentation").

80 *See id.* at 7–8 (Table A1, describing the different categories of loans).

81 *Id.* at 7.

82 *Id.* at 9.

83 *Id.* at 10.

84 *Id.* at 15, 29, 30.

same as all other corporate loans, the model would not account for their unique structures. These loans are predominantly provided to non-bank financial institutions for the purpose of financing financial assets, and have distinct loss dynamics due to their bankruptcy-remote structures, enforceable collateral arrangements, priority cash-flow waterfalls, and diversification.[85] As a result, the model would project artificially high expected credit losses for these loans under stress.

Under the current regulatory capital framework, some held-for-investment ("HFI") loans are treated as securitizations, which more accurately captures projected losses. When the Federal Reserve adopted its Basel III-based capital rule in 2013, it stated that "[b]oth the designation of exposures as securitization exposures (or resecuritization exposures, as described below) and the calculation of risk-based capital requirements for securitization exposures under the final rule are guided by the economic substance of a transaction rather than its legal form."[86] In the Corporate Model, the Federal Reserve should implement a similar approach that projects losses on these loans based on their "economic substance," which includes characteristics similar to HTM securitized products due to their similar structures, rather than their "legal form."[87] The Federal Reserve could use its existing HTM/available-for-sale ("AFS") securities model for the HFI exposures because this model already reflects the structural protections, collateral performance, and cash-flow priority of these exposures.[88] This would promote internal consistency across the Federal Reserve's credit modeling frameworks and treat structurally and economically similar exposures consistently across firms with similar risks.

To implement this recommendation, the Federal Reserve should add a field to Schedule H.1 of the FR Y-14Q that allows banks to indicate when a loan qualifies for securitization treatment under the regulatory capital framework. Additionally, the Federal Reserve should add new fields to capture the facility grade (issue rating that captures the expectation of loss at the facility level incorporating enhancement) and the "security type," for which the Federal Reserve already uses as segmentation variables in the securities HTM/AFS model.[89] Ratings should represent a firm's anticipation of principal loss on the loan, factoring in both PD and the severity of loss to be comparable to the HTM model input. The Federal Reserve should then use the securities HTM/AFS model to determine the loss rate of these exposures, which would more appropriately reflect actual projected losses than the proposed LGD and PD models in the Corporate Model. Further, changing the classifications of these exposures and treating them

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85 *See, e.g.*, Steven Schwarcz, Bankruptcy-Remote Structuring, 97 Am. Bankruptcy L.J. 1 (2023) (explaining that "[p]arties engaging in bankruptcy-remote structuring usually seek to reallocate risk more optimally").

86 Federal Reserve, *Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Riskweighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 Fed. Reg. 62,018, 62,112 (Oct. 11, 2013).

87 *Id.*

88 *See* Federal Reserve, Supervisory Stress Test Model Documentation: Market Risk Models, at 6–75 *available at* https://www.federalreserve.gov/supervisionreg/files/market-risk-models.pdf (hereinafter, "Market Risk Models Documentation").

89 *Id.* at 53.

within the HTM/AFS model would improve the accuracy of the stress test and the consistency of treatment across firms with similar risks while maintaining model simplicity.

2. The LGD model should provide different treatment for loans collateralized by agency qualifying collateral.

The Federal Reserve's approach to modeling LGD would be based on a standard corporate LGD model using corporate loan default data. This approach is not suitable for agency warehousing.

Firms make short-term loans that finance mortgages that are intended to be sold to the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation government-sponsored enterprises ("GSEs" or "agencies"). While these loans have long maturities, the collateral (mortgage loans) is typically delivered to the GSEs within several weeks, and firms are repaid by selling the loans to them. Due to the short-term nature of this financing and the guarantee of repayment by the GSEs, the existing models overstate the risk of these transactions.

The Federal Reserve should account for these types of loans, which finance agency-qualifying collateral and are to be delivered to the GSEs. A potential approach could be to assume that these loans have zero or a low LGD, which would align with the Federal Reserve's approach for firms' own loans under forward contracts with the GSEs.[90] To facilitate this treatment, the Federal Reserve should add an indicator to the loan purpose field in FR Y-14Q Schedule H.1 for firms to identify loans that are collateralized by agency mortgages.

3. The PD model should incorporate guarantor information.

The PD model would not sufficiently account for loan guarantees, particularly those from export credit agencies and trade finance structures.[91] As a result, the model would overstate the risk of these loans by ignoring the credit quality of legally enforceable guarantors.

The Federal Reserve could account for loan guarantees using a similar approach to the existing regulatory capital framework, in particular a substitution approach whereby a firm may "recognize the credit risk mitigation benefits of an eligible guarantee" by using the PD of the guarantor, rather than the borrower.[92] The PD model should also use this type of substitution approach, such that if the guarantor's obligor grade is greater than the borrower's, the model would use the guarantor's obligor grade to calculate PD and project losses.

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90 *See id.* at 82, n. 63.

91 *See* Credit Risk Models Documentation at 10-12 (Equations A2, A3, and A4, for Vendor PD and Projected Corporate PD, which take credit ratings and obligor risk into consideration, but not the value of a loan guarantee).

92 12 C.F.R. § 217.134(a); *see also* 12 C.F.R. § 3.134(a), 12 C.F.R. § 324.134(a).

To implement this change, using the FR Y-14Q fields that indicate when there is explicit recourse to a single guarantor, the Federal Reserve could identify the in-scope population.[93] To cover instances where there is only a partial guarantee, the Federal Reserve should add a field to Schedule H.1 to identify the amount that is covered by the guarantor, such that PD substitution applies only for the guaranteed amount.

The model should also implement the PD substitution approach to LGDs. When using PD substitution under the capital rules, firms also apply the LGD of the guarantee to the guaranteed portion.[94] With respect to U.S. government guarantees, applying this approach would result in zero LGD for guaranteed amounts. The Federal Reserve currently applies zero LGD for one type of U.S. government guarantee through the "ad hoc adjustment" that applies for FDIC shared-loss agreements.[95]

4. The Federal Reserve should allow for sufficient differentiation by rating and industry.

The Federal Reserve's PD model would not sufficiently recognize differentiation by rating and industry. For example, BB loans cover a wide spectrum of credit risk, with BB- loan default rates differing significantly under stress from BB+. The "All Other" category would collapse heterogeneous C&I exposures into a single segment.[96] Insufficient segmentation limits risk differentiation and overstates risk in the upper speculative-grade market.

The BB+, BB, and BB- rating categories should be modeled separately instead of being combined into a single bucket. Unlike for lower speculative-grade B exposures that tend to move together in stress, and for investment-grade exposures that tend to be resilient, granularity of BB loans is important to risk differentiation. The current level of aggregation in the Federal Reserve's model over-estimates default rates in both benign and stressed projection quarters for the upper speculative-grade exposures, forecasting them to be at the higher "overall BB" default levels. Historical industry benchmarks from the 2007-2009 financial crisis show differentiation of greater than double between default rates of BB- loans compared to BB+ loans.[97]

The industry segmentation should be extended to break out the currently broad categories of "Diversified Finance" and "All Other". The proposed segmentation would group facilities with dissimilar default risk profiles, which would produce higher-than-expected loss rates in stress for certain lower-risk facilities.

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93 FR Y-14Q, Line items 44 (Guarantor) and 48 (Guarantor Internal Rating).

94 12 C.F.R. § 217.134(c)(1)(iii); *see also* 12 C.F.R. § 3.134(c)(1)(iii), 12 C.F.R. § 324.134(c)(1)(iii).

95 Credit Risk Models Documentation at 47.

96 *Id.* at 13-14, 24 (Equation A2, Table A2, and table A4).

97 *See* Moody's Investors Service, Annual Default Study: Corporate Default Rate to Moderate in 2024 bur Remain Near its Long-Term Average (Feb. 26, 2024), *available at* https://www.moodys.com/zh-cn/creditfoundations/Default-Trends-and-Rating-Transitions-05E002/reports.

Within "Diversified Finance", the Federal Reserve should consider further segmentation for industry-level differentiation (*e.g.*, Oil & Gas versus non-energy industrials) where exposure-specific risk drivers differ materially and for facility purpose (*e.g.*, capital call subscriptions) where structural characteristics of the facility lead to materially lower default risk than broader diversified finance. Further segmentation could allow for the use of more risk-aligned macro drivers, such as oil price for Oil & Gas facilities.

The "All Other" category should be further segmented to distinguish exposures with materially different risk characteristics, such as trade finance, specialized lending, and non-bank financial exposures not falling under securitization treatment (as discussed above in Section IV.A.1).

5. The Corporate Model can incorporate credit ratings from rating agencies.

The proposed Corporate PD model would use credit rating agency ratings.[98] Although the stress test models constitute legislative rules for purposes of the APA, the Federal Reserve is permitted to use credit ratings from rating agencies in the Corporate Model consistent with Section 939A of the Dodd-Frank Act.

Section 939A broadly required the Federal Reserve and other agencies to review their regulations requiring the use of an assessment of creditworthiness and references to credit ratings within one year of the enactment of the Dodd-Frank Act.[99] The agencies also were required to modify those regulations to remove references to, or requirements of reliance on, credit ratings, and transmit a report to Congress describing these modifications.

The Federal Reserve has completed its obligations under these requirements.[100] Accordingly, although the Corporate Model is a legislative rule, Section 939A does not prohibit the Federal Reserve from using rating agency ratings in the model.[101] Section 939A's mandate related to a review of regulations in existence when the Dodd-Frank Act was enacted and does not prohibit references to credit ratings prospectively, including in new legislative rules such as the Corporate Model. We support the Federal Reserve's proposal to use rating agency ratings as this approach increases consistency and transparency, because it would not require the Federal Reserve to translate firm ratings into the Federal Reserve's ratings and explain those translations.

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98 Credit Risk Models Documentation 15, 20-21.

99 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 939A, 124 Stat. 1376, 1887 (2010).

100 Federal Reserve, *Report to the Congress on Credit Ratings* (July 2011), *available at* https://www.federalreserve.gov/publications/other-reports/files/credit-ratings-report-201107.pdf.

101 Similarly, rating agency ratings could be used in other aspects of the stress test and proposed models where useful.

B. CRE Model

The Commercial Real Estate Loss model ("CRE Model") would project quarterly losses for loans collateralized by domestic and international CRE loans, which includes loans collateralized by non-owner-occupied multifamily or non-farm, non-residential properties ("income-producing" loans) and construction and land development loans ("construction" loans). However, the CRE Model would not be used to project losses for CRE loans accounted for under the fair value option, which instead would be projected using the FVO Model, or real estate loans secured by owner-occupied properties, which would be projected using the Corporate Model.

The CRE Model would project losses using an expected-loss modeling framework based on data reported by firms on CRE loans with $1 million or more in committed balances and the conditions prescribed by the Federal Reserve's stress test scenarios.[102] The expected loss for a given loan is the loan's PD multiplied by the LGD multiplied by the exposure at default ("EAD").[103] The expected loss would inform the provisions for loan and lease losses, calculated by the Provisions Model, which determine the projections for net income.[104]

1. The CRE Model should directly incorporate DSCR into the PD sub-component.

The proposed PD model sub-component would rely on coefficients estimated using a logistic regression "that relates historical data on loan performance to loan characteristics, macroeconomic conditions, and other factors" combined with the information for a given loan.[105] For income-producing loans, the resulting PDs would be scaled upward if the loan is approaching maturity with a debt service coverage ratio ("DSCR") less than 1.2.[106] Instead, the Federal Reserve should incorporate DSCR data reported in the FR Y-14Q into its estimation of the PD sub-component. One method for doing so would be to specify an interaction between DSCR and the current indicator variable for income-producing properties. In addition, the DSCR cut-off and adjustment would be applied to all income-producing loans, without differentiating property types or loan types. The Federal Reserve does not appropriately justify this treatment. The DCSR forecast also considers only interest rate changes during the forecasting window, not changes in net operating income.

2. The PD and LGD sub-components should account for recourse.

Neither the PD sub-component nor the LGD sub-component would account for loans where there is recourse to a sponsor or guarantor. A straightforward way to resolve this shortcoming would be to leverage historical allowances for credit losses available in FR Y-14Q, Schedule H.2, Line 63 (ASC 326-20) to derive scaling factors for "full" and "partial" recourse. Alternatively, the presence of recourse could be

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102 Credit Risk Models Documentation at 45.

103 *Id.* at 46.

104 *Id.* at 45.

105 *Id.* at 49.

106 *Id.*

addressed separately for the PD and LGD subcomponents. For the PD subcomponent, the recourse flag available in Schedule H.2, Line 21 could be used in the logistic regression used to estimate the coefficients for the subcomponent. For the LGD subcomponent, the Federal Reserve could then examine firm-level historical loss projections for CRE loans under the severely adverse scenario and compare differences in LGD for loans with full recourse, partial recourse, and no recourse. Assuming there is some measured benefit to recourse, the Federal Reserve could then use a scalar tied to a specific percentile of the resulting distribution to adjust modeled LGDs or loss rates appropriately.

3. The discount factor regression in the LGD subcomponent should be amended to account for the change in CRE prices between purchase and sale.

The LGD sub-component would rely on the relationship between LGD, property value, and a loan's committed balance at the time of default.[107] To project a loan's collateral balance at the time of default, the LGD sub-component would use "loan-specific valuations, movements in broader commercial price indices, and a discount factor that captures the price discount on properties sold to resolve distressed bank debt."[108]

It is intuitive to estimate a distressed sale discount as a regression using transaction-level data. However, the proposed specification ignores the broader movement in real estate values between sales pairs. To account for this, the discount factor regression should incorporate the change in national CRE prices between purchase and sale.

4. The PD model subcomponent should be estimated to account for prepayment of performing loans prior to the stated maturity.

The proposed PD model subcomponent would not account for prepayments of loans prior to their stated maturities, which likely would lead to overstated maturity risk in the projections. Default and prepayment are considered competing risks. Ignoring prepayments in the model would artificially increase the number of loans exposed to default risk and could lead to an overstatement of losses. This issue may be pronounced for loans nearing maturity prior to the stress test projection horizon given the inclusion of dummy variables indicating periods around the maturity date.[109] Therefore, the Federal Reserve should account for prepayment of performing loans prior to maturity rather than assuming it to be zero.

5. The Federal Reserve should delineate affordable housing from other multi-family lending in FR Y-14Q reporting for CRE.

As noted above, the CRE Model would provide loss estimates for a wide variety of loan types. However, the model would not adequately differentiate between sub-asset classes, which could lead to punitive treatment of certain sectors, including multifamily affordable housing. Affordable housing

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107 *Id.* at 70.

108 *Id.*

109 *Id.* at 60 (The PD model includes indicators for proximity to maturity as this is a "key driver of default risk for CRE loans," with the "quarters leading up to maturity . . . a time of high risk for loan default.").

projects are typically supported by federal, state, and local programs, such as low-income housing tax credits, Section 8 vouchers, and housing trust funds. These programs provide stable income streams, reduce tenant turnover risk, and often incorporate mechanisms that mitigate losses during economic downturns. Previous Federal Reserve supervisory stress test scenarios have incorporated specific shocks for affordable housing, acknowledging the distinct risk profile of these transactions.[110]

The demand for affordable housing remains robust across economic cycles, driven by below-market rents, and typically exhibiting lower vacancy rates compared to market-rate housing or other CRE types. This demand stability translates into more resilient cash flows and lower default frequencies and severities. Further, regulatory agreements and the mission-driven nature of affordable housing often lead to preservation strategies in times of distress rather than immediate liquidation. These strategies, aimed at maintaining housing stock, inherently reduce losses by favoring restructuring and workout scenarios over forced sales.

The Federal Reserve could account for the unique characteristics of multifamily affordable housing by amending Line 9 of Schedule H.2 of the FR Y-14Q for commercial real estate to separately report affordable housing loans as distinct from other multifamily lending. To estimate historical performance differences for affordable housing loans, the Federal Reserve could use publicly available data provided by Fannie Mae that includes the requisite information.[111] Including this data may also provide a broader benefit as it is available for loans prior to the 2007-2009 financial crisis and so would supplement the commercial mortgage-backed securities ("MBS") data, which currently is the only source of data from that period.[112]

6. The Federal Reserve should model construction and development loans separately.

The PD model would apply the same model specifications for construction and development loans and stabilized, income-producing property loans. This lack of differentiation is inappropriate because construction and development loans will generally perform worse under stress than other CRE loans, as shown by the elevated delinquency rates experienced during the 2007-2009 financial crisis, demonstrated in Figure 2 below. We recognize that the Federal Reserve faces a challenge in modeling these loans

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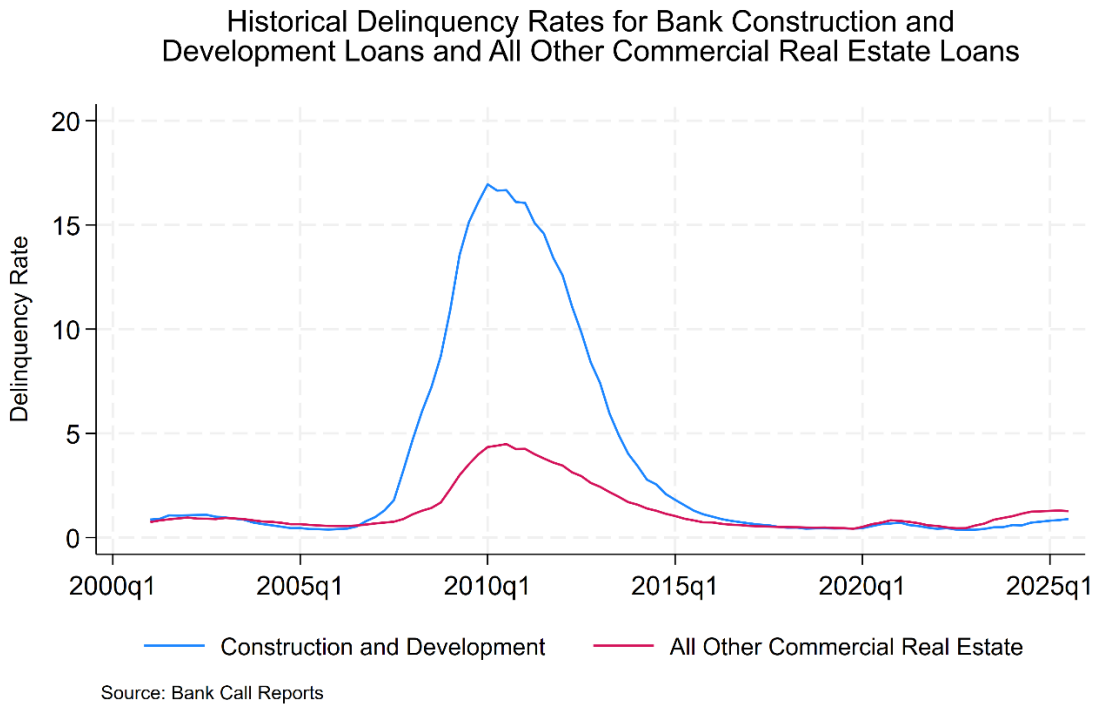
110 For instance, the 2024 scenarios included lower stresses for private equity-backed exposures related to affordable housing investments. See Federal Reserve, 2024 GMS Component: Severely Adverse Scenario Shocks, *available at* https://www.federalreserve.gov/supervisionreg/files/2024-stress-test-severely-adverse-market-shocks.xlsx (Private Equity tab).

111 This data is available at https://capitalmarkets.fanniemae.com/credit-risk-transfer/multifamily-credit-risk-transfer/multifamily-loan-performance-data. The available glossary suggests that Line 26 (Specific Property Type = Multifamily) and Line 55 (Affordable Housing Type) would provide the relevant information.

112 *See* Credit Risk Models Documentation at 64 (noting that the Schedule H.2 data also used in the CRE Model was "first collected in 2011Q3, though limited information is available back through 2009Q4").

separately due to lack of historical data,[113] but we recommend that the Federal Reserve conduct further research to allow it to segregate these loan types as soon as practicable.

Figure 2



C. Home Lending Models

The "Home Lending Models" include the First Lien Mortgage Loss model ("First Lien Model") and the Domestic Home Equity Loan Loss model ("Home Equity Model"). The First Lien Model would be used to project losses on domestic first-lien exposures secured by one-to-four family housing properties.[114] The Home Equity Model would project losses on domestic home equity exposures, including closed-end junior-lien home equity loans and home equity lines of credit, secured by one-to-four family residential real estate.[115] Both models would project losses at the loan level using an expected-loss framework, consisting of a PD component, an LGD component, and an EAD component.[116]

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113 *Id.* at 73.

114 *Id.* at 118.

115 *Id.* at 264.

116 *Id.* at 120–21, 265.

1. The PD model should incorporate vintage effects when projecting defaults.

The First Lien PD model is estimated with dummy variables for various vintages to capture the relative risks between loans originated in those time periods.[117] The Federal Reserve acknowledges that "loans originated immediately prior to the 2008 financial crisis period . . . are substantially riskier than loans originated before or after, while loans originated in or after 2009 are substantially less risky."[118] However, the proposed PD model would ignore these vintage effects in the projections resulting from the model and treat all loans originated in and after 2009 as having the same risk level as loans originated between 2002 and 2005.[119] As a result, by the Federal Reserve's own estimation, the projected default probabilities would be overly conservative. The Federal Reserve justifies this overly conservative approach on the basis that loans originated in and after 2009 "have not been exposed to a major housing downturn."[120] However, mortgage origination standards have significantly improved since the 2002-2005 time period, such that it is very unlikely that they behave similarly to loans made over 20 years ago in stress. The Federal Reserve should consider these significant reforms. In addition, estimating the model with vintage effects and excluding these effects in the model when making projections is not conceptually sound. If it had excluded the vintage effects in the estimation, the coefficients on other variables would have been different. Therefore, the Federal Reserve should incorporate vintage effects into the model used for projections to better capture the true risks of recently originated loans.

2. The PD model should consider more granular origination channels of a loan.

The First Lien PD model would incorporate limited differences between loans originated through various channels (*e.g.*, Retail, Wholesale, Wealth Management / Private Banking), by simply including an indicator for whether a loan is originated through the retail channel.[121] Similarly, the home equity PD models would simply include an indicator of whether a loan is originated through the wholesale channel.[122] However, a sizeable and growing segment of mortgage loans are originated through a wealth management or private banking channel, and are generally much less likely to default than loans originated through a typical retail or wholesale channel, all else equal. The Federal Reserve should use FR Y-14M data, which includes an indicator for channel of origination (including the wealth management or private banking channel), to assess predicted vs. realized PDs by source. Based on this assessment, the Federal Reserve should incorporate a scalar adjustment to predicted PDs to account for the channel of origination at more granular levels, including wealth/private banking channels.

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117 *Id.* at 137.

118 *Id.*

119 *Id.*

120 *Id.*

121 *Id*. at 131.

122 *Id.* at 274, 277, 282.

3. The LGD model should not treat all loans as private label mortgage-backed securities.

When estimating the First Lien LGD model, the Federal Reserve uses an indicator to identify whether an observation came from private label mortgage-backed securities ("PLS") data or agency data "to account for unobservable differences in loss severity between the two datasets."[123] However, in projecting LGD, the model would treat all loans as PLS loans.[124] On average, however, PLS loss severities are 5-9 percentage points higher than agency loss severities,[125] which would result in an overly conservative model. The Federal Reserve should include an indicator in the LGD model for whether a portfolio loan would be securitized in an agency MBS or PLS to capture the differences in loss severity, as shown by the estimates of the model.

4. The data sample period for the LGD model should be extended through 2022 to match the PD model period.

The LGD model would be calibrated using data only through 2015, while the PD model is calibrated with data through 2022.[126] The Federal Reserve explains that it "tested using more recent data to estimate the LGD model parameters and determined that the impacts on projections were small, given the limited number of additional liquidations that are added" (less than 15% of total liquidations in the dataset, according to the Federal Reserve).[127] Although the extension of the data period for the LGD model may not necessarily have a significant impact on results, calibrating PD and over the same time horizon allows for a more coherent model. Absent any reason not to include more recent liquidation observations (which the Federal Reserve does not provide), the two datasets should be consistent.

5. The PD and LGD models should account for the fact that not all defaulted loans will proceed to liquidation.

The proposed model would assume that all defaulted loans (defined as loans reaching 180 days or more past due, or if the loan status is marked as "real estate owned" or is undergoing liquidation)[128] ultimately proceed to liquidation, and it would calculate loss severity on this basis. As a result, the LGD model would be conditional on liquidation because it would be estimated only on loans that have been liquidated, whereas the PD model would be primarily based on reaching the 180-day threshold, which typically precedes a loan being designated as "real estate owned" or liquidation.

This approach would explicitly treat reaching the 180-day threshold as a terminal event, creating an inconsistency between the PD and LGD definitions within the expected loss framework. The Federal

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123 *Id.* at 205.

124 *Id.* at 205, 218.

125 *Id.* at 218.

126 *Id.* at 125, 222.

127 *Id.* at 222.

128 *Id.* at 121-22.

Reserve justifies this decision by stating that cures from loans after 180 days are rare—less than 5% of defaulted loans being cured based on historical data.[129] However, this observation largely reflects pre-crisis or early crisis periods, when self-cures were indeed uncommon and industry-wide loan modification and loss mitigation programs were not yet prevalent.

Since the 2007-2009 financial crisis, the introduction of robust and permanent loan modification programs has significantly increased the likelihood that defaulted loans can be resolved through means other than liquidation. These programs can prevent liquidation and facilitate cures from default status, typically resulting in lower loss severity than liquidation. By not accounting for the measurable portion of defaulted loans that are resolved through modification or other alternatives on a go-forward basis, the proposed model would overstate expected losses.

The Federal Reserve should revise the model framework to reflect that not all defaulted loans will proceed to liquidation. Specifically, the model should incorporate alternative default resolutions that are prevalent since the 2007-2009 financial crisis. This could include updating the LGD model to account for the proportion of defaulted loans that are resolved through loan modification, repayment plans, or other loss mitigation strategies, in addition to liquidation. The Federal Reserve could implement this approach by segmenting defaulted loans based on their ultimate resolution—liquidation versus cure/modification—and estimating loss severity separately for each segment.

The Federal Reserve also should use more recent data, as available, and empirically estimate the share of defaulted loans that cure or are modified, and the associated loss severities. The FR Y-14M dataset and other internal sources can provide valuable information on the outcomes of loans reaching 180 days or more past due.

If necessary, internal development data should be supplemented with industry studies or additional research should be conducted to calibrate the model for stress periods, such that the modeled share of cures and modifications in stress is more realistic given current industry practices. By explicitly modeling the alternative paths for defaulted loans and their respective loss severities, the revised framework would produce more accurate and economically meaningful estimates of expected losses under both baseline and stress scenarios.

D. Credit Card Model

The Domestic Credit Cards Loan Loss model ("Credit Card Model") would project loan losses and provisions on domestic credit card exposures, including for general purpose and private label credit cards.[130] "Credit cards" would include both "bank cards" and "charge cards."[131] To estimate losses for the Credit Card Model, the Federal Reserve would use historical data, payment status and loan losses, account characteristics, and economic conditions.[132] The Model would consist of PD, LGD, and EAD components,

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129 *Id.* at 152.

130 *Id.* at 384.

131 *Id.* at 385.

132 *Id.*

which would generate loss rates using accounts reported on the FR Y-14M.[133] Further, given distinctive characteristics of each, bank cards would be modeled separately from charge cards.[134]

1. The Federal Reserve should extend the definition of default for bank card accounts from 120 days or more past due to 180 days.

The Credit Card Model would define bank card accounts as in default if the account is five or more billing cycles past due or is charged off, corresponding to an account that is approximately 120 days or more past due.[135] The Federal Reserve acknowledges that this definition is shorter and more conservative than the definition of default at 180 days past due as determined by the Federal Financial Institutions Examination Council (the "FFIEC").[136] As a consequence of the more conservative definition, defaults and charge-offs may be pulled forward, creating higher early horizon losses, and changing EAD and LGD mechanics that are pegged to "default timing."

The shorter time to default would cause additional issues across models. For example, as specified, the Credit Card Model would distribute the impact of bank card accounts that default at the start of the projection horizon equally over the second through fifth quarters of the projection period.[137] While this treatment may be consistent with other categories of loans, the Credit Card Model definition of default at 120 days or more past due would not align with actual charge-offs which, in practice, are taken at 180 days or more past due. The shorter default threshold would, in turn, recognize defaults at the start of the projection that are not in practice defaulted. As a result, 29 months of losses would be recognized in the 27-month forecast horizon. To resolve this issue, the Federal Reserve should use 180 days past due as the default definition, or, alternatively, it should remove the additional defaults generated by the shorter default definition.

To summarize, we recommend that the Federal Reserve either: (i) align the supervisory definition of default and charge-off for credit cards to 180 days or more past due; or (ii) publish a sensitivity analysis and reconciliation demonstrating that the five-cycle threshold does not materially distort the level or timing of stress losses.

2. The Federal Reserve should raise the fixed 6% adjustment for interest and fees for projected Bank Card EAD.

The Credit Card Model would adjust the projected Bank Card EAD to exclude delinquent interest and fees,[138] assuming a fixed 6% of the balance at default is comprised of delinquent interest and fees. The Federal Reserve notes that this is intended to avoid double-counting, as delinquent interest and fees are

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133 *Id.* at 391.

134 *Id.* at 388.

135 *Id.* at 386–87.

136 *Id.* at 387.

137 *Id.* at 482.

138 *Id.* at 391.

"often reversed upon default" and reflected in reduced PPNR rather than in credit losses.[139] Notably, if interest and fees were to be misstated, the adjusted EAD would be correspondingly misstated, directly affecting projected losses and inaccurately offsetting the estimated interest income and fee reversals embedded in PPNR models.

Using the standard approximation that accrued interest over a delinquency window is roughly the annual percentage rate ("APR") multiplied by the days past due divided by 365, a 6% accrual over 180 days implies an average APR of roughly 12.2%. By contrast, Federal Reserve data for February 2025 reports credit card APRs around 21.4% (under "All accounts") to 21.9% (under "Accounts assessed interest").[140] Given these APRs, interest-only accrual over 180 days or more past due is roughly 10.6–10.8%, well above the assumed 6% share, and not considering late fees and other charges. The assessed interest and fees are likely even higher given that the credit card industry uses risk-based pricing, such that accounts which charge-off have a materially higher average APR than other accounts, and because assessed late fees can represent a substantial portion of balance at charge-off, especially for lower line accounts. Importantly, the 180-day default convention should be used as the basis for determining this adjustment regardless of the choice of default definition employed within the model, as this is consistent with actual interest and fee accrual practice given charge-off timing guidance. The choice of an inaccurate PD definition should not also result in an inaccurate assumption for interest and fee accrual periods. Further, firms generally see accrued interest and fee reversals in the range of approximately 12% to 20% (with variation by portfolio and segment, as well as by definition). This provides directional support for our view that the appropriate interest and fee reversal share at default should be materially higher than 6% as assumed by the Federal Reserve.

Accordingly, we recommend that the Federal Reserve: (i) publish the empirical basis for the assumed 6% share of balance at default for interest and fees, including the precise construction of fees; (ii) demonstrate stability across time, institutions, and key segmentation dimensions (*e.g.*, score, utilization, prime versus subprime, APR distribution); and (iii) revise assumptions to reflect accurate interest and fee accrual timing irrespective of default-timing convention (*i.e.*, whether it is 120 or 180 days or more past due) within the model to avoid systematic bias in projected EAD and misalignment with treatment in PPNR.

3. The Credit Card Model should account for attrition due to account closures.

The proposed Credit Card Model for bank cards would not consider the probability that an account will close without defaulting.[141] The Bank Card PD Model would apply a conditional default probability to each account from launch point on a quarter-over-quarter basis.[142] However, the account level PD produced by the model is conditional on the account surviving to that period inclusive of both default and

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139 *Id.* at 462.

140 Federal Reserve, Consumer Credit – G.19 (April 7, 2025), *available at* https://www.federalreserve.gov/releases/g19/20250407/.

141 Credit Risk Models Documentation at 437.

142 *Id.* at 394.

non-default forms of attrition.[143] When applying the model, however, and converting each period's conditional PD into an unconditional PD used to calculate expected losses, an estimate of an account's survival probability is used that is based only on default-related attrition prior to that period.[144] This ignores non-default attrition which will bias the unconditional PD upward by underestimating the expected survival probability. Considering the prevalence of inactive closures and voluntary closures due to low utilization throughout both benign and stress periods, the impact of ignoring non-default attrition on the estimate of unit-based cumulative defaults on a given set of accounts can lead to overestimated losses over nine or more quarters.

The documentation states that "the Board believes that the simplicity of the one-outcome approach outweighs the drawbacks. Due to the supervisory stress test's assumption of a constant balance sheet, the potential impact of events like closure is further mitigated because the model assumes that closed accounts are replaced with newly originated balances."[145] Thus, the Federal Reserve essentially accepts bias in account-level predictions on the basis that correcting them would potentially be undone by the manner in which the constant balance sheet assumption is currently implemented.

However, this conclusion may be incorrect for a model framework that properly accounts for competing risks and models non-default attritions together with default. One reason for this is that, for loans that close without default, the share of balances at the launch point is empirically observed to be disproportionately small relative to their share by count. Therefore, even if maintaining the constant balance sheet assumption requires injecting additional volume of new acquisitions to counteract the balance reduction due to closure attrition, injected acquisition volume that is properly tied to launch point balances of projected closed loans may have an impact disproportionally small compared to the bias in the account-level PD rate arising from ignoring these closures.

This issue could be resolved in several ways. One option would be to develop and implement a model for the competing risk of non-default closure. This should not require re-estimating the PD model but adding a model that estimates the probability of non-default closure conditional on survival to that period. Such a model should be expected to predict lower-balance accounts to be at higher risk for this form of attrition, and estimates for both forms of attrition would then be used together to project expected surviving balances to then appropriately derive expected defaults. Forecasted balance attrition from both forms can also feed back into new originations to maintain constant balances. An alternative option would be to apply a simple realistic assumption for a conditional non-default attrition rate (such as 1.5% per quarter). This could be matched with an assumption around balance replacement for closed accounts that reflects that these accounts will skew to lower balance. A further alternative may be to re-estimate the PD model directly on an unconditional basis where non-default closures are not removed from the risk set.

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143 *See id.* at 424 (describing that "accounts that have reached . . . closed status are not modeled *following the default date*" (emphasis added)).

144 *Id.* at 394.

145 *Id.* at 437–38.

4. The Federal Reserve should reconsider its approach to the exclusion of rapid charge-offs.

The Bank Card EAD Model would exclude accounts that are current and then default within two months.[146] The Federal Reserve states that a default on this timeline would be unreasonable given the definition of default at five or more cycles past due.[147] While this filter may reasonably remove implausible delinquency transitions, it could also exclude legitimate, non-delinquency-driven charge-off events (*e.g.*, bankruptcy, deceased borrower, fraud, settlement and forgiveness), which supervisory guidance and issuer practice recognize can be charged off on an accelerated timeline (often within 60 to 90 days of notification or discovery).[148]

Excluding legitimate, non-delinquency-driven charge-off events could introduce selection bias and a consistency problem between the PD and EAD models. This is possible if the PD framework continues to treat charge-offs as defaults irrespective of the delinquency path, while the EAD calibration removes a subset of those same default events. Industry experience suggests that these "rapid charge-offs" frequently exhibit lower line draw and utilization at charge-off than delinquency-driven defaults. Removing rapid charge-offs from the calibration would therefore bias EAD projections upward and overstate losses for portfolios where the events are non-trivial. Accordingly, we recommend that the Federal Reserve: (i) disclose the volume and characteristics of excluded observations; (ii) distinguish delinquency-driven charge-offs and non-delinquency charge-offs in the EAD sample where feasible, or segment the EAD model accordingly; and (iii) provide a sensitivity analysis showing the effect of including these observations on EAD estimates.

5. The Federal Reserve should test and consider expanding the set of macroeconomic drivers for the Credit Card PD Model.

As currently specified, the Credit Card PD Model would principally rely on the unemployment rate to capture macroeconomic sensitivity, while the EAD and LGD components would not be directly sensitive to macroeconomic factors.[149] The Federal Reserve solicits feedback on whether incorporating additional macroeconomic variables—such as real income measures and interest rates—could improve model robustness across a wider range of economic conditions.[150] In considering the utility of additional drivers, the Federal Reserve notes that, historically, real disposable income growth provided limited incremental

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146 *Id.* at 470.

147 *Id.*

148 *See, e.g.*, Federal Financial Institutions Examination Council, Uniform Retail Credit Classification and Account Management Policy, 65 Fed. Reg. 36,903 (June 12, 2000).

149 Credit Risk Models Documentation at 392.

150 *See id.* at 447 (Question E1). The Federal Reserve notes that credit card defaults have increased in recent years despite consistently low unemployment, suggesting that additional variables may be meaningfully associated with default risk. *Id*.

predictive value when included alongside unemployment,[151] though the recent divergence between these series suggests that additional macroeconomic drivers may now be more informative.[152] We agree that incorporating additional macroeconomic variables could improve model projections. Accordingly, we recommend that the Federal Reserve expand and test the set of macroeconomic drivers for the Credit Card PD Model to the extent that their inclusion is determined to be sufficiently beneficial.

6. The Federal Reserve should expand the set of customer attributes and behavioral variables considered in the Credit Card PD Model.

Beyond considering additional macroeconomic drivers for the Credit Card PD Model, the Federal Reserve should extend the set of customer attributes and behavioral variables considered. For example, variables differentiating transactors from revolvers, minimum payment amounts, payment ratios, and related payment-burden dynamics can improve predictive performance. This is especially relevant during periods when payment burdens shift due to changes in interest rates, inflation, or changes in minimum payment requirements. These additional variables would achieve greater accuracy in model projections.

E. Auto Model

The Federal Reserve would use the Domestic Auto Loan Loss Model ("Auto Model") to project loan losses and provisions on domestic consumer loans held for investment extended to allow for the purchase of new or used automobiles and light motor vehicles.[153] The model would project losses at the loan level, which are included in the "other consumer" category of projected loan losses.[154] Projected loan losses then would be used to calculate a firm's pre-tax net income.[155] The Federal Reserve would use the data firms provide in the FR Y-14Q, Schedule A.2 and apply the characteristics of the stress scenario to compute the PD, LGD, and EAD projections.[156]

While we appreciate the desire for simplicity, the Auto Model would not have sufficient granularity and risk-sensitivity. To enhance the models' risk capture, we recommend incorporating additional granularity into the models, as we discuss below.

1. The PD model should account for loan terms.

When underwriting auto loans, both the consumer characteristics and loan structure should be included in PD modeling. The proposed approach primarily focuses on consumer risk through characteristics such as credit score, payment status, origination date, original loan amount, and current

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151 The Federal Reserve cites the historically high correlation between the two variables in support of the proposition that, until recently, modeling both had limited utility, noting that this has since evolved. *Id*.

152 *See id.* at 445–46.

153 *Id.* at 502.

154 *Id.*

155 *Id.*

156 *Id.* at 503.

balance.[157] However, the approach ignores the structural elements of the loan (*e.g.*, loan-to-value ("LTV") ratio,[158] monthly payment amount, amount financed, payment to income ratio) that can mitigate consumer risk. Including other deal structure variables, such as monthly payment or loan size, would allow the models to more directly and accurately reflect changes in loan affordability over time, instead of relying on interest rate proxies as an indirect way of predicting changes in loan affordability. Accordingly, the Federal Reserve should calibrate the model using the credit bureau data, which includes loan term, or the Y-14Q data provided by firms, to capture this loan information at the segment level.

2. The PD model should account for early payoffs as a termination event.

Similar to the problem described in Section IV.D.3 with respect to the Credit Card Model, the Federal Reserve would not include early payoffs as a termination event in the Auto PD model. By not including all termination events in a competing hazards framework, the model would result in higher charge-off risk in later forecast horizons, as it overestimates the population of accounts "surviving" to default in future quarters. Including these termination events will increase the accuracy of the PD model.

3. The LGD model should account for repossession status of the collateral.

The LGD model would not account for repossession of the loan collateral, which risks overestimating total losses. Status of the collateral affects both the realized recovery of the loan and recovery timing, as when the creditor repossesses the collateral the recovery is both greater and occurs more quickly. This change can be easily implemented, as the Federal Reserve already has repossession information, which is used to determine whether the auto loan is in default for the PD model.[159]

4. The Federal Reserve should provide evidence supporting the inclusion of seasonality in used vehicle prices or remove it.

The LGD model includes a "seasonality" variable to "reflect[] that used car values are generally higher in the spring and decline over the rest of the calendar year."[160] However, the interaction of the seasonality of price changes with the applied stress scenario may overshadow the impact of the stress scenario on used auto prices. The Federal Reserve should test the seasonality specifications alongside the stress scenario to ensure that it is not significantly altering the impact of the scenario.

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157 *Id.* at 507–08.

158 The PD model would not include LTV data, which risks overestimating the loan-level and overall PD. Because this data is not currently available in the credit bureau data used by the Federal Reserve, it must be collected separately.

159 Credit Risk Models Documentation at 503–04 , 507. The information is reported in the FR Y-14Q Retail Auto Schedule A.2 (U.S. Auto Loan), summary variables $Repossession and $Current Month Repossession.

160 *Id.* at 535, 540.

F. Other Retail Model

The Other Retail Loss Model ("Other Retail Model") would project loan losses and provisions on loans for a range of loan categories or "portfolios."[161] Other Retail portfolios would encompass a range of loans that are not otherwise accounted for in the supervisory stress test models.[162] The portfolios include, among others, Domestic Small Business loans, Student loans, International Other Consumer loans, International Home Equity loans, and International Auto loans and leases.[163] These portfolios would be based on and largely defined by the FR Y-9C classifications.[164]

Generally, for these portfolios, the Federal Reserve would project a net charge-off rate for each portfolio in each quarter.[165] Depending on the characteristics of particular portfolios and historical data available for them, projections also would be modelled using regression frameworks or scalar models.[166]

1. The Federal Reserve should calibrate models using four-quarter averages for net charge-off rates.

To model losses for several Other Retail portfolios, the Federal Reserve would use an "autoregressive structure," relating quarterly net charge-off rates to their lagged values.[167] The Federal Reserve justifies this approach by stating that it accounts for persistence in the portfolio performance, and allows for model projections to be produced using limited data.[168] However, this approach builds undue persistence into projections. Further, using quarterly values in the estimation could introduce noise, negatively affecting the accuracy of the projections. To mitigate these issues and to produce more accurate projections, the models should instead be calibrated using the four-quarter averages for net charge-off rates.

2. Net charge-off rates for secured and unsecured Domestic Other Consumer and Domestic Small Business loans should be estimated separately.

Domestic Small Business and Domestic Other Consumer lending segments would not differentiate between secured and unsecured loans.[169] While indicator variables would be included in the regression, this approach assumes the same sensitivity to macroeconomic conditions regardless of whether the loan is

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161 *Id.* at 568.

162 *Id.* at 569.

163 *Id.*

164 *Id.* at 568.

165 *Id.* at 569.

166 *Id.* at 570.

167 *Id.* at 611.

168 *Id.*

169 *Id.* at 591 (Table G5).

secured.[170] Given that secured loans are notably less sensitive to changes in macroeconomic conditions, this assumption would lead to overpredicted losses in the model. Instead, net charge-off rates for secured and unsecured Small Business and Other Consumer loans should be estimated separately. For secured loans, reported loan-to-value information should be accounted for in the models. For all loans, the limited credit score information should be considered (as is done for private Student loans). Further, to support greater accuracy, credit score reporting on the FR Y-14Q should be amended to include the score instead of a simple indicator of whether it is above or below 620.[171]

3. The Federal Reserve should define delinquency for the International Cards Model based on a threshold of 90 days.

For the International Cards Model (used interchangeably with "international regression models"),[172] delinquency would be defined as 60 days or more past due.[173] The Federal Reserve justifies this definition by stating that utilizing a more restrictive threshold of 90 or 120 days past due would miss informative data that is meaningful for predicting future net charge-off rates.[174] However, the proposed 60-day threshold is inconsistent with the approach and justifications in the domestic Credit Card Model with respect to charge cards, which would have a 90-day threshold for default.[175] Accordingly, the Federal Reserve should define delinquency for the International Cards Model based on a threshold of 90 days or more past due.

4. The Federal Reserve should better account for geographic variation in its International Models.

The International Cards Model would delineate differences in geographies only through coarse fixed effects by region (*e.g.*, Canada, EMEA, LATAM, APAC) to measure regional economic conditions.[176] This approach reflects the limited regional data currently available in the FR Y-14Q.[177] Further, International Scalar Models[178] would not account for any geographic variation, despite the well-understood variation in loss rates across countries for like assets. This lack of geographic specificity would inevitably lead to inaccurate projections. For greater accuracy, the Federal Reserve should: (i) recompute International Scalar Models by region; and (ii) going forward, consider amending the FR Y14-Q data template to capture conditions in countries associated with each exposure.

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170 *Id.* at 639.

171 *See, e.g.*, *id.* at 627.

172 *Id.* at 570, n. 582.

173 *Id.* at 614.

174 *Id.*

175 *See id.* at 387, 404.

176 *Id.* at 592, 618, 630.

177 *Id.* at 630.

178 *Id.* at 635.

5. Macroeconomic variables should be tied to the corresponding region of exposure to ensure conceptual soundness.

The Federal Reserve would use U.S. macroeconomic conditions, such as the unemployment rate,[179] in the international regression models, which is conceptually unsound. Macroeconomic variables in these models should instead be tied to the region of exposure, or the most economically important areas within those regions.

6. For international portfolios with sufficient data to support further segmentation, three scalars should be used to model losses more accurately.

Under the International Scalar Models, the Federal Reserve would use single scalars to model various international portfolios.[180] Notably, this approach would not allow for any risk differentiation in loss estimates. The Federal Reserve discussed an alternative approach under which scalars could be re-weighted over time, though highlighting potential issues in implementation related to added complexity and insufficient information.[181] To resolve the lack of risk differentiation and to mitigate drawbacks related to the highlighted issues, the Federal Reserve could introduce two new fixed scalars for portfolios with sufficient data to support additional segmentation. As an illustrative example, for International First Mortgages, a "lower-risk" scalar could be calculated for higher-credit score and lower-LTV loans, and a "higher-risk" scalar could be calculated from the combination of the other segments. As all three scalars would be fixed, the Federal Reserve would obviate the added complexity of frequent recalibration.[182] Under this approach, portfolios for firms that do not report this information would continue to be modelled under the existing overall scalar.

Market Risk Models

G. Securities Model

The Securities Model, a component of the Market Risk Models, would calculate projected losses on AFS debt securities, HTM debt securities, and equity securities with readily determinable fair values not held for trading.[183] These losses are recorded in other comprehensive income ("OCI") or pre-tax net income,[184] both of which would ultimately be used to calculate a firm's projected capital ratios and capital requirements.

The Securities Model would generate its projections by (i) projecting the fair value of each AFS debt security and public equity security held by a firm, (ii) projecting credit losses for each AFS and HTM

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179 *Id.* at 599–600.

180 *Id.* at 635.

181 *Id.* at 636–37.

182 *See* Credit Risk Models Documentation at 67.

183 Market Risk Models Documentation at 7.

184 *Id.*

security, and (iii) calculating pre-tax unrealized gains and losses on AFS debt securities based on projected changes in fair value, with adjustments for projected credit losses and hedges.[185]

1. The Federal Reserve should provide more detail on the specification and tuning parameters of the MBS vendor model used in the Securities Model, as well as any model adjustments made.

The Securities Model would project the fair value of agency MBS by conducting a full revaluation using a third-party vendor model.[186] The Market Risk Models Documentation provides a brief description of how the third-party vendor model makes its projections,[187] but does not provide sufficient detail regarding the operation and mechanics of the model. The Federal Reserve should provide a more detailed description of the agency MBS model and the "tunings" that would be used to compute fair value changes (*e.g.*, how prepayment curves are linked to the scenario).

In addition, based on the Market Risk Models Documentation, it is unclear whether the Federal Reserve would conduct any overlays on the vendor model used to value agency MBS. For example, it is unclear whether the model would incorporate extrapolations for high- and low-coupon securities and how scenario projections for variables like house prices and the primary mortgage rate would be captured in valuations. The Market Risk Models Documentation, therefore, should also provide information on any overlays or other model adjustments that would be used to generate valuation projections.

2. The Securities Model's approach to valuing "other" AFS debt securities should be modified to better capture the characteristics of these securities.

The Securities Model would project the fair value of AFS debt securities, other than U.S. Treasuries and agency MBS, using rate and spread duration measures to capture a security's price sensitivity.[188] The Market Risk Models Documentation would define the spread duration as "the percentage change in a security's price for a given change in [option-adjusted spread ("OAS")]," and the rate duration as "the percentage change in a security's price for a given change in interest rates."[189] These values would be constant for a given security throughout the projection horizon and are obtained from a third-party vendor.[190] The spread duration would be multiplied by the change in projected OAS to determine the percentage change in fair value due to changes in credit spreads, and the rate duration would be multiplied by the change in projected interest rate to determine the percentage change in fair value due to

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185 *Id.*

186 *Id.* at 10.

187 *See id.* at 18–19.

188 *Id.* at 22.

189 *Id.*

190 *Id.* at 23.

changes in interest rates.[191] The change in projected OAS would be based on security type.[192] The change in projected interest rate would be determined by security type, as well as maturity (for direct obligations and municipal bonds) or weighted average life (for securitized products).[193]

For a callable bond, instead of determining the change in projected interest rate using the bond's maturity, the Securities Model should use the duration of the bond as the call feature would generally be expected to materially shorten the life of the bond. For municipal bonds specifically, the projection for change in interest rate would be the quarterly change in the U.S. AAA municipal yield, calculated by adding a spread term to the U.S. Treasury yield corresponding to a given security's maturity projected by the Yield Curve Model.[194] Using maturity-matching rather than weighted average life or option-adjusted duration for the selection of the shock could lead to a tenor mismatch, which would lead to more sensitivity to a shorter part of the yield curve despite a longer dated maturity. To resolve this, the Securities Model should use option-adjusted duration in determining the projection for change in interest rate for callable bonds, including municipal bonds.

In addition, the Federal Reserve should revise the duration approach used to value "other" AFS debt securities to incorporate convexity, as well as duration. Simply multiplying the change in projected interest rate and credit spread by the rate duration ignores convexity,[195] which can be important for large shocks such as those observed in stress tests. The large size of the shocks means that duration alone is insufficient to reliably approximate valuation changes. Under large credit spread shocks, the lack of a credit spread convexity component could lead to an overestimation of the decline in fair value for floating rate credit products.

3. <u>To estimate credit losses, the Securities Model should use a more risk-sensitive model.</u>

The Securities Model would use a model to estimate credit losses for AFS and HTM securities based on the PD, recovery rate, and amortized cost of a given security.[196] The coefficients for PD and recovery rate would depend on the security type and whether the security is investment grade or speculative grade.[197]

The approach would not be sufficiently risk-sensitive as securities within "investment grade" and "speculative grade" have significantly varying risk characteristics. The Federal Reserve should increase the

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191 *Id.* at 22.

192 *Id.* at 28.

193 *Id.* at 25.

194 *Id.* at 26.

195 Bond price to yield is curved. Duration is a linear approximation of this curve.

196 Market Risk Models Documentation at 48.

197 *Id.* at 54.

risk sensitivity in the model by specifying a PD and recovery rate that vary with credit rating (*e.g.*, AAA, AA, etc.). Credit losses should then be projected using the initial rating of a given security at jump-off.

4. The proposed reinvestment approach for U.S. Treasuries and agency MBS should be adopted and expanded to other contexts.

The Market Risk Models Documentation would include proposed changes to projecting the fair value of U.S. Treasuries and agency MBS that would account for the aging of these securities resulting in roll-off.[198] The constant balance sheet assumption requires the Federal Reserve to incorporate a related reinvestment assumption. The proposed approach would assume that a firm reinvests maturing securities into one-year U.S. Treasuries.[199]

We support the Federal Reserve's proposal to move away from the constant portfolio assumption for U.S. Treasury securities and Agency MBS in favor of a more dynamic approach that allows for security aging, maturities, paydowns, and explicit reinvestment. The proposal suggests that the Federal Reserve has done extensive analysis of the proposed reinvestment method and we encourage the Federal Reserve to make this analysis public. Although the reinvestment proposal has some shortcomings, we believe that in context it is a sensible simplifying approach.

The proposed reinvestment approach, however, would ignore a firm's duration management approach when reinvesting. In particular, this methodology would ignore duration needs arising from changes to a firm's deposit/loan profile and would not account for replacing duration aging from other runoffs such as HTM securities or accrual swap hedges. If the proposed reinvestment methodology is adopted, the Federal Reserve should explicitly document that the choice to model reinvestments based on portfolio maturities is a simplifying assumption that ignores these considerations.

In addition, for consistency across the stress test, the reinvestment assumption should be reflected in calculating RWAs, as well as OCI. The Federal Reserve's RWA calculation should recognize the relative difference in risk between U.S. Treasuries and the securities that are being replaced (*e.g.*, corporate bonds).

The reinvestment approach should also be extended to securities other than U.S. Treasuries and agency MBS. Modelling portfolio aging for U.S. Treasuries and agency MBS without modelling a similar dynamic in other products creates an artificial disadvantage for credit-sensitive securities, which would realize losses throughout the entire forecast period based on starting duration.

Finally, the Market Risk Models Documentation should also provide more detail on how cashflows from hedges (*e.g.*, interest payments from an interest rate swap) are reinvested and how the subsequent cashflows from the new security are addressed in the PPNR Model. If portfolio aging is considered, then aging on all interest rate hedges also should be reflected.

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198 *See id.* at 64–77.

199 *Id.* at 73.

5. Interest rate hedges should be modeled using a discounted cash flow / full revaluation methodology.

The Securities Model would calculate OCI accounting for credit losses and applicable hedges.[200] To account for hedges, the Securities Model would calculate a hedge ratio for each AFS security to incorporate fair value hedges that hedge interest rate risk and that are not one-sided.[201] The Federal Reserve would calculate the hedge ratio based on amortized cost and reportable hedge percentage provided in Schedules B.1 and B.2 of the FR Y-14Q.[202] The reportable hedge percentage line item in Schedule B.2 is calculated based on the swap's notional amount, as a percentage of total swap hedge notional. The hedge ratio would then be used to calculate the impact of a hedge by effectively removing rate impacts from the hedged portion of security results.[203]

This method of calculating interest rate hedge impacts to OCI would not capture the full economic impact of interest rate hedges. The hedge ratio approach would effectively remove security-side impacts without considering the characteristics of the hedges. As a notional-based measure, the approach would ignore the tenor of the interest rate swap, which therefore excludes impacts from tenor differences between asset and hedge that could be present in the case of partial term hedges and portfolio layer method ("PLM") hedges. Additionally, the Federal Reserve would incorporate simplifying assumptions for fully hedged securities, such as setting fully hedged agency MBS market values to be constant from the jump-off point, which effectively would omit effects from OAS and other parameters even though an interest rate hedge would not offset such impacts.

To resolve this issue, all interest rate hedges in the Securities Model should be modeled using a discounted cash flow / full revaluation approach, which is consistent with the model used for valuing U.S. Treasuries. This recommended approach should not be limited to just PLM hedges, as the Market Risk Models Documentation discusses.[204] In addition, as discussed above in Section IV.G.4, if the Federal Reserve decides to model aging and runoff, runoff in swap hedges should also be reflected. This would better capture the relevant risks and provide a more accurate calculation of the stress results. Further, the changes proposed to Schedule B.2 of the FR Y-14Q are sufficient to enable a discounted cash flow full revaluation of swap hedges.[205]

6. The Federal Reserve should revise how it incorporates amortized cost in OCI.

As described above, the Securities Model would account for hedges in OCI by calculating a hedge ratio based on amortized cost and hedge percentage, as reported in the FR Y-14Q.[206] In the Market Risk

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200 *Id.* at 57.

201 *Id.*

202 *Id.*

203 *Id.* at 58.

204 *Id.* at 76–77.

205 *See* Proposal at 51,936.

206 Market Risk Models Documentation at 57.

Models Documentation, the Federal Reserve acknowledges the drawbacks of its approach, specifically that "the amortized cost reported in FR Y-14Q, Schedule B.1 is an adjusted value that incorporates the effect of other items, including fair value hedges. This adjusted amortized cost would provide an imprecise measure of the accretion / amortization schedule. The securities most impacted by this adjustment would be those securities with fair value hedges in place."[207]

To more accurately incorporate amortization, the Federal Reserve should adopt the following approach: for any amortized cost reporting that includes life-to-date hedge adjustments, the Federal Reserve should adjust the security's amortized cost by removing the hedge adjustment. To reflect this adjustment, the Federal Reserve should use the swap's clean present value as a proxy for the hedge's rate impact, and amortize the net amortized cost. This recommendation, in conjunction with calculating swap hedges using a discounted cash flow approach as described in Section IV.G.5 above, would better reflect the true economic impact of the scenario on OCI. This approach is consistent with our recommendation for the PPNR Model, where the current Federal Reserve proposal results in "one-sided" amortization in situations where amortized cost embeds life-to-date hedge adjustment, and where one recommended solution is also to remove the hedge adjustment by using swap clean present value as a proxy for hedge rate impact.

To facilitate this approach, we recommend including in Schedule B.1 of the FR Y-14Q a flag identifying whether amortized cost contains hedge adjustments and including in Schedule B.2 the clean present value of swap hedges.

H. Credit Valuation Adjustment Model

The credit valuation adjustment model ("CVA Model") estimates counterparty credit risk losses, which are a component of trading and counterparty losses, in the GMS for firms with substantial trading or custodial operations.[208] The CVA Model is used to determine whether a firm would be sufficiently capitalized to absorb material stress to counterparty creditworthiness and the stress impact on the value of derivatives receivables.[209]

Firms use CVA to adjust the "risk-free value of a derivative position" by the risk that the counterparty might default at some future point over the lifetime of the derivative position using market data aggregated at the counterparty level.[210] CVA changes daily depending on market conditions.[211] The Federal Reserve applies the CVA Model to GMS firms using the data they provide in Schedule L

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207 *Id.* at 68.

208 *Id.* at 239.

209 *Id.*

210 *Id.*

211 *Id.* at 240.

(Counterparty) of the FR Y-14Q, and calculates the projected CVA losses in the GMS scenario as the difference between the stressed CVA projections and the projections in the unstressed data submission.[212]

1. The CVA Model should continue to use its current approach of using firm-provided stressed counterparty-level CVA input data.

The Federal Reserve currently uses the information firms provide in the FR Y-14Q to determine stressed CVA and should continue doing so. The Federal Reserve has sought input on moving to a sensitivity-based model to estimate CVA losses;[213] a sensitivity-based model would materially weaken stress-loss accuracy. Standard single factor sensitivities and profit and loss ("P&L") shifts are not suitable for macro (multi-factor) scenarios for the CVA book, particularly in a severely adverse stress test.

A sensitivity-based model would result in several key problems. First, sensitivities do not capture the cross-gamma component (particularly Credit into Rates/FX/Commodity), which arise from the interaction between changes in counterparty credit risk and changes in market risk factors. In firms' experience, cross-gamma second order losses can be nearly as significant as the first order losses. Second, the supervisory stress test stress for CVA also includes additional shocks and adjustments (*i.e.*, stressed collateral haircuts, removal of rating-triggered thresholds, inclusion of margin period of risk ("MPOR"), stressed LGDs, etc.), each of which materially contributes to stress losses and would not be captured in sensitivities reports. Consequently, a sensitivities-based model would be insufficient and provide an inaccurate basis for assessing CVA stress loss in supervisory stress tests, regardless of granularity.

Expanding the data collected in Schedule L.4 of the FR Y-14Q to implement the sensitivity-based approach, as contemplated by the Federal Reserve,[214] would not resolve the limitations of this approach. Expanding the approach by adding more risk factors, currencies, and granular tenor points and requiring firms to submit counterparty level data would serve only to increase the model's complexity and the firms' data submission requirements and operational load for little to no benefit.[215] We urge the Federal Reserve to retain the existing methodology of firm-provided counterparty-level stressed inputs (*i.e.*, expected exposure ("EE") / PDs using Schedule L.2) as the primary method to calculate CVA, as it already incorporates all the above factors.

2. The Federal Reserve should retain its current approach to reporting for the CVA model.

In the Market Risk Models Documentation, the Federal Reserve considers adopting CVA sensitivity reporting requirements that align the FR Y-14Q, Schedule L.4 reporting with FRTB reporting, which would raise several issues.[216] First, as discussed above, this approach would not capture cross-gamma losses that

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212 *Id.* at 240–41.

213 *Id.* at 265 (Question G1).

214 *Id.* (Question G2).

215 *Id.* (Questions G3 and G4).

216 *Id.* (Question G5).

are known to significantly impact firms' CVA losses. Second, FRTB sensitivities would be problematic compared to the business-as-usual ("BAU") sensitivities currently submitted in Schedule L.4. FRTB parameterization (*e.g.*, LGDs and exposure treatment) differs from both the BAU approach and from the current supervisory stress test stress parameterization. As a result, it would not offer any advantage, and is in fact likely to make it more difficult to derive or explain stress losses as the Federal Reserve would need to adjust for or remove certain FRTB-specific assumptions from the projected losses.

The Federal Reserve indicated that it is also considering moving the reporting location of firm CVA hedges from the FR Y-14Q, Schedule F (Trading) to the FR Y-14Q, Schedule L (Counterparty) and including them in the CVA loss model.[217] This would lead to an incongruence in data collection and modeling. CVA hedges are trading instruments (*e.g.*, credit default swaps ("CDS"), FX forwards and options, interest rate swaps, cross currency swaps, swaptions, commodity swaps, equity swaps, etc.), which are best valued within the Trading P&L Model, in line with other trading instruments. In addition, moving CVA hedges to Schedule L would introduce significant operational burden and modeling complexity. We therefore recommend that Federal Reserve keep the current reporting location of CVA hedges on Schedule F and leave them out of the CVA Model.

3. <u>The Federal Reserve should clarify the scope of counterparties subject to CVA risk for purpose of the supervisory stress test.</u>

We recommend that the Federal Reserve clarify that firms are not required to include inter-affiliate transactions, security financing transactions, and centrally cleared transactions, including client-cleared transactions, in the scope of CVA loss estimates for purpose of the supervisory stress test.[218] This approach would maintain consistency in treatment across RWAs[219] and the SCB, and would result in stress testing including exposures only where there is CVA calculated for accounting purposes and, as such, where any losses could arise. The exclusion of these exposures from the scope of CVA would also reduce operational complexity as it would eliminate calculations that firms otherwise would not perform.

In particular, central counterparties ("CCPs") engage in clearing and are designed to remove bilateral counterparty risk, with multiple layers of safeguarding mechanisms such as initial margin, variation margin, and daily settlement, as well as a member default fund. As a result, CVA is not reported for cleared transactions on the balance sheet.

I. Trading Profit and Loss Model

The Trading Profit and Loss Model ("Trading P&L Model") estimates the impact of the GMS shocks on a firm's trading position. It estimates mark-to-market P&L for the firm's trading positions and Other

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217 *Id.* at 266 (Question G7).

218 *Id.* at 268, n. 289.

219 See 12 C.F.R. §§ 3.132; 217.132; 324.132 (requiring calculation of a CVA risk-weighted asset amount only for over-the-counter derivatives). While client cleared derivative transactions are in scope for the current CVA charge, it has been a long-standing industry recommendation that they should be excluded from the CVA charge on the basis that they are off-balance sheet and as such no balance sheet CVA is calculated.

Fair Value Assets, which is then included as realized losses in the projected pre-tax net income in the first quarter of the stress test horizon.[220]

The Trading P&L Model has two components: the Market Value Component and the Sensitivity-Based Component.[221] The Market Value Component stresses market values for certain trading positions reported in FR Y-14Q Schedule F (Trading) and the Sensitivity-Based Component produces stress loss estimates for the remaining Schedule F (Trading) positions.[222] The Federal Reserve currently takes the data inputs for both components directly from the GMS shock template and firms' Schedule F submissions without adjusting them before they are factored into pre-tax net income.[223]

1. The Federal Reserve should not floor results from the Trading P&L Model and should leverage aspects of FR Y-14A Trading P&L attribution data to better capture second-order risks.

We recommend that the Federal Reserve retain the current approach in which the Trading P&L Model results are included in pre-tax net income without adjustment, whether positive or negative.[224] The GMS scenario drives stress losses from the Largest Counterparty Default ("LCPD") and CVA, in addition to Trading P&L. Further, as the SCB effectively provides a 2.5% floor, there is no need for additional floors within granular input calculations contributing to a firm's SCB.[225]

The Federal Reserve's methodology to calculate Trading P&L does not comprehensively capture higher-order risks and cross-asset risks as it primarily utilizes sensitivity-based calculations, including P&L grids provided in the FR Y-14Q Schedule F submission.[226] Examples of risks not fully captured in the current methodology include second-order volatility risk in equities, rates, commodities, and FX, as well as cross-asset risks. We recommend that the Federal Reserve use P&L attribution data provided by firms in the FR Y-14A.4 Trading sub-schedule for estimating these second-order risks, while maintaining the Federal Reserve's current approach for market-value based components and sensitivity-based components for linear risks. The FR Y-14A.4 Trading sub-schedule estimates are granular and include specific attributions to second-order and cross-asset risks. In addition, for those asset classes where the Federal Reserve uses FR Y-14A.4 estimates, it can utilize its current sensitivity-based methodology along with the spot vol grids provided in FR Y-14Q Schedule F as a benchmark. Further, results of Trading P&L losses by asset class should be included in firm-specific disclosures referenced in Section II.E to enhance transparency regarding the results.

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220 Market Risk Models Documentation at 176.

221 *Id.* at 177.

222 *Id.*

223 *Id.* at 183, 202.

224 *See id.* at 205 (Question E1).

225 *See* 12 C.F.R. §§ 225.8(f), 238.170(f).

226 Market Risk Models Documentation at 176–77.

2. The Federal Reserve should floor the impact of GMS shocks applied to agency pass-through securities at the corresponding TBA price.

If the Federal Reserve continues to use the FR Y-14Q-based stress loss model for agency pass-through securities, it should account for securities that meet specified characteristics and are eligible to be delivered into corresponding To-Be-Announced securities ("TBAs").[227] Accordingly, the downside of such agency pass-through securities is limited to the corresponding TBA price due to the deliverability option. The current GMS design, combined with the stress loss calculation methodology, would not be able to account for this dynamic, leading to shocked pool prices below corresponding TBA prices.

To resolve this issue, we recommend that the Federal Reserve amend the FR Y-14Q submission (within the Trading/Agency schedule) to enable the collection of the dollar amount of pay-ups for all pass-through pools against their corresponding TBA securities. This data is crucial for accurate GMS stress loss calculations. Using this data, the Federal Reserve could apply a percentage haircut to the total dollar pay-up for stress loss calculations. To prevent double-counting under this approach, it would be essential that the spread shocks applied to both pass-through pools and TBAs be maintained at the same level.

In the interim, until changes to the FR Y-14Q data collection are implemented, we recommend that GMS shocks applied to agency pass-through securities distinguish between deliverable and non-deliverable pools via special collection, with a lower shock applying to the former, or simply reduce the magnitude of the spread shock to pass-through securities. This simpler approach is described in more detail in the 2026 Scenarios Letter.[228]

J. Trading Issuer Default Loss Model

To calculate the loss to a trading portfolio under stress, the Trading Issuer Default Model ("Trading IDL Model") uses each issuer's credit rating-based PD to determine whether the issuer would default or survive under several stress scenarios.[229] The Federal Reserve then creates a distribution of potential default loss under each scenario and selects a loss amount from the upper end of the distribution to determine the final loss amount on the portfolio.[230]

1. The Federal Reserve should consider eliminating the Trading IDL component from GMS as a part of overall capital calibration consideration across Basel III and Supervisory Stress Testing.

The Federal Reserve should resolve overlap between RWAs and the SCB to prevent excessive capital requirements for firms' capital markets activities. One mitigation strategy is to eliminate Trading IDL component from GMS stress losses. The Federal Reserve should do so for the forgoing reasons.

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227 FINRA Rule 6710(a), (v), (u).

228 *See* 2026 Scenarios Letter at 9.

229 Market Risk Models Documentation at 206–07.

230 *Id.* at 206.

- Trading IDL is not tied to the supervisory scenarios and primarily targets low-probability issuer default tail events beyond the supervisory stress narrative, effectively an incremental loss on top of the stress test.

- Trading IDL fundamentally measures the same issuer default risk that is already structurally captured within: (i) the current Incremental Risk Charge under the market risk framework based on Basel 2.5 and (ii) the future Default Risk Charge in the FRTB framework. Retaining a separate supervisory stress testing Trading IDL construct would result in duplicative coverage of the same jump-to-default risk, increasing the likelihood of double counting across capital stacks.

- Eliminating Trading IDL could serve as a meaningful mitigation strategy to offset net overall capital increases for capital markets activities post FRTB. FRTB implementation is expected to introduce significant increases in RWA across the industry even under permissioned use of the Internal Models Approach to complement the Standardized Approach. A prior quantitative impact study, along with industry consensus, anticipate a RWA increase of approximately 40% (under the Internal Models Approach) to approximately 70% (under the Standardized Approach) over the current market risk framework after assuming the mitigation items included in any future rule-making.[231] Eliminating Trading IDL within the supervisory stress test would act as a targeted calibration adjustment that preserves overall resilience while aligning the supervisory stress framework with the post-Basel III finalization capital framework.

2. <u>If the Trading IDL component is retained, the Federal Reserve should make changes to the Trading IDL model.</u>

We recommend excluding sovereigns and related counterparties with a zero or low risk weight as defined under the regulatory capital framework from Trading IDL, consistent with their LCPD treatment, as well as recalibrating the PD and Recovery Rate assumptions particularly for these exposures. We also recommend simplifying the jump to default calculation for non-linear credit products through using corporate exposure data from FR Y- 14Q Schedule F.23 tab (and removing private equity data on this tab).

Firms have observed that the current Monte Carlo simulation model for Trading IDL could produce unintuitive results. Although the model is designed to capture default risk for credit, by capturing certain sovereign debt as credit the model would skew toward highly rated developed market sovereign exposures, which are more often considered—or treated in practice—as interest rate products (*e.g.*, U.S. Treasury securities). This effect could constrain firms' capacity to intermediate and warehouse critical treasury risks for the sovereign debt instruments of developed economies. To resolve these concerns and enhance alignment with established risk management practices, as well as consistency with the regulatory

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231 *See Meeting Among Staffs of the Federal Deposit Insurance Corporation, Federal Reserve System, Office of the Comptroller of the Currency, and Representatives from the International Swaps and Derivatives Association ("ISDA"), Securities Industry and Financial Markets Association ("SIFMA"), and Certain Member Banks* (Jan. 30, 2024), *available at* https://fdic.gov/system/files/2024-06/2023-regulatory-capital-rule-large-banking-organizations-3064-af29-staff-026.pdf.

capital rule and LCPD frameworks, we recommend the following improvements to optimize the Trading IDL Model:

- *Align in-scope issuer population with the LCPD methodology*: Specifically, this entails implementing the recommendation discussed for LCPD, which would exclude the following exposures from the Trading IDL calculation to be consistent with LCPD: Sovereigns, supranational entities and multilateral development banks ("MDBs") that receive a 0% risk weight and public sector entities and government sponsored entities that receive a 20% risk weight under the regulatory capital framework. Applying these consistent filters to Trading IDL would achieve greater comparability and coherence across regulatory frameworks.

- *Differentiate PD inputs between sovereigns and corporates*: Historical observations, demonstrated through various studies,[232] consistently demonstrate that the average PD for sovereigns is typically different from that for corporates within the same rating bucket.[233] Incorporating this distinction would lead to more accurate risk assessments. The Federal Reserve could consider incorporating Moody's sovereign cumulative default rates by rating. This would be an inherently conservative approach as Moody's calculations account for both technical defaults and selective defaults, whereas the Trading IDL model assumes a full default of the sovereign across all outstanding obligations. Such conservatism further supports the following recommendation to use long-term average recovery rates for Trading IDL.

- *Recalibrate sovereign recovery rates*: The current application of a 25% recovery rate in the event of sovereign default is overly conservative. Data indicates that less than 16% of all sovereign defaults have historically resulted in a recovery rate below 25%.[234] Given the highly idiosyncratic nature of sovereign defaults and the lack of a clear link to the overall market environment, the Federal Reserve should consider a more empirically supported sovereign recovery rate (*e.g.*, the historical average/median recovery rate of approximately 50%).[235]

- *Refine total Trading IDL calculation methodology*: The current model calculates a firm's total default loss by segmenting trading book credit exposures into sovereign, municipal or agency, and corporate portfolios.[236] Each segment is assessed in isolation and losses are then summed to arrive at a firm's total projected default loss, without incorporating any

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232 See, *e.g.*, Moody's Investors Service, *Sovereign Default and Recovery Rates, 1983-2024, available at* https://www.moodys.com/sites/products/defaultresearch/2007400000587968.pdf.

233 *See id.* at 9 (Exhibit 8 comparing sovereign and corporate cumulative default rates by rating from 1983 to 2024).

234 *Id.* at 10 (Exhibit 9).

235 *Id.*

236 Market Risk Models Documentation at 207.

diversification benefits, which could lead to an overestimation of total Trading IDL.[237] Instead, total IDL should be calculated at the overall portfolio level, as opposed to as the sum of losses of individual segments. In addition, there should be no additional stress loss floors for segments or for the overall Trading IDL component.

- *Utilize stressed jump-to-default post FX devaluation prescribed in the GMS scenario as an input to sovereign local currency exposures for Trading IDL*: This approach effectively incorporates default exposure post-GMS FX shocks, thereby reducing the double-counting of stress losses between Trading IDL and Trading GMS stress-loss calculations. While a comprehensive calculation of stressed jump-to-default across all issuers and risk factors might impose a significant data submission burden, the impact of FX devaluation risk on local currency sovereign bonds can be efficiently quantified by using existing data within the FR Y-14Q Trading submission. For example, the Federal Reserve could apply prescribed FX depreciation in the GMS scenario to reported local currency sovereign market value/notional amount. Unlike other market variables—such as equity prices or credit spreads—that often rebound following a severe shock, significant currency depreciations in emerging markets tend to be persistent.[238] Consequently, it is more reasonable to assume that FX shocks within the GMS framework will continue to influence results over the subsequent quarters of the forecast horizon.

K. Largest Counterparty Default Model

The Largest Counterparty Default Model ("LCPD Model") calculates the loss each GMS firm would experience if its largest counterparty were to default under the GMS scenario.[239] The Federal Reserve developed the LCPD model in response to the 2007-2009 financial crisis, which exposed the interconnectedness of large firms and the how the stress at one large firm can lead to distress at another.

The LCPD model estimates the losses a firm would experience if its single largest counterparty, ranked by stressed exposure, were to default under the GMS scenario, adjusted for associated collateral and single-name credit default swap hedges against the counterparty.[240] The Federal Reserve then multiplies the stressed net exposure by 0.9, to capture the assumption that firms will lose 90% of the exposure when default occurs, and subtracts any CVA attributed to the counterparty from the loss.[241] The LCPD loss is then applied to the first quarter of the stress test projection horizon.[242]

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237 *Id.* at 208.

238 This pattern is evident in the historical behavior of currencies like the ARS (Argentine peso), EGP (Egyptian pound), TRY (Turkish lira), and NGN (Nigerian naira).

239 Market Risk Models Documentation at 267.

240 *Id.* at 268.

241 *Id.*

242 *Id.*

1. The Federal Reserve should recalibrate the LCPD Model to appropriately reflect the enhanced financial stability gains following reforms after the 2007-2009 financial crisis.

The LCPD Model would assume a fixed 90% LGD,[243] which would reflect the historical losses observed during the 2007-2009 financial crisis.[244] However, since the crisis, several major financial reforms (*e.g.*, margin requirements, mandatory central clearing, enhanced prudential regulation) have been introduced globally that reduce counterparty credit risk and enhance financial stability. Accordingly, assuming a fixed 90% LGD for all counterparties would not appropriately reflect the benefits of post-crisis financial reforms. We recommend that the Federal Reserve publish a grid distinguishing counterparty types by industry or sector and use differentiated LGDs in the LCPD calculation.

In addition, the LCPD Model would assume that the exposure is equal to the stressed exposure calculated under the GMS without any changes in the horizon assumed by the GMS Model.[245] Therefore, the LCPD Model would fail to appropriately recognize the risk-reducing benefits of margin agreements. The Federal Reserve should consider differentiating between margined and unmargined counterparties and should engage with the industry in doing so.

To further improve risk capture, we also recommend that the Federal Reserve use an average of a firm's top five largest counterparties. Using losses solely from a firm's single largest counterparty does not accurately capture risk, as all firms cannot simultaneously face default from their single largest counterparty in an industry-wide scenario. Further, using an average of a firm's top five largest counterparties would also decrease volatility in the stress test results.

2. Certain sovereigns, MDBs, public sector entities, and GSEs should be excluded from the LCPD.

The Federal Reserve should exclude certain counterparties with a zero or low risk weight under the regulatory capital framework.[246] This includes sovereign, supranational entities and MDBs that receive a 0% risk weight, as well as public sector entities and GSEs that receive a 20% risk weight. This approach would maintain consistency and coherence in capital treatment between RWAs and the SCB.[247]

Alternatively, if the Federal Reserve determines not to utilize a risk weight-based criterion, it should exclude from the LCPD calculation all sovereign, supranational entities, MDBs, public sector entities, and GSEs rated AA- or better under a firm's internal credit rating system, as calculated by its second-line credit risk management function.[248] This approach would exclude only the highest-credit-quality

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243 *Id.* at 277.

244 *Id.*

245 *Id.* at 278.

246 See 12 C.F.R. §§ 3.32(b); 217.32(b); 324.32(b).

247 *See* 2026 Scenarios Letter at 8–9.

248 As is, the LCPD excludes only a limited number of MDBs. *See* Market Risk Models Documentation at 269.

counterparties, in turn improving risk sensitivity relative to the historical G7 exclusion, and achieving broadly similar outcomes across institutions.[249]

In addition, the Federal Reserve should revise the counterparty aggregation principles utilized in the LCPD Model so that sovereign agencies, central banks, sovereign wealth funds and state-sponsored entities are treated like the relevant related sovereign and excluded from the LCPD.[250] This approach would align with credit risk management principles.

3. The Federal Reserve should not broaden the LCPD to incorporate balance sheet-wide counterparty exposure.

The Federal Reserve requested feedback on "incorporating balance sheet-wide counterparty exposure, beyond derivatives and securities financing transactions (for example margin lending), as per the SCCL rule" in the LCPD Model estimate.[251] As LCPD is intended to capture counterparty loss due to an instantaneous market shock, we believe the incorporation of other balance sheet-wide exposure is inappropriate. We recommend not including it in the model, but instead continuing to focus the LCPD Model on derivative and securities financing transaction portfolios, as the current LCPD scope is appropriate for assessing the risks it is meant to capture.

L. Fair Value Option Model

The Federal Reserve uses the Fair Value Option Model ("FVO Model") to project gains and losses on loans subject to fair value accounting, which is then factored into their calculation of a firm's pre-tax net income for each quarter of the stress test horizon.[252] Specifically, the FVO Model projects mark-to-market P&L on (i) loans accounted for under the FVO, which are marked to market, (ii) HFS loans, which are marked to the lower of cost or market value, and (iii) certain loan hedges.[253] Firms elect whether to treat loans as HFS or FVO for accounting purposes.[254] However, HFS and FVO loans are treated the same in the model in terms of capital impact with changes in fair value.[255]

The FVO Model contains three sub-models for (i) wholesale loans (the "Wholesale Model"), (ii) retail loans (the "Retail Model"), and (iii) loan hedges. The comments below focus on the Wholesale

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249 While internal ratings may be variable by institution, a common minimum internal rating would achieve a degree of consistency in approach.

250 *See* Market Risk Models Documentation at 270.

251 *Id.* at 289 (Question H10).

252 *Id.* at 78.

253 *Id.*

254 *Id.*

255 *Id.*

Model and the Retail Model. The former projects P&L for HFS/FVO corporate and CRE loans, while the latter projects P&L for HFS/FVO residential mortgages and other consumer loans.[256]

1. The Wholesale Model should be revised to better capture LGD in the Corporate and CRE Models.

The Federal Reserve should make several changes to the FVO Model's Wholesale Model to improve risk capture for HFS/FVO corporate and CRE loans. The Wholesale Model currently captures losses due to defaults on the HFS corporate and CRE loans, as well due to changes in the mark-to-market of the loans.[257] For the default losses, Federal Reserve assumes a static LGD of 50%, which is inappropriate given the variety of loans for which the Wholesale Model is used to project losses,[258] including highly collateralized loans, such as CRE Multi-Family, as well other highly secured loans either held as FVO or, in some cases, moved to HFS prior to sale.

Historically, a static 50% LGD assumption may have been reasonable when the majority of loans were corporate loans because they were predominantly loans held to syndication. However, the finalization of the Basel III rules in the U.S. would result in a revised boundary between the trading book and banking book. Further, the composition of firms' portfolios of short-term bridge loans can significantly fluctuate with market conditions (*e.g.*, competition from non-bank lenders may shift bank portfolios more toward investment grade as private credit facilities provide more high-yield financing). As a result, firms' HFS/FVO portfolios may now contain more non-corporate loans such as CRE, margin loans, and other secured financial collateral than was the case historically, making the 50% LGD assumption inappropriate given the difference in loss characteristics of those loans.

For computing LGD on corporate and CRE loans, the Federal Reserve should use the LGD models specified in the Credit Loss documentation.[259] Using these models would promote consistency of risk capture across similar exposures. The Federal Reserve would not need to collect additional data because it already has all the same information for Corporate and CRE loans as HFI loans, as all are included on Schedules H.1 and H.2.

2. The Wholesale Model for CRE should account for construction loans.

The Wholesale Model would assume that unfunded CRE loans are immediately funded, such that the EAD at the time of origination is equal to the fully committed balance.[260] While this assumption may be reasonable for permanent loans, it should not apply to construction loans. In the Credit Risk Models Documentation on the CRE Model, the Federal Reserve notes that construction loans draw over the life of

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256 *Id.* at 79.

257 *Id.* at 84.

258 *Id.* at 100.

259 Credit Risk Models Documentation at 28–34, 73–86 (describing Corporate LGD Model and CRE LGD Model).

260 Market Risk Models Documentation at 98.

the loan, but justifies the immediate funding assumption because construction loans have shorter terms.[261] The assumption may also be reasonable on average for a firm's HFI portfolio, but is inappropriate for data center construction loans, which are typically between three to seven years and, given their size, may have large exposures held as HFS/FVO.

The Federal Reserve should assume that the loan balance increases evenly over a fixed period. For example, a period of five to six quarters may be appropriate for CRE constructions loans. Further, this assumption could be limited to loans with more than two years until maturity. The Federal Reserve already has the data required to implement this change on Schedule H.2 and can study the funding dynamics of construction loans as its available data increases.

3. The Retail Model should account for fixed rate consumer, non-residential loans.

The Retail Model would not incorporate interest rate duration into projections for consumer, non-residential loans, reflecting an assumption that these loans are floating rate.[262] However, firms may have portfolios of student and other consumer loans that are fixed rate, and therefore exhibit material interest rate sensitivity that is not captured under the current methodology. In a falling interest rate scenario, firms may not receive the benefit of the increase in value leading to lower modeled P&L. The Federal Reserve should estimate interest rate duration for fixed-rate, consumer, non-residential loans. The Federal Reserve would not need to collect any additional data to implement this change, as it already captures interest rates for such loans on Schedule A.

4. The Retail Model should account for shorter durations of certain residential loans.

To calculate P&L on HFS/FVO residential mortgages, the Retail Model would assume a fixed duration of 5.4 years (using the 2020-2024 vintage) across all residential mortgage types.[263] However, this assumption is improper as some products, such as jumbo mortgages, typically have a shorter duration. Under a falling interest-rate environment in earlier quarters, the use of a fixed duration assumption can materially overstate interest-rate sensitivity and effective durations, resulting in higher modeled P&L under the current methodology. The Federal Reserve should refine its estimate of residential loan duration or consider collecting and using firms' own estimates of duration for residential mortgages.

5. The Wholesale Model should incorporate FLEX protection to calculate HFS portfolio pricing.

The Wholesale Model would not capture the reduced risk in firms' HFS portfolio that results from firms' negotiations in the Broadly Syndicated Loan ("BSL") market. Firms often negotiate "FLEX" protection with a borrower to guard against changes in the credit environment that occur between the time of committing a price to a borrower and completing the process of syndicating the risk. FLEX protection

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261 Credit Risk Models Documentation at 89.

262 Market Risk Models Documentation at 113.

263 *Id.* at 112.

includes both margin FLEX for higher coupons at par and original issue discount ("OID") FLEX for direct offsets to commitment.

The Federal Reserve should include the impact of FLEX to reduce losses on loans in the process of syndication. Firms would need to provide data on Margin FLEX and Original Issue Discount FLEX to the Federal Reserve, which could be included to reflect the benefit of higher cash flows from Margin FLEX in market price and in faster syndication behavior for deals with better pricing. Incorporating FLEX would improve the model's accuracy in estimating pricing and would not increase yield at par. OID FLEX should offset losses directly as it affects the principal commitment amount.

6. The FVO Model should not use a linear model to project credit spread.

The current FVO valuation approach for floating-rate loans would rely on simple linear sensitivity assumptions to project credit spread.[264] This assumption does not reflect the convex behavior of credit instruments under large spread widening. As a result, under severe stress, a linear assumption can produce unrealistic valuations. The Federal Reserve should enhance the model so that valuations under large spread moves are recovery-consistent and nonlinear.

7. The Federal Reserve should publish the high yield corporate bond OAS variable path and provide model coefficient estimates.

Firms require additional data from the Federal Reserve to provide informed comments on the high yield corporate bond OAS Path. Although the Federal Reserve disclosed the high yield corporate bond OAS formula and drivers, it did not publish either the OAS path used in the stress test or the model coefficients used to generate it.[265] Because high yield OAS is an input to rating-specific corporate spread projections (BB/B/CCC), firms cannot replicate the Federal Reserve's projections without the coefficients and realized path (and any floors or initialization). Further, firms are unable to replicate the Federal Reserve's analysis, and, based on their own analyses, believe that the path may be overly severe.

M. Private Equity Model

The Private Equity Model ("PE Model") would project changes in fair value of PE assets over the stress test horizon.[266] These losses would be calculated based on investment carry values, segmented by industry, geography and accounting treatment.[267] The PE Model would capture movements in the stock market and their effect on PE fair values.[268]

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264 *Id.* at 81.

265 *Id.* at 146–47, 292, 294 (Equation C-7, Figure C-2, Equation I-1, Figure I-1).

266 *Id.* at 156.

267 *Id.*

268 *Id.*

1. The Federal Reserve should revise its approach to modeling embedded goodwill.

The Federal Reserve proposes to exclude amounts of goodwill embedded in private equity carry values that are not counted in CET1 capital.[269] The approach to accounting for embedded goodwill relies on assumptions regarding goodwill impairment which may not align with generally accepted accounting principles ("GAAP"). In turn, these assumptions may lead to an overstated associated capital deduction amount.

The Federal Reserve's approach may differ from accounting standards, under which goodwill impairment is assumed to be impaired proportionately with carrying value, in line with the percentage change in carrying value and an equity macro variable. However, accounting standards may be interpreted such that investment impairments are fully allocated to goodwill until the goodwill balance has been fully impaired.

The Federal Reserve should adopt the following change to calculate embedded goodwill independent from the carrying value to which it fully applies losses.

- Calculate the pre-tax noninterest revenue impact using the existing approach, without using initial carrying values calculated using carry values reported net of embedded amounts of goodwill;

- Calculate goodwill, and its associated capital deduction, independently from investment balances using the following formula:

  Embedded goodwill: $A_t = A_{t-1} - MIN (- B_t, A_{t-1})$

  Where:

  A = Aggregate embedded goodwill amount at the end of projection quarter *t*, and

  B = Aggregate gain/loss for investments with embedded goodwill in projection quarter *t*; and

- Adjust the embedded goodwill deduction by the relevant PE losses, up to the amount of embedded goodwill, in the Aggregation Model.

To illustrate, consider an investment has a carrying value of $2,000, and goodwill balance/deduction of $1,000 at the end of the prior projection quarter (*t*-1). Carrying value declines by 20% in the current quarter resulting in a loss of ($400), carrying value of $1,600 and goodwill/deduction of $600. In this example, the Federal Reserve's approach would result in additional capital declines of $200 after both the investment loss and reduction in goodwill deduction are considered.

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269 *Id.* at 170.

Figure 3

		Federal Reserve Approach		Proposed Approach	
	Item	**Amount**	**Calculation**	**Amount**	**Calculation**
A	Carrying value$_{t-1}$	$2,000	-	$2,000	-
B	Goodwill/deduction$_{t-1}$	$1,000	-	$1,000	-
C	Net Exposure$_{t-1}$	$1,000		N/A	
D	Pre-tax loss	($200)	C x -20%	($400)	A x -20%
E	Goodwill/deduction	$1,000	B	$600	B – MAX(MIN (-D, B), 0)
F	Δ Goodwill/deduction	$-	-	($400)	E- B
G	Net, pre-tax capital impact	($200)	D	$0	D - F

Further, to facilitate this change, the FR Y-14Q Schedule F.24 (Private Equity) should be updated to allow firms to elect to provide a list of private equity investments with embedded goodwill which detail the investment carrying value and embedded goodwill amounts.

Operational Risk Model

N. Operational Risk Model

The operational-risk loss model ("Operational Risk Model") estimates potential operational losses over the hypothetical stress scenario, using a nine-quarter time horizon.[270] Although operational risk is a noninterest expense component of PPNR, the Federal Reserve models operational risk losses separately because they "tend to exhibit distinct characteristics."[271] The Operational Risk Model captures losses stemming from events such as fraud, computer system failures, process errors, and, most prominently, lawsuits by employees, customers, or other parties.[272]

Given the idiosyncratic nature of operational risk losses, we recognize that designing a model to capture their behavior under stress is inherently challenging, even when robust historical data are available. The model design process requires the Federal Reserve to make several design assumptions,

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270 Federal Reserve, Supervisory Stress Test Model Documentation: Operational Risk Model, at 4, 12, *available at* https://www.federalreserve.gov/supervisionreg/files/operational-risk-model.pdf (hereinafter, "Operational Risk Model Documentation").

271 *Id.* at 4–5.

272 *Id.* at 5.

which are discussed in the Operational Risk Model Documentation.[273] The proposed approach reflects several important strengths that advance principles of stability, robustness, consistency, and comparability across firms.[274]

We recognize the benefits of shifting toward a distributional approach for projecting operational losses, which should be less sensitive to assumptions about the timing and impact of large loss events and therefore yield less volatile results across stress test cycles. We also view the segmentation of losses by Basel event type as an important step toward better reflecting the distinct distributional properties and risk profiles across loss categories. Finally, the proposal to exclude certain highly liquid assets from total assets for purposes of scaling historical losses should improve the stability of projections by reducing volatility driven by fluctuations in liquid balance sheet components.

While these elements represent meaningful progress, we believe there are two material areas where further refinement would significantly strengthen the framework and better align it with observed industry experience:

- *Timing and allocation of losses.* The proposed approach would recognize large legal losses (which are typically recognized under the "Clients, Products, and Business Practices" event type)[275] in a single quarter, even if the triggering event unfolds or is realized over multiple periods.[276] This design choice does not sufficiently reflect the well-documented lags in occurrence, litigation, and settlement. The Federal Reserve has acknowledged this shortcoming in model design.[277] Accordingly, we recommend aligning the timing of loss recognition with empirical evidence demonstrating how these losses materialize over time.
- *Calibration of the confidence level (percentile) across the stress test horizon.* The Federal Reserve would use the 93rd percentile of the distributional model's aggregate loss distribution, based on the historical frequency of severe recessions, to estimate stressed losses.[278] This proposed methodology for selecting and applying the percentile used to project operational risk losses is not sufficiently aligned with scenario dynamics and recognition lags.[279] Accordingly, for internal

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273 For example, the current model does not consider recoveries that can mitigate the impact of losses, relies on simple asset scaling rather than incorporating additional bank characteristics that may better reflect firms' loss profiles, and adds losses across all event types without applying dependence factors, despite using high percentiles of an unconditional distribution which do not represent expected losses in a downturn. *Id.* at 11.

274 *Id.* at 20.

275 *See id.* at 25, 33.

276 *Id.* at 10.

277 The Federal Reserve acknowledges that operational losses tend to result in a "heavy-tailed probability distribution" due to this timing lag. *Id.* at 22.

278 *Id.* at 23.

279 *Id.*

consistency and transparency, we recommend that the Federal Reserve reconsider and better align its proposed methodology.

In addition to these two priority issues, there are several other design choices that may warrant consideration for future enhancements. First, the Federal Reserve's choice to model losses on a gross basis without recoveries[280] may overstate their net impact on P&L. In reality, recoveries may mitigate the impact of losses.[281] Second, the choice to rely on total assets as the primary scaling variable[282] would not reflect differences in business models and risk profiles. Given this design choice, we encourage the Federal Reserve to provide additional insight into sensitivity analyses performed on scaling, including any alternative scaling methods considered.[283] Third, the current level of segmentation would not sufficiently capture the risk profiles of firms. Additional segmentation, whether by business line or other loss characteristics, may be warranted.[284] Fourth, adding losses across all event types, without dependence factors, may overstate risk by assuming simultaneous tail events. Finally, while the use of industry-level data supports comparability and stability across firms, it can also dilute firm-specific risk profiles. We encourage the Federal Reserve to provide additional insight into this choice and insight into sensitivity analyses that it performed.[285]

1. <u>The allocation of operational risk losses should not be uniform across the nine-quarter time horizon.</u>

The proposed approach would project losses evenly across the nine-quarter stress horizon. For large legal losses, often included in the event type category "Clients, Products, and Business Practices" ("CPBP"),[286] this assumption is difficult to reconcile with observed recognition dynamics. Legal matters leading to large losses typically unfold over multiple quarters, and accounting impacts often occur years after the underlying trigger event or the onset of adverse conditions. Accordingly, assuming an even distribution of legal losses across the stress test horizon does not reflect their recognition in practice.

Importantly, stress test results are sensitive not only to the magnitude of the total loss, but also to the timing of the impact to P&L and capital over the projection horizon. A uniform allocation of the total nine-quarter loss overstates near-term losses for legal exposures, obscures the recession-then-recovery narrative embedded in the scenario, and reduces interpretability of quarter-by-quarter results for both supervisors and firms.

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280 *Id.*at 11.

281 *Id.*

282 *Id.* at 35.

283 *Id.* at 35–36.

284 *Id.* at 12–16.

285 *Id.* at 8–9.

286 *See id.* at 9–10 for a discussion of the categories for loss event types. For purposes of our discussion, we assume that large legal losses are reported under CPBP.

Multiple sources support the conclusion that large operational risk losses, especially large legal or CPBP losses, are recognized with material lags and often continue to grow after initial recognition. Sources include an analysis of ORX global consortium data, which indicates that a meaningful share of losses increases substantially after they are first reported. Among losses that increased, the median time to stabilization was around eight quarters, with an average time of approximately 11 quarters, and with CPBP-related sub-categories exhibiting particularly large increases.[287] These results confirm that a significant subset of large operational risk losses, including those most relevant to CPBP losses, are realized over extended periods and often increase substantially after initial recognition. These findings are consistent with other published research. For example, a study analyzing industry event types provides empirical evidence of a significant lag in the realization of large legal losses, particularly for CPBP losses.[288] The study indicates average lags of nearly seven quarters, with a substantial share of losses not recognized within two years of occurrence.[289] Further, industry experience with large legal matters corroborates this analysis. Experience commonly reflects long timelines from initiation to settlement, with loss recognition concentrated later in the life of a matter rather than uniformly over time. Accordingly, we recommend that the Federal Reserve reconsider its assumption to reflect this uneven recognition of losses.

To maintain transparency and ease of implementation, we recommend that the Federal Reserve adopt a simple back-loaded allocation profile for CPBP losses while retaining the existing even-spread allocation for non-CPBP losses. This recommendation is targeted at large legal losses under CPBP, for which the empirical case for lagged recognition is strongest, and is not meant to suggest a blanket backloading of all operational risk losses. Instead, we recommend the Federal Reserve adopt one of the following three alternative options:

- *Monotone allocation of CPBP losses*: Allocate CPBP losses with weights that increase over the nine-quarter stress test horizon (*e.g.*, proportional to quarter number) such that later quarters receive progressively larger shares. This would capture lagged recognition without requiring incident-level calibration.

- *Simple skewed split for CPBP losses:* Allocate a smaller share of CPBP losses to earlier quarters and a larger share to later quarters (*e.g.*, 25% across the first four quarters and 75% across the last five quarters). If the Federal Reserve would prefer a different split (*e.g.*, 20% and 80% or 30% and 70%), we could provide supporting summary evidence.

- *Losses timed to reflect actual experience with industry-wide data:* Using industry data, such as the FR Y-14Q data, the Federal Reserve could determine the proportion of losses realized within and outside the nine-quarter stress horizon. This approach would be more empirically driven and would use industry-wide incident-level data to determine the timing of legal losses. Losses

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287 ORX is the largest operational risk management association in financial services, owned and driven by member institutions, which include some of the largest global banks. ORX has the largest and most comprehensive dataset on operational risk losses dating back to the early 2000s.

288 W. Scott Frame, Nika Lazaryan, Ping McLemore & Atanas Mihov, Operational Loss Recoveries and the Macroeconomic Environment: Evidence from the Banking Sector, 165 J. of Banking & Fin. 4 (2024).

289 *Id.*

realized within the stress test horizon would be allocated across the nine quarters based on the observed quarterly distribution of settlements, while losses realized outside of the stress test horizon would be allocated to the ninth quarter. Including losses in the projection that are, in reality, realized outside of the stress test horizon would support the principle of conservatism.

At minimum, we recommend that the Federal Reserve publish a sensitivity analysis comparing the current uniform allocation to a back-loaded CPBP allocation. This sensitivity analysis should show the impact of the chosen methodology on the quarterly loss profile. This would allow firms to better interpret results and would, in turn, improve the transparency of the model.

2. The time horizon should be consistent with the calibration of the loss percentile.

The Federal Reserve proposes to estimate operational risk losses using a distributional modeling approach that generates an unconditional aggregate loss distribution.[290] Under this framework, the Federal Reserve would determine projected losses under the Severely Adverse Scenario by applying a high percentile of the model's aggregate loss distribution to the full nine-quarter projection horizon.[291] The Federal Reserve should reconsider this approach.

As proposed, the approach would create internal inconsistencies with both the scenario narrative and the rationale for the chosen calibration. The Federal Reserve supports its choice of the 93rd percentile confidence level based on annual periods—that over a 60-year period, four severe recessions were observed.[292] This rationale implies a one-year time horizon instead of the nine-quarter time horizon used in the Operational Risk Model. Applying a constant tail percentile to the nine-quarter horizon and allocating it uniformly across the nine quarters creates internal inconsistencies with the calibration rationale.

To resolve these issues, the Federal Reserve should: (i) clarify the mapping from historical "severe recession" frequency to the nine-quarter stress testing horizon (including the relevant time aggregation); (ii) demonstrate, through a sensitivity analysis, how projected losses vary across reasonable horizon-consistent alternatives (*e.g.*, calibrating directly to nine-quarter windows and applying a recession-phase percentile during recession quarters and a materially lower percentile during recovery quarters); and (iii) explain how the chosen approach interacts with loss recognition lags (especially for legal or CPBP losses), and how the framework avoids implicitly assuming tail conditions throughout both recession and recovery quarters.

Further, instead of using a single percentile applied to the nine-quarter period, which treats the entire horizon as a stressed horizon, we recommend using a two-horizon approach. This approach would separate the estimation of losses resulting from stress from the estimation of losses incurred in the other quarters under benign economic conditions. Specifically, the Federal Reserve could: (i) use a one-year loss distribution and apply a single tail confidence level to represent the stressed component of losses,

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290 Operational Risk Model Documentation at 6.

291 *Id.* at 23.

292 *Id.*

consistent with the time horizon used to calculate the likelihood of the stress period; (ii) use a five-quarter loss distribution and apply a lower confidence level to represent the business-as-usual losses; or (iii) map the total nine-quarter loss estimate resulting from the sum of the estimates for the two horizons using an allocation rule that follows the criteria discussed in Section IV.N.1 above.

PPNR Model

We agree with the Federal Reserve that the existing Pre-Provision Net Revenue Model ("PPNR Model") is not appropriate for projecting firm-specific income in the stress tests.[293] The existing regression-based models are driven by inadequate FR Y-9C data that does not capture the specific business models or risk profiles of different firms with sufficient detail or granularity. In addition, the existing models are too simplistic and miss important features of firms' revenue and expense generation processes that would have a material impact on their projections. Accordingly, we support using an entirely new modeling approach for projecting PPNR in the stress tests.[294]

The proposed PPNR Model would model income from banking services, activities, and products, net of expenses related to the provision of those same categories of income, and excluding loan loss provisions.[295] PPNR Model components would include net interest income (*i.e.*, interest income minus interest expense), noninterest income,[296] and noninterest expense.[297]

The Federal Reserve would separately model 23 PPNR components, relating each to firm characteristics and macroeconomic variables.[298] Model types would vary depending on economic factors driving each component, along with their statistical properties, data availability, and heterogeneity. Structural models would be used for interest income and interest expense (excluding certain interest expense categories), discount factor models would be used for noninterest revenues, and efficiency ratio models would be used for noninterest expense.[299]

We agree that the proposed structural models for interest income and interest expense would broadly represent a significant improvement in methodology relative to existing models. The structural approach is generally more detailed and better able to capture important sources of firm heterogeneity in business mix and risk profile. Even given these advantages, it will be critical that the proposed structural models be appropriately sensitive to specific business and market features that are relevant for measuring income and expense. Below we identify several specific shortcomings that the Federal Reserve should

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293 *See* Federal Reserve, Supervisory Stress Test Model Documentation: Pre-Provision Net Revenue Model, at 6, *available at* https://www.federalreserve.gov/supervisionreg/files/pre-provision-net-revenue-models.pdf (hereinafter, "PPNR Model Documentation").

294 *See id.* at 6.

295 *Id.*

296 "Noninterest income" is used interchangeably with "noninterest revenue" throughout this section.

297 PPNR Model Documentation at 6–7.

298 *Id.* at 7.

299 *Id.* at 9–11 (Table A1).

resolve for these models to credibly and accurately project firm-specific interest income and expense during a period of stress.

Conversely, the proposed discount factor models would not be appropriate for projecting noninterest revenues in the stress tests. While we welcome the effort to develop an enhanced model suite, this modeling approach has several conceptual and data-related shortcomings that we discuss in more detail below. Accordingly, we recommend that the Federal Reserve completely redesign and redevelop its approach to modeling noninterest revenue. To facilitate this effort, we offer an approach to modeling noninterest revenue that could be adopted on a temporary, interim basis, while a more conceptually sound set of models is developed. Moreover, given the substantial changes that would be required, and the need to depart fully from the proposed discount factor approach, the Federal Reserve must propose the new noninterest revenue models for public comment. We provide a set of key principles that should guide the development and design of these models.

The efficiency ratio models would also not be appropriate for projecting noninterest expenses in the stress tests. This approach has several conceptual and data-related shortcomings that we discuss in more detail below. We outline an alternative approach to modeling noninterest expense that would be simpler than the proposed efficiency ratio approach, while still adhering to the Federal Reserve's stress testing principles. This alternative approach would be sufficiently sensitive to important differences in firm business mixes and risk profiles, and, in turn, would capture important variations in noninterest expense projections during a stress event.

Finally, it is important to note that our evaluation of the proposed models is complicated by a substantial lack of analysis and data concerning their overall fit and performance. The lack of transparency in the proposal hampers our ability to assess and analyze the models and offer fully informed feedback. Accordingly, in several instances we request additional information and data on the proposed models, which would enhance transparency and support informed comment more generally.

In the following sections we offer specific comments on the proposed models for each of the following: Interest Income PPNR Models, Interest Expense PPNR Models, Noninterest Revenue PPNR Models, and Noninterest Expense PPNR Models.

O. Interest Income PPNR Models

The Federal Reserve has proposed replacing the previous regression-based models with structural models to project interest income.[300] As a conceptual matter, the move to structural models is generally preferred. Importantly, though, these models should endeavor to be as detailed and as granular as possible to ensure that specific and relevant features of a firm's portfolio or business line are captured. The PPNR Model Documentation commonly refers to a principle of "simplicity,"[301] but that principle cannot be used as a means of disregarding key aspects of a business line or a portfolio that is relevant to capital.

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300 *Id.* at 9.

301 *See, e.g.*, *id.* at 9.

Given that the models are used to set each firm's binding SCB, it is imperative that they be sensitive to variations in a firm's risk profile.

As a general matter, in several areas, the PPNR Model Documentation does not provide enough detail on the specification or empirical performance of the models to elicit informed comment. While the Federal Reserve provides information on the specification and calibration of the models, it provides limited information on how the models perform. In addition, in the case of certain vendor models, there is no discussion of specification or performance. The release makes several broad and overarching qualitative statements about the degree of fit and adequacy of the models, but no quantitative details are provided to justify those claims. While this concern is less relevant for the structural models than for the regression-based models, the Federal Reserve must provide sufficient information to allow firms to comment on the proposed models. Without this level of transparency, firms are unable to provide more meaningful feedback.

Below we provide specific comments on aspects of the proposed structural models for interest income. Generally, the models should be improved to better capture specific features of the sources of firms' interest income that are relevant for capital adequacy measurement. In addition, certain comments underscore the need to provide more information on the specification and performance of certain models, which would offer greater transparency and facilitate more informed comment.

1. <u>The Federal Reserve should adjust its measurement and treatment of loan interest income.</u>

a. The Federal Reserve should more accurately reflect the actual base rate of retail loans and should not assume that the base rate for retail loans can be uniformly identified with the Prime Rate.

As proposed, the base rate for retail loans would be identified with the Prime Rate.[302] However, the pricing of retail loans is sensitive to the maturity of the loan. Maturity considerations are relevant for the base rate of several other retail loan types as well, such as auto loans and student loans.[303] The Federal Reserve should more accurately reflect the actual base rate that is linked to the tenor of the loan that is used to price and generate interest across the entire range of retail loan products.

b. The Federal Reserve should more accurately reflect the actual base rate of wholesale loans and not assume that the base rate for wholesale loans can be uniformly identified with the 3-month U.S. Treasury rate.

For wholesale loans, the base rate is uniformly identified with the 3-month Treasury rate.[304] As in the case of retail loans, this approach introduces a skew towards the short end of the yield curve that is not consistent with the maturity of all wholesale loans. To the extent that wholesale loans reflect longer

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302 *Id.* at 181.

303 *See id.* (Equation A33 and related discussion).

304 *Id.*

maturities, and the longer end of the yield curve moves without commensurate movements on the short end, the models would miss pricing dynamics that are important for interest income on wholesale loans.[305] The Federal Reserve should more accurately reflect the actual base rate that is used to price and generate interest across the entire range of wholesale loan products.

c. The Federal Reserve should identify revolving credit card accounts from the FR Y-14M data, and the calculation of the interest rate spread should be explicitly limited to these accounts.

The PPNR Model Documentation outlines a mechanism for forecasting interest income on retail loans, including on consumer credit cards.[306] This would be accomplished by determining the proportion of card balances that are revolving by identifying accounts active in the past 12 months that have incurred a finance charge in any of the prior three months.[307] We agree that isolating revolving accounts is appropriate, as these are the accounts that generate interest income.

However, the Federal Reserve does not explicitly state that the interest rate spread used for forecasting interest income from credit cards should be calculated solely from the identified population of revolving accounts. The Federal Reserve instead appears to suggest that the spread is calculated based on the entire portfolio.[308] Since revolving accounts typically have higher APRs than transacting accounts, calculating the spread across all accounts would bias the estimate downward, resulting in an underestimation of interest income.

The Federal Reserve should identify revolving accounts from the FR Y-14M data, and the calculation of the interest rate spread should be explicitly limited to these accounts. The spread should not be derived from the entire portfolio, as this would dilute the estimate and misrepresent the true interest income generated by revolving balances.

d. The Federal Reserve should account for hybrid mortgages in calculating loan interest income for hybrid portfolios.

The Federal Reserve outlines a mechanism for forecasting interest income on retail loans, including mortgages, by segmenting them into fixed-rate mortgage ("FRM") and adjustable-rate mortgage ("ARM") categories.[309] However, the proposal does not define what constitutes a FRM or ARM for the purposes of this segmentation. While it is common practice to classify hybrid mortgages as ARMs—as they would be

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305 *See id.* (Equation A33 and related discussion).

306 *Id.* at 177–180.

307 *Id.* at 178–79.

308 *See id.* at 179.

309 *Id.* at 177.

classified in the First Lien Model[310]—it could significantly underestimate loan interest income for hybrid portfolios under stress scenarios in this context.

This issue would arise because the Federal Reserve assumes that all ARMs reprice quarterly.[311] In stress scenarios, interest rates, including those for mortgages, are typically projected to decline, which would reduce forecasted interest income as loans are assumed to reprice quarterly. Most non-FRMs today are longer-term hybrid loans with fixed interest periods of five, seven, or ten years, meaning their rates will remain fixed for much (or all) of the nine-quarter forecast horizon. The Federal Reserve does not address the treatment of hybrid loans and, since some may reprice during the forecast period, it appears they may be included in the ARM segment. This approach could lead to a substantial underestimation of interest income on these loans in stress scenarios, especially in scenarios where interest rates decline over the nine-quarter horizon.

Instead, the Federal Reserve can use FR Y-14M data, which includes fields that identify the fixed-rate period for hybrid loans, enabling the Federal Reserve to determine which loan balances will reprice and which will remain fixed in each quarter of the forecast horizon. Using this information, only balances scheduled to reprice in each quarter should be treated under the proposed ARM methodology. Balances that remain fixed should be handled through the FRM methodology. Although this approach may add some complexity to the forecasting process, it would yield significantly more accurate projections.

e. The Federal Reserve should use facility-level tenor matched base rates for the Spread for Wholesale Projection.

The Federal Reserve would use the median origination date for wholesale loans for the Spread for Wholesale Projection,[312] which is problematic when computing loan spreads due to a potential mismatch between the date of the loan and the date for the base rate. When computing loan spreads, the Federal Reserve should use loan-level tenor matched base rates for the spread calculation. Alternatively, balance-weighted origination dates for fixed-rate loans, rather than the median dates, should be used. This would better align the average used to compute loan rates with the average used to compute base rates.

f. The Federal Reserve should utilize a spread that is internally consistent and varies over the projection spread for the Interest Income on Loans Projection.

Loan interest income is generated by the base rate and the spread on the loan.[313] As a result of the Federal Reserve's flat balance sheet assumption,[314] loans that mature, default, or prepay are replaced

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310 *See generally* Credit Risk Models Documentation at 166 (describing how the variables used to estimate ARMs moving from current to delinquent account for fixed interest rate periods).

311 *Id.* at 180 (describing that variable-rate products' rate resets quarterly).

312 *See id.* at 182 (Equation A37).

313 *See id.* at 181–182.

314 *See id.* at 174.

with loans of a similar category (*e.g.*, mortgage loan, corporate loan).[315] These new loans are assigned a new (and generally lower) base rate while the loan spread is assumed to be fixed.[316] In the severely adverse scenario, though, credit spreads are assumed to increase significantly during the projection period.[317]

To increase internal consistency, the Federal Reserve should utilize a spread that is consistent with other risk spreads that are articulated in the severely adverse macroeconomic scenario and utilized elsewhere in the stress tests (*e.g.*, Corporate Model, Interest Expense on Other Borrowing). It is not internally consistent to assume constant spreads on loans when risk spreads are broadly assumed to increase significantly in the scenario.[318] Moreover, the assumption of a constant spread clearly underestimates loan interest income, as newly originated loans would be expected to be issued at higher spreads.

Accordingly, all loans that are deemed to be originated over the stress period due to maturation, default, or prepayment should be replaced with loans that carry a loan spread that is consistent with the severely adverse scenario at each point in time. As a descriptive example, in the case of corporate loans, corporate loan spreads could be empirically linked to BBB loan spreads for each distinct rating category. Then, as new loans within each rating category are originated, a loan spread consistent with the level of the BBB spread in the severely adverse scenario can be applied to newly originated loans. This would be done in a manner consistent with the empirical relationship between corporate loans and BBB spreads for each rating category. A similar approach could be adopted for other loan categories as well (*e.g.*, mortgages, retail loans).

This approach for newly originated loans would be consistent with the overall behavior of risk spreads in the severely adverse scenario, and would prevent loan interest income from being systematically underestimated.

2. <u>The Federal Reserve should adjust the treatment of hedges.</u>

a. For amortized cost that includes hedge adjustment, the Federal Reserve should consider alternative approaches.

The Federal Reserve would amortize hedge adjustments into net interest income without an offset in swaps' present value amortization. Under fair value hedge accounting, the hedge adjustment in amortized cost ("AC") should be amortized into net interest income ("NII") and offset by the amortization of the swap's present value ("PV"), resulting in a near-zero net effect (absent ineffectiveness). The Federal Reserve would include the hedge adjustment amortization in NII, but would only model the swap's accrual

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315 *Id.*

316 *Id.*

317 *See, e.g.*, Federal Reserve, 2026 Macroeconomic Model Guide (Final), *available at* https://www.federalreserve.gov/supervisionreg/files/2026-final-macroeconomic-model-guide.pdf.

318 *See* PPNR Model Documentation at 181-82 (Equations A33 and A35 and related discussion).

(fixed minus floating), omitting swap PV amortization.[319] This would result in "one-sided" amortization, materially misstating NII and failing to reflect the true economics of hedged positions.

For amortized cost that includes hedge adjustment, the Federal Reserve should adopt a consistent approach by either: (i) amortizing swap PV to offset AC that includes hedge adjustment, or (ii) adjusting AC for swap PV and amortize the net AC, eliminating the need for separate swap amortization. To implement this recommendation, Schedule B.2 could include Swap Clean PV and Maturity Date to facilitate amortization or adjustment calculation. Schedule B.1 could include a flag indicating whether amortized cost includes or excludes a hedge adjustment.

b. For debt hedges, the Federal Reserve should capture the hedge adjustment and its amortization schedule.

The Federal Reserve currently does not collect information on terminated fair value debt hedges or cash flow ("CF") hedges. When a fair value debt hedge is terminated, the hedge adjustment is amortized into NII over the original life of the hedged debt instrument. For terminated CF swaps, the clean PV of the swap at termination is amortized into NII over the original life of the swap. Without collecting the clean PV of the cash flow swap or the closed fair value hedge adjustment on the debt instruments, the Federal Reserve would miss a material component of NII related to the ongoing amortization of terminated hedge adjustments, resulting in incomplete and inaccurate income projections.

For fair value debt hedges, the Federal Reserve should capture the hedge adjustment and its amortization schedule. For CF swaps, the model should capture the clean PV at termination and the amortization period. This will ensure that the amortization of hedge adjustments and swap PVs is properly reflected in NII. To implement this recommendation, the unamortized terminated hedge adjustments alongside the remaining amortization period should be reported in either a new schedule or as a sub-section of an existing schedule.

c. The Federal Reserve should recognize hedges that do not meet accounting hedge criteria but meaningfully reduce economic risks.

Certain hedges that firms may use in managing risk at a portfolio level (*e.g.*, Interest Rate Risk in the Banking Book ("IRRBB Hedges")), would not qualify as accounting hedges (for example, interest rate swaps that do not qualify as accounting hedges because they cover net IRRBB risk instead of one clearly identified asset or cash flow). As these portfolio hedging programs are specifically targeted for mitigating Banking Book NII risk, we believe they should also be incorporated into the NII hedge calculations. Specifically, the FR Y-14Q schedules relating to accounting hedges should be amended to identify non-accounting portfolio-level hedges.

3. <u>The Federal Reserve should collect data on securities' coupon rates.</u>

To resolve inconsistencies in the treatment of securities in the Interest Income Model, the Federal Reserve should collect its own data on coupon rates instead of relying on vendor data. The Interest

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[319] *See id.* at 222.

Income Models for U.S. Treasuries, MBS, and other securities either use coupon rates from vendor data or automatically default to reported yield in Schedule B.1.[320] For floating-rate instruments, the Federal Reserve assumes that all instruments are indexed to the 3-month Treasury rate due to limitations in vendor securities data.[321] Reverting to a reported yield or indexing floating rate instruments to the 3-month Treasury rate can cause several inconsistencies, including contractual versus model yield and hedge adjustments.[322] Instead, the Federal Reserve should add a field in the FR Y-14Q, Schedule B.1 for the coupon rate for all securities, which would be reported alongside existing fields such as maturity date and amortized cost. By adding a new field, the Federal Reserve can use the Schedule B.1 reported coupon if vendor data is unavailable.

4. The Federal Reserve should adjust its treatment of mortgage-backed securities for the Interest Income on Mortgage-Backed Securities Regression Model.

a. The Federal Reserve should provide greater transparency on the specification and tunings of vendor-supplied MBS models.

The Federal Reserve makes broad reference to a "vendor model" for the Interest Income MBS Model without any discussion of the model or its calibration.[323] Without further detail, firms do not have a sufficient basis for comment. The Federal Reserve should provide more information on the specifications of the vendor models to enhance firms' ability to comment.

b. The Federal Reserve should replace the static Weighted Average Life assumption with the cash flow forecast (including prepayments) in the vendor model for MBS.

The Federal Reserve would amortize premiums and discounts on agency MBS using a static Weighted Average Life ("WAL") assumption.[324] This method would smooth the impact of prepayments over the entire projected life of the bond, failing to capture the true timing of income recognition (*i.e.*, when prepayments occur). As a result, the Interest Income MBS Model does not reflect the real-world acceleration of amortization and paydown profit and loss in response to changes in prepayment speeds due to interest rate movements or scenario path. This would be inconsistent with how prepayment impacts are accounted for in practice, and could misstate net interest income under stress. Because the Federal Reserve already uses vendor models to project agency MBS cash flows and prepayments,[325] the same modeled prepayment paths should be used to drive the timing of premium and discount

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320 *Id.* at 192, 195, 200. The Federal Reserve defaults to reported yield in Schedule B.1 for MBS only if the vendor information is unavailable. *Id.* at 196.

321 *Id.* at 204.

322 *See id.* at 196.

323 *Id.* at 195–96.

324 *See id.* at 197.

325 *See id.* at 196.

amortization in net interest income. This would make the model more accurate by reflecting the actual timing of payments in amortization income.

5. The Federal Reserve should use expected life or WAL from vendor models or internal analytics to project interest income on "other securities."

The Federal Reserve would use the legal maturity date from Schedule B.1 to project the holding period, income, and amortization of "other securities" in the Interest Income on Other Securities Projection.[326] This is not reasonable for many structured and callable bonds, which have expected lives or average lives much shorter than their legal maturity due to amortization, prepayments, or call features. Using the legal maturity date would overstate the duration, balance, and income, and would result in unrealistically slow amortization of premiums or discounts. This would also create an inconsistency with the Securities Model (*see* Market Risk Models Documentation), which would use vendor-supplied durations based on expected cash flows, not just legal maturity.

The Interest Income on Other Securities Projection should instead use expected life or WAL from vendor models or internal analytics, which are based on projected cash flows and reflect the true expected timing of principal return. This would align the PPNR Model and Market Risk Models, result in more accurate income and amortization projections, and better reflect the actual risk and behavior of structured and callable securities.

P. Interest Expense PPNR Models

As in the case of the proposed models for interest income, the transition to structural models for interest expense would represent an improvement. As previously discussed, however, these structural models must be appropriately sensitive to the specific features of different firm business models to ensure that stress test projections are sufficiently accurate to capture important dynamics that would be expected to impact capital adequacy assessments. In our discussion below, we provide comments on specific aspects of the proposed models that are intended to improve their reliability and accuracy in projecting interest expense across a range of different firms during a stress period.

1. The Federal Reserve should introduce deposit beta segmentation for the Interest Expense on Other Domestic Deposits Model.

For the Interest Expense on Other Domestic Deposits Model, the Federal Reserve would apply the median deposit betas reported by firms to estimate interest expense.[327] This approach could overlook significant variation in betas and launch point rates paid driven by individual deposit franchise characteristics. The Federal Reserve should introduce deposit beta segmentation by the characteristics described below.

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326 *Id.* at 60–61. "Other securities" are pooled instruments backed by a variety of loan types, such as asset-backed securities, commercial MBS, collateralized loan obligations, and callable corporates. *Id*.

327 *Id.* at 213.

a. The Federal Reserve should incorporate deposit betas that vary across wholesale and retail deposits.

For many firms, retail deposit betas on "Other Domestic Deposits" are generally meaningfully lower than their wholesale counterparts. Accordingly, this significant behavioral difference should be captured by including different deposit betas for wholesale and retail deposits. Deposit migration across products (*i.e.*, domestic time deposits and other domestic deposits) can pose material impacts on interest expense particularly when there are significant interest rate movements. Segmenting beta by retail and wholesale classifications, and including estimated rate up and down betas for each segment, would more accurately reflect client behavior across different lines of business and rate environments. Definitions provided in Regulation WW provide an example of how retail and wholesale deposits can be defined.[328]

b. The Federal Reserve should incorporate deposit betas that vary by firm size.

Larger firms have historically exhibited lower deposit betas as their value proposition centers on digital capabilities, a broader range of financial product offerings, and an extensive branch and ATM network, rather than competing purely on rate. Accordingly, to capture these differences in deposit franchises, it is appropriate to incorporate deposit betas that vary by firm size.

2. The Federal Reserve should use a currency-weighted index of foreign interest rates to project interest expense on foreign deposits.

The Federal Reserve proposes to use U.S. Treasury rates to model interest expense on foreign deposits in the Interest Expense on Foreign Deposits Model.[329] This approach would be inadequate, as it would overlook currency and interest rate differences across countries. The Federal Reserve should instead employ a currency-weighted index model, built from each firm's reported geographic or currency exposures to more accurately reflect foreign deposit costs and reduce basis risk. Further, collecting data on the top currencies held in deposit accounts would allow the use of appropriate regional reference rates and would eliminate currency mismatches.

Q. PPNR Regression Models

The Federal Reserve proposes to use regression models for two components of PPNR, net interest income on trading assets and liabilities and interest expense on Other Borrowing, unlike all other components of interest income and expense.[330] We recommend that the Federal Reserve split these two regression models into three parts and follow a distinct modeling approach for each.

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328 *See* 12. C.F.R. § 249.3.

329 PPNR Model Documentation at 215.

330 *Id.* at 169.

1. The Federal Reserve should revise the approach to projecting markets net revenue.

The Federal Reserve proposes to include "other short-term borrowing" as part of the interest expense model for Other Borrowing.[331] Instead, the Other Short-Term Borrowing line item[332] should be included as part of the sales and trading net interest income model, as those liabilities are generally used for funding trading assets. The proposed net interest income model for sales and trading should be modified. More specifically, the proposed regression model employs the 3-month Treasury yield as the sole driver of net interest income on trading assets and liabilities.[333] This approach is inappropriate because net interest income on trading assets and liabilities is generated from a wide array of interest earning assets, including assets of various maturities and assets denominated in foreign currencies. The 3-month Treasury yield would therefore fail to adequately capture currency exposures beyond the U.S. Dollar. Further, this approach would assume reinvestment into a hypothetical Treasury security with one year to maturity,[334] which overlooks the actual tenor distribution of firms' balance sheets. Accordingly, an empirically viable regression model for net interest income for trading assets and liabilities must also include interest rates at other maturities beyond three months, as well as interest rates on bonds denominated in foreign currencies.

Compounding the above issues, disclosure limitations—specifically, the unavailability of firm-specific fixed effects and equation-level net interest income forecasts in the private disclosures—limit our ability to provide informed commentary on the proposed methodology. We encourage the Federal Reserve to provide enhanced disclosure to facilitate more informed commentary. Finally, we note that we ultimately recommend joint modeling of both net interest income and noninterest income for sales and trading, as discussed in Section IV.R.2.d, which would resolve the issues identified above while more accurately projecting sales and trading revenue.

2. The Federal Reserve should use a structural model to project subordinated and senior debt interest costs.

As discussed in Sections IV.O and IV.P, the Federal Reserve has proposed replacing the previous regression-based models with structural models to project interest income and interest expense. However, the Federal Reserve proposes using a regression model for interest expense on "other borrowing," which includes interest expense on subordinated debt, other short-term borrowing, and other interest-bearing liabilities.[335] This approach is at odds with the broader shift to structural models[336] and should not be implemented with respect to modeling subordinated debt and senior debt interest expense

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331 *Id.* at 159.

332 *See id.* at 230.

333 *Id.* at 225.

334 Market Risk Models Documentation at 732. The same reinvestment assumption applies as in the Securities Model. *See* PPNR Model Documentation at 192–93.

335 PPNR Model Documentation at 159.

336 *Id.* at 230–35.

since, in general, structural models are better equipped to recognize important differences in exposures and bank business models than regression-based approaches.

For subordinated debt and senior debt, the Federal Reserve should use a structural model based on CUSIP-level data, as is currently the practice for subordinated debt. The Federal Reserve could in turn use the structural model to project interest expense on bank issued securities, incorporating any hedges reported on Schedule B.2 with the hedge relationship on the suggested new Schedule B.3. If the goal is to map all hedging relationships, the Federal Reserve should consider introducing a separate schedule ("Schedule B.4") to report long-term debt/borrowings so the Federal Reserve can model these fair value hedge relationships adequately. The Federal Reserve can then use Schedule B.3 to link the accounting fair value hedges of long-term debt reporting in Schedule B.2 to the hedged items (long-term debt) reported in Schedule B.4.

3. The Federal Reserve should use a simple regression-based model, or simply hold constant all remaining other borrowing in Other Interest-Bearing Liabilities that is not covered by the proposed structural model for subordinated and senior debt.

The remaining liabilities represented in the line item for Other Interest-Bearing Liabilities represent a wide range of liability types.[337] As a result, the Federal Reserve should either hold this component of interest expense flat over the projection horizon or use a simple regression model to project this component of interest expense.

R. Noninterest Revenue PPNR Models

The Federal Reserve's proposed approach to noninterest revenue ("NIR")[338] would not reflect actual historical experience, but would instead rely on firm stress projections from stress testing cycles from 2014-2024.[339] At a conceptual level, the proposed approach has five significant drawbacks. First, historical projections relate to previous modeling methodologies that have changed substantially over the past decade. Second, historical projections necessarily relate to historical balance sheets, business lines, risk profiles, and product offerings that may no longer be relevant given both regulatory changes and changes in the banking industry over the last several years. Third, stress projections do not represent an unbiased assessment of an individual firm's expected performance during stress. Rather, the projections are an outcome of the supervisory process and have been historically influenced by supervisory guidance and expectations. Fourth, the firms' prior projections are based on each firm's view of its balance sheet evolution during stress, especially for credit card, other retail loans, commercial lending and deposits. As a result, the key source data used to produce the Federal Reserve's NIR projection is not aligned with the assumption of a flat balance sheet. The proposal would provide some adjustment for the difference in firm and Federal Reserve balance sheet assumptions, but the adjustment would be ad hoc, and would not vary across firms, and would not conceptually relate to the projection that a firm would make if it were constrained to assume a flat balance sheet over the stress period. Fifth, the use of firm projections raises

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337 *See id.* at 230.

338 "Noninterest income" is used interchangeably with "noninterest revenue" throughout this section.

339 PPNR Model Documentation at 239.

clear transparency concerns, as it is not feasible to assess the underlying assumptions that drive the firm projections, which are the key input to the proposed NIR models.

In addition to these conceptual concerns, there are important data issues that would complicate the use of firm projections in the NIR models. The double-counting of losses in the HFS, FVO, and PE portfolios would be of particular concern. The historical stress projections include projections for losses in each of these portfolios, while losses in these portfolios would also be projected in other models (*i.e.*, HFS/FVO, PE Models). Accordingly, these losses would be counted once in the PPNR projection and again in the portfolio-specific loss projection. This double-counting of losses is unsound and must be substantively resolved in the overall stress testing framework.

Considering these significant drawbacks, the Federal Reserve should continue to consider its approach to modeling NIR. In the long run, the Federal Reserve should develop an entirely new set of data-based, granular NIR models that capture the full range of business lines and risk profiles across the entire industry.

Development of new NIR models that are sufficiently granular, data-based, and conceptually sound will require the Federal Reserve to propose the new models for public comment. Understanding that the development of these models will take time, we recommend that the Federal Reserve employ the newly proposed discount factor models, along with certain changes which we outline below, to project NIR on a temporary and interim basis. While we do not support this approach as a permanent solution, the interim modifications we recommend would mitigate the most significant shortcomings while the Federal Reserve carries out longer-term model development.

We describe in turn the necessary adjustments to the proposed discount factor models that must be made to ensure that they are appropriate to project NIR on an interim and temporary basis. We then turn to a set of principles to guide the development of new NIR models, which, prior to finalization, must be released for public comment.

1. <u>The Federal Reserve should adopt a modified version of the proposed discount factor NIR models, on an interim basis, while new models for NIR are developed.</u>

On an interim and temporary basis, we recommend that the Federal Reserve use a modified version of the historical projection-based discount factor models that are described in the proposal. As currently specified, these models would suffer from several limitations, as described above. We have identified a set of critical adjustments to these models that, if adopted, would improve the quality of the proposed models for use in the short term. While not appropriate as valid long-term solutions, these critical adjustments would mitigate salient issues on a limited and temporary basis while the Federal Reserve develops new NIR models. We outline each of the required changes to the discount factor models below.

a. The Federal Reserve should segment the NIR discount factor models by three distinct firm classifications.

As proposed, the NIR models would aggregate projections for firms with significantly different business practices and risk profiles into a single model with a single set of drivers.[340] The resulting models would not be sufficiently sensitive to important differences across firms within the industry. To allow for a minimally sufficient heterogeneity in the NIR models, they should be segmented by the following industry classifications: U.S.-based global systemically important banks ("GSIB"), other U.S.-based banks ("Non-GSIB") and foreign banking organizations ("FBO"). These three classes of firms exhibit significantly different business lines, business practices, and risk profiles that render a fully aggregated and combined NIR model inappropriate for use in the stress tests. In the longer term, as discussed in the modeling principles outlined below, models for NIR should be more granular and better tailored to the activities of specific firms. On an interim and temporary basis, however, segmentation of the NIR models across these three firm classifications would provide for enough heterogeneity to render them viable for use in the short term.

b. The Federal Reserve should use a lookback period that is significantly shorter than 12 quarters when computing the discount factor NIR projection for several NIR components.

The proposed NIR models multiply the 12-quarter average income for each NIR component with the projected NIR discount factor path to compute projected NIR over the stress period.[341] For NIR relating to asset management, wealth management, deposits, and credit and charge cards, a 12-quarter average income measure would be too backward-looking and would not reflect the current economic circumstances that determine revenue generation. As a specific example, in the case of asset management and wealth management, revenues are primarily determined by assets under management ("AUM"). Revenues generated by asset and wealth management activities will be determined by AUM at the jump-off point of the stress test, and not AUM from two to three years in the past. Similar considerations are also important for NIR generated from wealth management activities, deposits and credit and charge cards. Notably, the relevant balances that exist at the jump-off of the stress test are maximally relevant for determining future revenues. While some degree of averaging may be appropriate to resolve short-term, seasonal, or cyclical fluctuations in revenues for certain NIR components, a 12-quarter lookback would be too backward-looking. Instead, a shorter lookback period that appropriately captures the current profile of each business should be employed.

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340 *See id.* at 170.

341 *See id.* at 235, 238.

c. The Federal Reserve should not use a discount factor model to project the "Miscellaneous" NIR component. Rather, the Federal Reserve should project a constant level over the nine-quarter stress period with a zero floor.

The Federal Reserve proposes to use a discount factor model for the "Miscellaneous" component of NIR.[342] We disagree with this approach. Miscellaneous NIR encompasses a wide variety of economically disparate and distinct revenue sources that cannot be aggregated into a single component. Applying a single, aggregated model to these revenue sources is inappropriate and does not reflect important sources of heterogeneity in NIR across firms.

In the longer run, the Federal Reserve should consider the composition of the Miscellaneous NIR component, which, as specified, is overly broad. It should seek to identify specific components that can be modeled separately in order to improve firm-level heterogeneity in the stress tests. On a temporary and limited interim basis, the Federal Reserve should simply use a constant projection. Further, this constant projection could employ seasonal effects for greater accuracy.

d. The Federal Reserve should resolve the double-counting of losses in HFS/FVO Loans, and PE exposures.

As discussed above, a key shortcoming of the proposed discount factor models is that the historical firm projections that drive the models include projected losses on HFS/FVO Loans, and PE exposures. At the same time, the Federal Reserve maintains separate loss models that project losses in each of these portfolios. Accordingly, the use of firm projections to model NIR would result in the double counting of losses on HFS/FVO Loans and PE exposures. This double-counting of losses results from the use of the discount factor models and must be corrected before the proposed models are utilized on an interim basis. In the specific case of PE exposures, projected losses can be isolated and removed from firm projections by excluding the projection associated with line 17 on Schedule A.7.a of the FR Y-14A. Other HFS/FVO loan projections are incorporated across several line items, including line items 15, 16, and 18.

2. <u>The Federal Reserve should redevelop and re-propose all of the NIR models to be consistent with a set of high-level modeling principles that promote accurate, data-based, and conceptually sound models that appropriately reflect important sources of NIR heterogeneity within the banking system.</u>

As previously discussed, the proposed discount factor models are not appropriate for firm-level NIR projection in the stress tests. Importantly, while we suggest a modified version of the proposed discount factor models on a temporary, interim basis, this approach is not appropriate for generating firm-level NIR projections in the stress tests on a permanent basis. With respect to NIR from trading revenue specifically, we do not agree with the Federal Reserve's proposed alternative approach to use one regression model for all firms, without differentiating between large and small firms and various lines of

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342 *See id.* at 243 (Equation A64).

business.[343] As discussed elsewhere in this Section IV.R, differentiating between firms by size is essential for the NIR for trading model to appropriately capture risk.

In the long term, the Federal Reserve should redevelop and re-propose the entire set of NIR models to ensure that these models are conceptually sound, accurate, data-based, and appropriately reflect important heterogeneity in the business models and risk profiles of banks that are subject to the supervisory stress tests. Below, we outline high-level principles that are intended to inform and guide redevelopment of the NIR models.

a. The NIR models must consider sufficiently detailed and granular NIR categories that appropriately capture the range of different business models, practices, and risk profiles within the banking system.

The proposal contemplates modeling ten specific NIR components.[344] As categorized, these components are overly aggregated and mix economically distinct revenue categories that should be modeled separately. The resulting NIR projections would fail to appropriately stress firms' revenue and adequately capture the degree and range of heterogeneity in NIR generation across the entire banking sector.

In certain cases, greater granularity in NIR categories can be achieved simply by leveraging existing data already collected as part of the FR Y-14 process. As an example, the proposal specifies a single model for other loan-related NIR.[345] This aggregate NIR category includes NIR generated by each of mortgages and home equity, other retail and small business lending, and commercial lending.[346] The FR Y-14 schedules already collect data on each of these individual revenue categories. Disaggregating into these more specific categories is preferable, as the economic drivers that are important for each of these categories may differ. Therefore, aggregating each of these distinct categories into a single revenue category would lead to imprecise projections. Moreover, subjecting all firms with different loan portfolios to the same underlying model for all other loan-related NIR would unduly mask important firm-level heterogeneity. As an example, some firms may have significant home lending portfolios but not commercial lending, which may react differently under a stress environment. This type of heterogeneity should be explicitly considered in the stress test.

In other cases, an appropriately granular set of NIR categories may require that the Federal Reserve collect new, additional data. As an illustrative example, it is common for FBOs to have revenue sharing arrangements (often referred to as "transfer pricing") with their foreign parent. Transfer pricing involves booking transactions outside of the Intermediate Holding Company ("IHC"), followed by transferring revenue to the IHC for participation in such transactions. This revenue sharing has unique characteristics and is very resilient in stress, given it is common to have a "cost plus" structure that is also

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343 *See id.* at 105.

344 *See id.* at 169–70 (Table A6).

345 *See id.* at 240 (Equation A57).

346 *See id.* at 236 (describing that other loan-related noninterest income includes data from Rows 14E, 14S, and 15 of FR Y-14Q, Schedule G and FR Y-14A, Schedule A.7.a).

typically floored at zero (*i.e.*, there is no loss sharing, only profit sharing). In the proposed models, transfer pricing revenue would be distributed across three separate categories: (i) sales and trading, (ii) investment banking and private equity, or (iii) miscellaneous income; all three categories use the discount factor approach and subject transfer pricing revenue to the same models as other, more volatile revenue components. Accordingly, in order for the Federal Reserve to appropriately capture this important NIR source for FBOs, a new NIR category should be created to reflect the lower risk profile and other unique characteristics for this type of revenue. As transfer pricing revenues are not currently captured as part of the FR Y-14 data collection process, a new data collection would be required for transfer pricing revenues.

Finally, as discussed above, the "Miscellaneous" category would aggregate a wide range of economically distinct revenue generating activities that are driven by distinct economic drivers. Moreover, different firms have varying levels of exposure to each of the distinct revenue categories within the Miscellaneous category. Accordingly, aggregating these disparate sources of revenue into a single category masks important sources of NIR variation throughout the banking system. Accordingly, the Federal Reserve should consider stratifying the miscellaneous category into several economically distinct NIR categories that appropriately reflect important sources of revenue generation heterogeneity within the industry. Because the FR Y-14 data collection does not currently break out the miscellaneous category more finely, a new data collection would need to be initiated.

b. The NIR models should be based on granular and specific data which directly relates to the observed empirical behavior of the revenue activity of interest. Overly aggregated data, inaccurate data, or projection-based data should not be employed in the NIR models.

In any context, a key modeling principle is that the underlying data being used to estimate a model and generate projections should accurately reflect the actual empirical properties of the activity being considered. In the case of NIR models and projections, the FR Y-9C data that informed the previous NIR models was too aggregated and noisy to be useful for stress test modeling. The FR Y-14Q data is better suited to this modeling exercise and should be uniformly favored over FR Y-9C data or projection-based data sources. As discussed above, in some cases, the NIR modeling effort will require the collection of additional data on certain revenue generating activities (*e.g.*, transfer pricing revenues, AUM by asset class). In these cases, the Federal Reserve should collect additional NIR data using an approach similar to that employed for collecting NIR data in the FR Y-14Q.

c. The NIR models should be specified either as structural or regression-based models that appropriately capture the full range of behavior in the underlying revenue activity.

The NIR models should be specified either as structural models or as regression-based models that clearly link the underlying revenue activity to a conceptually sound set of drivers.[347] In addition, the model drivers should be sufficiently diverse in order to capture the full range of behavior in the underlying activity. Several of the proposed discount factor NIR models are specified as simple univariate regression

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[347] The set of drivers should show a demonstrably reliable and systematic impact on the revenue activity of interest.

models.[348] In the PPNR Model Documentation, the preference for simple, univariate models is often supported with reference to the principle of simplicity.[349] While simplicity is an appropriate principle in model development, it is not the sole consideration and should not have an undue influence on model specification. Many NIR generating activities are, by their nature, complex and responsive to a range of economic factors. Accordingly, it is entirely appropriate for the NIR models to capture this complexity by including multiple, well-reasoned economic drivers where necessary, which aligns with the Federal Reserve's principle of robustness and stability. Not including these drivers could lead to inaccurate outcomes that would be inconsistent across firms.

As a specific example, we reference the proposed Investment Services Noninterest Income Discount Factor.[350] Investment Services NIR comprises revenues from both Securities services and clearing,[351] which are unlikely to exhibit similar behavior under stress. Securities services NIR (lines 20B, 20C, and 20D of FR Y-14Q, Schedule G) is driven by equity index levels whereas clearing NIR (line 20E of FR Y-14Q, Schedule G) is driven by volatility. Accordingly, it would be more appropriate to develop a richer model that differentiates between the drivers for securities services versus clearing.

d. The NIR model for sales and trading should jointly model the behavior of net interest income and noninterest revenue.

The proposed modeling framework for sales and trading would separately model the interest income, interest expense, and noninterest revenue generated through sales and trading activities.[352] This approach is inefficient and inappropriate given the natural offsets between each of these components. As a specific example, for a Total Return Swap that is hedged by a long stock, a decline in interest rates, which typically occurs in stress test scenario, may lower non-interest income but simultaneously lower trading funding costs. Modeling net interest income and noninterest revenues jointly would explicitly account for this and related natural offsets, while specific modeling of each component may fail to capture such an offset. In addition, the joint modeling of all sales and trading components would improve the parsimony of the models (*i.e.*, one model rather than three), and would also be consistent with the stress testing principle of simplicity. Further, this would allow the Federal Reserve to simplify the associated data collection.

e. The NIR models must substantively resolve any double-counting of losses in HFS Securities, FVO Loans, and Private Equity exposures.

We described above, in the context of our suggested interim and temporary approach to modeling NIR, the double counting problem related to HFS/FVO Loans and PE exposures. We note again and

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348 *See, e.g.*, PPNR Model Documentation at 240 (describing discount factor specifications for several components of noninterest income that include only one independent variable).

349 *See, e.g.*, *id.* at 171–72.

350 *See id.* at 242.

351 *See id.* at 236 (describing that investment services noninterest income is based on row 20 of the FR Y-14Q, Schedule G).

352 *See id.* at 8.

underscore the importance of resolving the double counting of losses in stress testing. In developing new NIR models, the Federal Reserve should resolve any potential source of loss double counting to ensure that projected losses on HFS/FVO Loans, and PE exposures, are only counted once. We generally expect that models adhering to the principles stated above would resolve the double counting problem. But, to the extent that other modeling choices are made that vary from the above principles, it is critical that any potential source of double counting be removed from the stress testing process.

S. Noninterest Expense PPNR Models

The Federal Reserve proposes an efficiency ratio model to project noninterest expense.[353] For several reasons, the specified model and approach would be problematic and inapt for modeling the stress tests. Namely, given industry changes to cost structures which have taken place over the last few years, the five-year lookback period poses a notable issue. Noninterest expense modeling needs to be keyed to the most recent experience of the firm (*e.g.*, cost structure). This should not look too far backward from the jump-off point. Further, the treatment of non-recurring expenses is problematic. As non-recurring expenses are idiosyncratic and not persistent, rendering them comparatively extraordinary, these expenses should be deducted or otherwise addressed accordingly.

Beyond these drawbacks, efficiency ratio modeling would pose another notable issue. Efficiency ratio modeling would not provide for sufficient heterogeneity across firms, nor would it include any lag effects. While costs and expenses would adjust to economic conditions, it would not be immediate in all cases. The proposed efficiency ratio approach would directly link noninterest expense to revenue based on the prior five-year average, without explicitly considering a firm's recent cost structure, any cost management actions that a firm may take in response to stress, or actions that a firm may have already taken in the recent past to improve efficiency (particularly with respect to variable costs). Efficiency ratios are assumed to decline over time following an immediate jump, which in some cases would imply an increase in cost despite a drop in revenue under stress. The shape of the time series path of efficiency ratios is also assumed to be the same across firms, which would fail to recognize an important source of heterogeneity across firms. As a result, this approach would produce a much more conservative and conceptually unsound outcome as compared to the current model.

Figure 4[354]

Efficiency Ratio	PQ1	PQ2	PQ3	PQ4	PQ5	PQ6	PQ7	PQ8	PQ9
Federal Reserve proposed model	72%	72%	71%	70%	69%	68%	67%	66%	66%
Federal Reserve current model	69%	65%	63%	64%	61%	60%	61%	62%	59%

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353 *See id.* at 246.

354 This table is calculated based on industry aggregate NIE using data publicly disclosed by the Federal Reserve. *See* Federal Reserve, 2025 Detailed Nine Quarter Paths, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm; Federal Reserve, 2025 Detailed Hypothetical Nine Quarter Paths Under Proposed Models, *available at* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2026.htm.

1. The Federal Reserve should implement a simpler modeling approach for noninterest expense.

Noninterest expense modeling should be anchored to a firm's most recent experience. To accomplish this, the Federal Reserve could implement a simplified structural model. This simplified model would hold a significant number of cost components flat at their jump-off levels, given they generally do not vary with the economic cycle, while allowing certain other cost components to vary with economic scenario variables and drivers of revenue, to the extent they may be sensitive to market changes or are strongly associated with revenue.

For noninterest expenses that do not vary meaningfully with the economic cycle, such as fixed compensation, we recommend that these be held flat (based on a trailing four-quarter average) at the jump-off level throughout the nine-quarter projection horizon. This approach would be both simple and transparent and would comport with the actual experience of firms.

For variable pay (including stock and cash-based compensation and commissions), the model should reflect that as economic drivers worsen and/or revenues decline these expenses would also be expected to decline. For example, commission income would generally be linked to investment management fees though a commission to fee ratio, while stock and cash-based pay would be linked to both worsening macroeconomic drivers and declining revenues.

For all other non-compensation expenses that vary with the economic cycle (*e.g.*, marketing expenses), the Federal Reserve should collect additional data regarding expenses, and the model should then use appropriate FR Y-14 schedule data and relevant economic drivers and/or revenues to project these expenses over the nine-quarter horizon. These data and drivers would be expected to drive expenses and show a reliable empirical relationship with expenses.

The Federal Reserve has identified certain limitations regarding the proposed efficiency ratio approach and invited feedback on its use.[355] We note that this approach would not adequately capture heterogeneity across firms. It would use a five-year lookback window to calculate revenue shares,[356] which would not account for substantial changes in revenue mix within the industry. In contrast, the suggestions outlined above would resolve these limitations. These suggestions would leverage an individual firm's recent cost structure, while also maintaining a conservative, simple, and consistent approach.

Aggregation Models

T. Retained Earnings Model

The Aggregation Models would be used to calculate a firm's adjusted net income, which then would be used to calculate a firm's projected capital ratios and ultimate capital requirements.[357] The

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355 *See* PPNR Model Documentation at 250-51 (Questions A198-202).

356 *See id.* at 248 (Equation A67).

357 Proposal at 51,860.

Retained Earnings Model "[p]rojects retained earnings by combining supervisory projections of pre-tax net income, tax and capital distribution items."[358] In the stress test context, "[r]etained earnings represent the undistributed profits which a firm could use to absorb losses and serve as a key component of projected common equity tier 1 capital."[359]

Under the "Retained Earnings Model," the Federal Reserve would calculate pre-tax net income, and then subtract tax expense from (or adds the impact of a tax benefit to) pre-tax income.[360] The components of tax expense projections under stress would include quarterly: (i) taxes owed; (ii) "changes in deferred tax assets that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances and net of deferred tax liabilities" ("DTAs from NOL"); (iii) "change in deferred tax assets arising from temporary differences, net of deferred tax liabilities" ("DTAs from Timing"); and (iv) change in valuation allowance.[361]

1. The Federal Reserve should apply regulatory deduction thresholds to DTAs from Timing, with no valuation allowance equation.

According to the Aggregation Models Documentation, the Federal Reserve aims to calculate tax expense "in a simple, consistent manner."[362] However, the Retained Earnings Model would determine the amount of DTAs able to be realized in a manner that unnecessarily introduces complexity into the model. The Federal Reserve should instead apply the thresholds used under the regulatory capital rules to determine whether DTAs are subject to deduction to simplify the model and to increase consistency and uniformity across firms.

DTAs may only be realized to the extent there is taxable income they can offset. The Federal Reserve would use the valuation allowance equation in its Retained Earnings Model to determine "whether a firm will have sufficient taxable income to realize its deferred tax assets from temporary differences."[363] The valuation allowance equation includes a four-quarter look forward, where DTAs are realizable only to the extent of projected taxes owed in that period.[364] The valuation allowance is therefore "the gap between a firm's stock of DTAs from Timing and the next four quarters of future taxes owed" and is recorded as a "contra-asset" against a firm's DTAs, thereby reducing DTAs by the amount of the valuation allowance (*i.e.*, the amount of DTAs the firm is projected not to be able to realize) and increasing tax expense.[365]

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358 Proposal at 51,862.

359 Aggregation Models Documentation at 26.

360 *Id.* at 29.

361 *Id.*

362 *Id.*

363 *Id.* at 34–35.

364 *Id.* at 35.

365 *Id.* at 34–35.

Under the current regulatory capital rules, all advanced approaches firms must deduct from CET1 the amount of any of a list of certain designated items (including DTAs from Timing) that individually exceeds 10% of CET1 capital.[366] The aggregate of those items that do not exceed 10% of CET1 may not exceed 15% of CET1; any amount above that threshold would also be deducted from CET1.[367] All other non-advanced approaches firms must make deductions for certain designated items (including DTAs from Timing) that exceed 25% of CET1 capital.[368]

Aligning the approach in the stress test to the approach used in determining non-stress capital requirements makes sense given firms continue as going concerns in the stress test. Therefore, DTAs should be taken into account in projected, stressed CET1 in the same manner in which they are taken into account for non-stress capital requirements. Not doing so ignores the tailoring principle of the capital framework and results in an approach that is more punitive to non-advanced approaches firms. In addition, applying the thresholds to DTAs from Timing in the stress test projections would be consistent with the Federal Reserve's principles of consistency and comparability across firms.[369] Calculating a look-forward valuation allowance would increase variability in the results and is unnecessarily complex.[370] Eliminating the valuation allowance would also avoid debate over the length of the look-forward period—as the Federal Reserve noted in the Aggregation Models Documentation, "a wide range of alternative look-ahead and look-behind specifications are possible."[371] In addition, when the federal banking agencies adopted the 10% and 15% thresholds in connection with their implementation of Basel III, in response to commenters' assertions that the thresholds were too "punitive," the agencies acknowledged that this approach was "stricter" than the previous approach, which involved a one-year look-forward similar to the valuation allowance equation.[372] The Federal Reserve's proposed approach essentially combines the Basel III framework (by applying numerator deductions) and Basel I framework (by applying a look-forward analysis) in a manner that is punitive, complex, a source of inconsistency across firms, and inconsistent

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366 12 C.F.R. §§ 3.22(d)(2)(i); 217.22(d)(2)(i); 324.22(d)(2)(i). Under the Basel III Endgame proposal, all Category I through IV firms would be required to apply these thresholds to DTAs. Federal Reserve, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, 88 Fed. Reg. 64,028, 64,037 (Sept. 18, 2023).

367 *Id.* §§ 3.22(d)(2)(ii); 217.22(d)(2)(ii); 324.22(d)(2)(ii).

368 *Id.* §§ 3.22(d)(1); 217.22(d)(1); 324.22(d)(1).

369 Stress Testing Policy Statement, 12 C.F.R., pt. 252, App. B.1 (2021). The Federal Reserve did not propose changing these principles in the Policy Statement. *See* Proposal at 51,859, 51,952–53.

370 The Federal Reserve acknowledges that "the impact of different DTA types depends on various factors, such as size, pre-tax net income stress path, and amortization and depreciation schedules." Aggregation Models Documentation at 34. These differences would be exacerbated by applying a look forward valuation analysis.

371 *Id.* at 37.

372 Office of the Comptroller of the Currency and Federal Reserve, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 Fed. Reg. 62,018, 62,069 (Oct. 11, 2013).

with the current capital framework. Therefore, the Federal Reserve should eliminate the valuation allowance equation, and rely solely on the thresholds used in the regulatory capital rules.

U. Provisions Model

As part of the Aggregation Models, components of the Provisions Model would be intended to reflect the calculation of allowances for credit losses under the hypothetical stress scenario.[373] To do so, the Provisions Model would calculate the quarterly change in a firm's credit loss allowances under the hypothetical stress scenario.[374] The main components of the Provisions Model would be the allowance for expected loan, lease, and securities losses in each quarter and realized losses in each quarter.[375]

1. As the Provisions Model is currently presented, the Federal Reserve should not incorporate the CECL accounting standard into its projections of provisions or anywhere else in the supervisory stress testing framework.

The proposal notes that the Federal Reserve is considering incorporating the current expected credit losses ("CECL") standard for calculating allowances in the supervisory stress testing framework in the future, though not as part of this proposal.[376] In particular, the Federal Reserve seeks comment on whether to incorporate CECL into the Provisions Model within the broader Aggregation Models, which the Federal Reserve uses to calculate allowances for credit losses under the stress scenario.[377]

CECL is a forward-looking measure that was adopted to replace the prior backward-looking incurred loss accounting standard. CECL is not necessary to incorporate for stress testing because the current framework is already forward-looking as a result of projecting loan loss provisions four quarters ahead.[378] Further, the proposal notes that determining provisions under CECL would require the Federal Reserve to make additional assumptions and that, "in aggregate, the cumulative loan loss provisions under the supervisory severely adverse scenario are similar to provision projections submitted by the firms that have adopted CECL."[379] Therefore, the costs of incorporating CECL in the Provisions Model—or in any other part of the supervisory stress testing framework—would far outweigh the benefits.

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373 Aggregation Models Documentation at 12.

374 *Id.*

375 *Id.*

376 *See* Proposal at 51,862 (Questions 2 and 3).

377 *See* Federal Reserve, Supervisory Stress Test Model Documentation: Aggregation Models, at 12, 26, *available at* https://www.federalreserve.gov/supervisionreg/files/aggregation-models.pdf (hereinafter, "Aggregation Models Documentation") (Questions B1, B2, B3, B4, and B5 considering changes to the current Provisions Model, including incorporating CECL).

378 Proposal at 51,864.

379 *Id.*

The Provisions Model already incorporates underlying credit loss models, which serve as a reasonable and operationally efficient substitute for CECL.[380] The model has some limitations, including that it considers losses over only a four-quarter horizon and therefore could result in not incorporating increases in expected credit risk beyond that period.[381] The Provisions Model also does not account for individual firms' portfolio weighted average life and relies on a constant balance sheet and mix.

Notwithstanding these shortcomings, we do not recommend transitioning to a CECL framework. Any CECL implementation must align with the principles outlined in the Federal Reserve's Stress Testing Policy Statement. Although aspects of CECL's approach to capturing emerging risk and recognizing credit losses earlier are conceptually consistent with the goals of stress testing, its practical implementation would introduce significant complexity and inconsistency across firms. In practice, CECL reserves increase over time as economic conditions deteriorate, not all at once. The Federal Reserve would need to formulate an industry-wide assumption for phasing in increases in reserves. The allowance would also reflect improved expectations (reserve release) when the scenario supports such a conclusion, and the absolute level should be sufficient to cover projected losses. In addition, introducing CECL's lifetime expected loss estimate would also need to be balanced with the accuracy and risk sensitivity of the credit loss models. Introducing CECL would have to be in combination with improvements in risk differentiation and collateral valuation, rather than relying on the proposed simplified and conservative credit loss models.

To determine whether to implement CECL, the Federal Reserve would need to assess whether the benefits of implementation outweigh the operational and resource burdens and potential volatility from doing so, as well as the reduced consistency and standardization that would result from incorporating CECL with the current Provisions Model. Given these potential burdens and inconsistencies, as the Provisions Model currently stands, and in the absence of any stated mitigants to resolve these matters, the Federal Reserve should not incorporate CECL into the Provisions Model or elsewhere in the supervisory stress testing framework.

Scenario Models and Guides

V. Global Market Shock Model

We support efforts by the Federal Reserve to enhance the transparency and public accountability of its annual stress test. While we welcome these efforts as they apply to the Global Market Shock ("GMS") Component,[382] we have identified several key issues pertaining to firms' capital markets activities that we believe should be resolved. Further, we have included recommendations that the Federal Reserve

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380 Aggregation Models Documentation at 14–18.

381 *Id.* at 22.

382 Federal Reserve, *Supervisory Stress Test Model Documentation: Global Market Shock Component* (Oct. 2025), *available at* https://www.federalreserve.gov/supervisionreg/files/gms-model.pdf (hereinafter, "GMS Model Documentation").

should consider implementing to resolve these issues. The recommendations are outlined here and discussed in more detail below.[383]

- As discussed in Section III.B, the Federal Reserve should resolve overlaps between RWAs and SCBs to prevent excessive capital requirements for firms' capital markets activities, ensuring requirements are aligned with actual risks.

- The Federal Reserve should maintain detailed GMS risk factor granularity, continue to publish relative shocks, and publicly disclose GMS scenario selection criteria and guardrails for adjustment to ensure transparency and consistency, if the GMS component continues to remain part of the SCB calculation with the implementation of the finalization of Basel III.

    1. The Federal Reserve should maintain the current risk factor granularity and continue to publish relative shocks even if the number of disclosed risk factors is substantially reduced as proposed.

To simplify the Global Market Shock Component, the Federal Reserve would substantially reduce the number of disclosed risk factors to approximately 2,300 shocks,[384] determined based on their relevance for developing a global market shock scenario narrative, the materiality of the risk factor, quality of data, and consistency across asset classes.[385] We encourage the Federal Reserve to instead retain the current level of risk factor granularity. This granularity is essential to generating a scenario that accurately captures risk to firms' financial market activities.

If the Federal Reserve instead determines to reduce the number of disclosed risk factors as proposed, it should publish mapping methods for public review and perform the mapping itself to maintain consistency across firms. Further, risk factors should be directly reflected in the full shock file and published in the current format. Taken together, these recommendations would obviate additional operational burden in mapping from the full shocks to simplified shocks (or vice versa), along with the added cost and complication of implementation efforts and ongoing maintenance.

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383 In addition, the threshold for firms subject to the GMS should be indexed to nominal GDP and reconsidered. In 2017, the agencies amended the definition to capture firms with total trading assets and liabilities equaling $50 billion or more, or representing 10% or greater of total assets. Note that the 2017 amendment made the GMS scoping mechanism more conservative—not less—as prior to the amendments, a firm was scoped in only if its total trading assets and liabilities exceeded $100 billion, a threshold that would be significantly higher in today's environment given economic growth and inflation. *See* Bank Policy Institute, Letter to the FDIC re Notice of Proposed Rulemaking—Adjusting and Indexing Certain Regulatory Thresholds (Sept. 26, 2025), *available at* https://bpi.com/wp-content/uploads/2025/09/BPI-FDIC-Indexing-Comment-Letter-2025.09.26.pdf (arguing that regulatory thresholds in general should be indexed to nominal GDP).

384 GMS Model Documentation at 22–23, 86, 88.

385 *Id.* at 86.

Further, the Federal Reserve invited feedback specifically on whether to stop reporting relative shocks.[386] We strongly encourage the Federal Reserve to continue to publish relative shocks. If only absolute shocks were published, firms that adopt relative spread shocks under their internal methodology and infrastructure would be required to convert from absolute into relative shocks. This would entail various assumptions, including for benchmark assets and indices, which would result in increased operational burden and inconsistency across firms.

2. The Federal Reserve should establish and disclose guardrails for the selection and adjustments to the GMS scenarios.

In the 2026 Scenarios Letter, we noted that the GMS methodology, including its judgment-based adjustments, affords considerable discretion to the Federal Reserve with limited accountability and transparency.[387] We noted further that this could lead to economically incoherent scenarios, which could result in continued volatility in binding capital requirements year-over-year.[388] To promote greater coherence and transparency in the GMS framework, we recommend that the Federal Reserve establish and disclose guardrails for these adjustments and discretionary decisions, as well as publish these guardrails for notice and comment.

3. The Federal Reserve should establish and apply an applicability test to determine, prior to each application, whether a quantile regression is appropriate for calibrating a secondary risk factor shock given its limitations.

A quantile regression estimates the influence of one variable on the percentile of another variable. As an example, for credit shocks, once the Federal Reserve has defined the primary shock to the Moody's Baa-Aaa spread, it would substitute the primary shock into an estimated quantile regression to derive the 90th percentile secondary shock to the BBB bond spread.

The Federal Reserve's use of quantile regressions is not well-justified.[389] A quantile regression does not capture correlation between extreme shocks or tail dependency. A quantile regression merely measures the effect of any change in the independent variable, whether small or large, on the kth percentile of the dependent variable.[390]

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386 *Id.* at 88.

387 2026 Scenarios Letter at 12.

388 *Id.*

389 The Federal Reserve justifies the use of quantile regressions on the basis that "[i]n market risk, extreme shocks tend to happen simultaneously during financial crises. This behavior is captured by the quantile regression model because it expresses the conditional quantiles of secondary risk factors as a function of primary risk factors." GMS Model Documentation at 25. Similarly, the Federal Reserve noted that ". . . the quantile regression model described in Section C.ii.1.a [is] designed to capture tail outcomes of the dependent variable." *Id*. at 66.

390 The quantile regression may be written as $Q_\tau(Y|X = x) = \alpha_\tau + \beta_\tau x$.

The quantile regression answers the question: what is the effect of a marginal change in one financial quantity on observations of another financial quantity that are in the τ^{th} percentile? The quantile regression does not describe the joint probability of a simultaneously large shock to both variables. It does not imply that a large shock to one variable must necessarily follow a large shock to a different variable.

To see how a quantile regression can be seriously misleading, assume that there are two statistically independent variables, with the dispersion of one variable depending on the other one.[391] We performed a simulation of both variables over 500 periods and then estimated a quantile regression between them. Table 1 shows the slope estimates for various quantiles, which are statistically significant at the 1% level.

Table 1

Quantile	Slope Estimate
0.1	-0.74
0.75	0.468
0.9	0.714

Even though the variables are statistically independent, the quantile regression estimates what seems to be a strong tail relationship between them. The reason for the misleading estimation is that the quantile regression is picking up the growing variance of the dependent variable, as can be seen in Figure 5 below.

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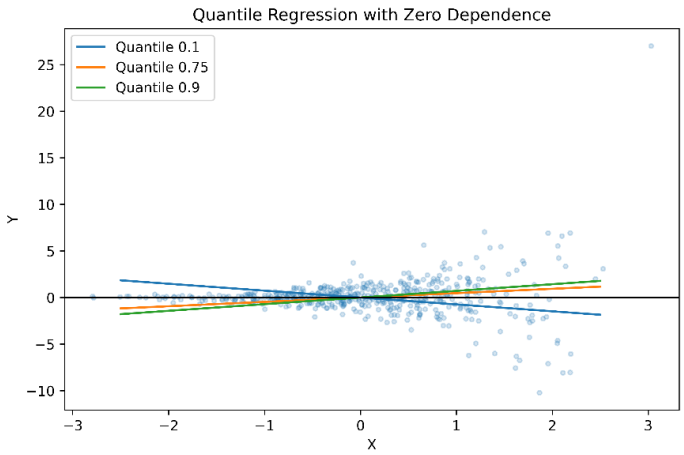
391 More formally, assume $X_t \sim N\ (0,1)$, $Y_t = \sigma(X_t)$, $\sigma(X_t) = e^{.8X_t}$, $\epsilon_t \sim N(0,1)$, and $X_t \text{ and } \epsilon_t \text{ are independent}$.

Figure 5



The slope for the 90th percentile quantile rotates counterclockwise from lower quantiles because it is attempting to capture the larger values of the dependent variable as its variance grows, but there is no correlation between the variables.

When quantile regressions are used in the GMS to model secondary risk factors based on primary risk factors,[392] the methodology can result in overly severe shocks by first conditioning on the tail of the primary risk factor and then conditioning on the tail of the secondary risk factor (*i.e.*, the tail of the tail).

4. The Federal Reserve should retain the instantaneous GMS approach and the 2026 liquidity horizon assumptions.

The Federal Reserve should retain the 2026 GMS liquidity horizon assumptions, including using the same liquidity horizon for all risk factors within an asset class. In addition, the Federal Reserve should maintain the current instantaneous GMS approach and should not use the alternative dynamic approach discussed in the GMS Model Documentation.[393] As the Federal Reserve describes, instantaneous GMS has the advantages of simplicity and comparability of market losses across firms.[394] The alternative dynamic assessment approach would significantly increase operational burden, and complexity with the number of assumptions required, reducing transparency and comparability across firms.

5. The Federal Reserve should index the thresholds for the GMS for economic growth and inflation and consider opportunities to tailor the application of the GMS.

With respect to the scope of the GMS, consistent with the principles of regulatory tailoring, we encourage the Federal Reserve to revisit nominal dollar thresholds for automatic indexing (for economic growth and inflation) and potential recalibration to ensure they remain fit for their prudential regulatory

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392 GMS Model Documentation at 24–26.

393 *Id.* at 82–83.

394 *Id.* at 82.

purpose of scoping in firms appropriately based on their risk profile. The definition of "significant trading activity" used for scoping firms into the GMS was amended in 2017 to capture firms with total trading assets and liabilities equaling $50 billion or more (trading assets threshold), or representing 10% or greater of total assets (proportionality test); this amendment made the GMS scoping mechanism more conservative—not less—as prior to the amendments, a firm was scoped in only if its total trading assets exceeded $100 billion, a threshold that would be significantly higher in today's environment given economic growth and inflation.

The Federal Reserve should also consider whether both the trading asset threshold and proportionality test should apply in the same manner or in tailored ways for Category I through III firms. Given the characteristics of Category III firms, including their size and different risk profiles as measured by the tailoring framework, the Federal Reserve should ensure the scope of the GMS is consistent with the principle of regulatory tailoring and risk-sensitive differentiation of requirements across prudential tailoring categories and balances the costs resulting from being subject to the GMS with prudential outcomes.

6. Securitized product shocks in the GMS should include spread shocks in addition to market value-based shocks.

The shocks to securitized products in the GMS are market value-based,[395] which does not always properly reflect market behavior. In addition, using market values does not account for bond duration. The Federal Reserve should adopt a spread-based shock approach for securitized products, which would capture the impact of duration. The Federal Reserve should also add fundamental parameters, such as the conditional prepayment rate and conditional default rate to accurately capture the risk inherent in securitized products.

The Federal Reserve should disclose both shock types (price and spread), with standardized definitions to permit comparability across firms. Spread shocks align stress inputs with market conventions and internal risk models, while price shocks ensure simplicity and comparability across firms.

W. Comments Related to Scenario Design

In general, the proposed scenario design framework, which includes both guide-based and model-based variables, raises questions about the coherence of the supervisory stress testing narrative. Although we welcome the increased transparency and public accountability introduced by the proposed scenario design framework, we have concerns regarding the proposed interaction between these two types of variables.

Using a combination of models and guides with broad parameters that attempt to incorporate salient risks would, at times, require trade-offs between scenario consistency and other design principles, such as severity. The Federal Reserve develops model-based variables using economic models that incorporate historical data, whereas guide-based variables are developed by considering recent recession experience and macroeconomic trends. The Federal Reserve also has asserted that it has discretion

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395 *See id.* at 8.

regarding how it applies the guides and whether to depart from the guides (even though this purported discretion is not consistent with the Federal Reserve's obligations under the APA), leading to an even greater potential for scenario incoherence as variables may shift in a way that does not make economic sense or is uncorrelated with other related variables. This is particularly problematic to the extent that an incoherent scenario design affects firms' binding stress capital requirements through the SCB. In light of these potential issues, the Federal Reserve must sufficiently explain and justify its design choices in respect of a given scenario to allow an opportunity for the public to assess the trade-offs between scenario design principles.

Further, in setting values for the proposed scenario design framework, the Federal Reserve should reflect the structural and regulatory changes that distinguish historical periods of stress from stress that is plausible after intervening reforms. Given the impact of wide-ranging structural changes that have taken place in response to the 2007-2009 financial crisis, along with distinctive features of today's market structure when compared with historical precedent, the Federal Reserve should consider regulatory and market structure evolution in determining values for its guides.

Below we discuss specific recommendations for determining the paths of variables in the supervisory scenarios.

1. <u>The Federal Reserve should clarify adjustments made to arrive at core PCE inflation.</u>

The Federal Reserve primarily uses an equation to determine PCE inflation,[396] but also notes that the Federal Reserve "augments the equation with shocks in the first year of the simulation in order to capture and replicate the contribution" of factors not present in the equation.[397] The proposal does not further explain this "augmentation." To achieve the transparency objectives of the proposal, the Federal Reserve should clarify the adjustments it makes to the model and the effects of these adjustments on the model and its results.

2. <u>Values for international variables in the Euro area, the United Kingdom, and Japan should be differentiated.</u>

The scenario design framework would contemplate identical trough values and ranges of GDP and inflation for the Euro area, United Kingdom, and Japan.[398] The proposal explains that the Federal Reserve arrived at the proposed guides by aggregating the three economies and using the variable history during

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396 We note that there appears to be a typo in the formula for PCE inflation. The formula as drafted seems to say the increases in unemployment increase inflation (*i.e.*, the sign for the unemployment coefficient in the formula should be negative, rather than positive as it appears in Equation D1). *See* Federal Reserve, Supervisory Stress Test Model Documentation: Macroeconomic Model Guide, at 22, *available at* https://www.federalreserve.gov/supervisionreg/files/macroeconomic-model-guide.pdf (hereinafter, "Macroeconomic Model Guide").

397 *Id.* at 24.

398 Proposal at 51,947–48.

the 2007-2009 period as a guide.[399] This methodology is not conceptually sound given that each of these three jurisdictions has operated on different economic trajectories since the 2007-2009 financial crisis. Notably, the Brexit referendum in June 2016 has led to a decoupling between the European Union and the United Kingdom, and Japan has experienced distinctly lower medium- to long-run growth rates when compared with the Euro area and United Kingdom.[400] Accordingly, the Federal Reserve should incorporate jurisdiction-specific factors in determining the guides for these countries/regions, rather than applying a common shock across multiple jurisdictions. Further, the Federal Reserve should provide additional transparency with respect to these variables by explaining how it chooses trough values within the prescribed range, and the variables it analyzes in making that choice, when it releases the scenarios for comment each year.

3. Additional data points should be considered when setting paths for variables at similar levels of severity.

The proposed scenario design framework contemplates that, for certain variables subject to guides, "it could be appropriate to set the paths for these variables at similar levels of severity."[401] In making this determination, "the Board would consider the expected severity of the unemployment rate and house prices variables and the prevailing macroeconomic and financial conditions described in the baseline scenario."[402] The proposed approach implies that the Federal Reserve uses unemployment and house prices as two main variables for determining the path of other macroeconomic variables. This approach is not conceptually sound.

In particular, the updated Scenario Policy Design Statement provides that the Federal Reserve seeks to avoid adding sources of procyclicality to the severely adverse scenario. Applying common shocks across these variables could lead to a violation of this principle. For example, recent experience demonstrates that, although unemployment remains low and house prices are elevated, mortgage spreads and commercial real estate prices have not recovered from their respective cyclical highs and lows. Setting similar levels for the paths of these variables without analyzing other variables could introduce procyclicality into the stress tests, as would be the case for commercial real estate prices in the proposed 2026 severely adverse scenario, as discussed in the 2026 Scenarios Letter.

To the extent the Federal Reserve intends to use the unemployment rate and house prices to determine the path of other variables, it should consider additional data points to capture the idiosyncratic

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399 *Id.* at 51,922.

400 *See* International Monetary Fund, Real GDP Growth (% change): Japan, United Kingdom, Europe (IMF DataMapper), *available at* https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/JPN/GBR/EURO?year=2025 (last visited Feb. 19, 2026) (demonstrating consistently lower real GDP growth in Japan since 2008 when compared with the United Kingdom and Euro area).

401 Proposal at 51,946.

402 *Id.*

nature of those other variables (*e.g.*, spot prices, year-over-year trends), which would result in a more sound and accurate methodology and result.

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The Associations appreciate the opportunity to comment on the proposal. If you have any questions, please contact the undersigned at sarah.flowers@bpi.com, HBenton@aba.com, scampbell@fsforum.com, gzhang@sifma.org, and LGalletta@isda.org, respectively.

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The Associations

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Appendix I: FR Y-14 Comments

The Federal Reserve recognizes that certain data that firms have previously been required to submit as part of the FR Y-14 reports is no longer necessary. The proposal would remove from the FR Y-14 reports certain "items and documentation requirements that are no longer needed to conduct the supervisory stress test," and would also call for additional data "that would support the supervisory stress test models and improve risk capture."[403]

We appreciate the Federal Reserve's efforts to streamline the FR Y-14 reports to remove burdensome data requirements that are not required for stress test purposes and streamline immaterial portfolio-level collections. We also encourage the Federal Reserve to consider whether there are additional items that can be removed from the data collection.

Based on the model documentation that the Federal Reserve published in connection with the proposal, it appears that the Federal Reserve currently uses a very limited number of data fields collected across FR Y-14 report schedules for stress testing. While we recognize that certain FR Y-14 data may be used to support stress testing or "for continuous monitoring efforts,"[404] the Federal Reserve has not explained how individual FR Y-14 data requirements, including under the proposed models, would support ongoing monitoring of a firm's material financial risks.

For example, the Federal Reserve indicates that data from FR Y-14Q Schedule H.1, Fields 52-82 is not used in stress testing in the Credit Risk Model Documentation on the Corporate Model. These fields require firms to report obligor financial data related to a credit facility's primary source of repayment from the firm's financial spreading systems.[405] The Federal Reserve explains that while it has considered using firm submitted financial data or third-party vendor data to estimate PD directly, doing so would "inevitably increase model complexity and operational challenges."[406] Additionally, the Federal Reserve states that "[i]Initial efforts to estimate PD more directly did not provide an unambiguous improvement over the current approach, leading the Board to maintain the less complex model currently in use."[407] We agree that a more granular and direct approach that relies on this FR Y-14Q data would be unlikely to provide an improvement over the current approach. Therefore, it is unclear how requiring such data would support ongoing monitoring of a firm's material financial risks. Moreover, while firms use obligor financial data in underwriting and ongoing credit monitoring of graded corporate loans, it is burdensome to maintain processes and controls to align with the specific Schedule H.1 reporting requirements, which are not designed for firms' business purposes.

While the Federal Reserve expressly acknowledges that it does not use the Schedule H.1 obligor financial data fields, we believe there are other instances where FR Y-14 data elements are not used to

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403 Proposal at 51,874.

404 Federal Reserve, *Instructions for the Capital Assessments and Stress Testing information collection (Reporting Form FR Y-14Q)* at 5 (September 30, 2025), *available at* https://www.federalreserve.gov/reportforms/formsreview/FR_Y-14Q_Instructions_B3.pdf (hereinafter "Draft FR Y-14Q Instructions").

405 *Id.* at 171–72.

406 Credit Risk Models Documentation at 18.

407 *Id.*

assess material financial risks, through stress testing or otherwise. We therefore encourage the Federal Reserve to consider eliminating additional items from the data collection as well as other enhancements. For example, the Federal Reserve should consider eliminating reporting requirements in the FR Y-14 reports that are duplicative of requirements under other reports, such as the FR Y-9C. The Federal Reserve should conduct a thorough review of the data collected in the FR Y-14 reports to identify, and disclose to the public, the items that are used for stress testing (including challenger models and for back-testing), items that are used for supervision and regulation, and items that are not used. Any items in the latter category should either be removed or the Federal Reserve should explain why it seeks to continue collecting that information. The Federal Reserve should also publish clear criteria for adding or retaining any data element, providing transparency for use cases and ensuring that data collected for the purpose of supervision and regulation is aimed at capturing material financial risk and aligns with the reasons for collecting the data.

Further, the Federal Reserve should amend the instructions for the FY Y-14A, FR Y-14Q, and Y-14M to align reporting requirements, eliminate duplicative processes, and reduce regulatory burden. For example, firms are required to report certain FVO loans on FR Y-14Q Schedule J as well as FR Y-14M Schedule A. It is not clear how the Federal Reserve uses the data provided in FR Y-14M, which is subject to much more granular reporting criteria than FR Y-14Q Schedule J. In addition, the Federal Reserve should eliminate definitional and reporting differences between the FR Y-14 reports and U.S. GAAP to mitigate operational burdens and reduce the risk of potential reporting errors. For example, the FR Y-14Q instructions include different criteria to classify loans as modified, as compared to U.S. GAAP. The Federal Reserve should align these criteria to eliminate the burden on firms to maintain dual reporting processes.

Below we provide recommendations regarding the Federal Reserve's proposed changes to FR Y14 reporting, as well as additional recommendations for streamlining FR Y-14 reporting requirements.

A. The Federal Reserve should utilize certain data already collected and include certain new data fields in the FR Y-14 reports to improve the stress test models.

Section IV contains several recommendations to improve the models used in the Federal Reserve's supervisory stress test. Certain of those recommendations would use data already collected by the Federal Reserve in the FR Y-14 reports, as described in Section IV. However, some of them would require the Federal Reserve to collect additional data, including the following:

- As discussed in Section IV.A.1, the Federal Reserve should add to Schedule H.1 of the FR Y-14Q a field that allows firms to indicate when a loan qualifies for securitization treatment under the regulatory capital framework, as well as new fields to capture the facility grade (issue rating or loss-rate rating) and the "security type."

- As discussed in Section IV.A.2, the Federal Reserve should add a field to Schedule H.1 of the FR Y-14Q to allow firms to identify loans that are collateralized by agency mortgages.

- As discussed in Section IV.A.3, the Federal Reserve should add a field to Schedule H.1 of the FR Y-14Q to identify the amount of a loan covered by the guarantor.

- As discussed in Section IV.B.5, the FR Y-14Q, Schedule H.2 Field 9 (Property Type) allowable values should be updated to separately report affordable housing loans as distinct from other multifamily lending.

- As discussed in Section IV.G.6, we recommend including in Schedule B.1 of the FR Y-14Q a flag identifying whether amortized cost contains hedge adjustments and including in Schedule B.2 the clean present value of swap hedges.

- As discussed in Section IV.I.2, the FR Y-14Q, Schedule F-15 (Agencies) should add an additional row for banks to report dollar pay-up values of pass-through pools to their corresponding TBAs.

- As discussed in Section IV.J.1, the FR Y-14Q, Schedule F (Trading) should be revised to account for the removal of Trading IDL in the GMS model. If the Trading IDL is eliminated, the following fields can be decommissioned.

Sub-schedule	Line Item
F.20 Sovereign Credit	Notional
F.21 Credit Correlation	Notional long/short (Index Products and Bespoke)
F.22 IDR-Corporate Credit	Table A: SN - MV long/short, Notional long/short (SN, and Other)
	Table B: Index Products - Bespoke MV long/short, Notional long/short
	Table C: Other - Bespoke MV long/short, Notional long/short
	Table D: SN breakdown >$50mm (Name, Rating, MV, Notional, CS01)
	Table E: SN breakdown <$50mm (by rating, MV long/short, Notional long/short)
	Table F: Index Products by Series (MV & Notional by tranche points, Payer Options by spread moneyness)
	Table G: Summary of Bespoke tranche products by long/short
F.23 IDR-JTD	Issuer name (by long/short)
	Country (by long/short)
	Industry (by long/short)
	Rating (by long/short)
	Recovery rate (by long/short)
	JTD DE0 (by long/short)

Alternatively, the Federal Reserve could use F.23 IDR-JTD as the data source for Trading IDL. In that case, we recommend decommissioning the following data collection:

	Notional
F.21 Credit Correlation	Notional long/short (Index Products and Bespoke)
F.22 IDR-Corporate Credit	Table A: SN - MV long/short, Notional long/short (SN, and Other)
	Table B: Index Products - Bespoke MV long/short, Notional long/short
	Table C: Other - Bespoke MV long/short, Notional long/short
	Table D: SN breakdown >$50mm (Name, Rating, MV, Notional, CS01)
	Table E: SN breakdown <$50mm (by rating, MV long/short, Notional long/short)
	Table F: Index Products by Series (MV & Notional by tranche points, Payer Options by spread moneyness)
	Table G: Summary of Bespoke tranche products by long/short

- As discussed in Section IV.L.4, the Federal Reserve should add a field for duration for HFS/FVO loans to Schedule J to capture bank-provided duration estimates, or the Federal

Reserve should come up with a method to estimate duration to account for the shorter duration of certain residential loans.

- As discussed in Section IV.M.1, FR Y-14Q Schedule F.24 (Private Equity) should be updated to allow firms to elect to provide a list of PE investments with embedded goodwill that details the investment carrying value and embedded goodwill amounts.

- As discussed in Section IV.O.2, the Federal Reserve should amend Schedules B.1 and B.2 of the FR Y-14Q to collect additional information related to hedges and should collect unamortized terminated hedge adjustments alongside the remaining amortization period in either a new schedule or as a sub-section of an existing schedule.

- As discussed in Section IV.O.3, the Federal Reserve should add a field to Schedule B.1 of the FR Y-14Q to collect the coupon rate for all securities, which would be reported alongside existing fields such as maturity date and amortized cost, in case vendor data is unavailable.

- As discussed in Section IV.P.1, the Federal Reserve should add fields to FR Y-14Q Schedule G.3 to stratify deposits at the retail versus wholesale level and apply separate rate-up and rate-down betas to each portfolio segment in modeling interest expense.

- As discussed in Section IV.Q.2, insofar as the Federal Reserve determines to map all hedging relationships, it should consider introducing a separate schedule ("Schedule B.4") to report long-term debt/borrowings so the Federal Reserve can model these fair value hedge relationships adequately.

B. The Federal Reserve should not require the supplemental information proposed to be collected for Schedules F and L and should clarify expectations for providing the FR Y-14A supporting documentation that is proposed to be removed.

The Federal Reserve proposes an effective date for the reporting changes of September 30, 2026 report date.[408] We note that implementation of these reporting changes will take significant time and resources at every firm, and that this burden should be considered as an additional confounding factor where the Federal Reserve weighs changes that could pose other operational costs on firms.

We do not support several of the Federal Reserve's proposed changes to FR Y-14Q reporting. For example, the proposal to incorporate into the FR Y-14Q, Schedule L instructions certain data requests that have historically been made on an ad hoc basis[409] raises concerns regarding operational burden and alignment with the Federal Reserve's stated objective of reducing supporting documentation requirements. For example, the Federal Reserve proposes to ask for the five primary risk factors as compared to the previous year's stress test, and the amount of CVA change, for each of the Federal Reserve's market shock scenarios between the previous and current severely adverse stress scenario

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408 Proposal at 51,934.

409 *Id.*

(GMS) reporting dates.[410] Reporting this information would require significant additional computation during the reporting period. The other proposed supplemental information requests would similarly impose significant burden on firms to produce regularly.

Although we appreciate the Federal Reserve's effort to standardize and provide greater clarity around supervisory information needs, formalizing these additional data elements within the instructions effectively expands the scope of required production activities associated with the FR Y-14Q, Schedule L. These data requests often require material incremental effort, including data sourcing across multiple systems, enhanced controls and reconciliations, and additional governance review. Embedding these requests in the instructions, without corresponding adjustments to timelines or expectations, increases complexity and duration of the Schedule L production process. As a result, firms may need to reallocate resources or defer other risk management to meet these expanded requirements. We encourage the Federal Reserve to reconsider the scope and timing of these additions, or to provide additional implementation flexibility or lead time to better align with that objective. At a minimum, the Federal Reserve also should permit firms to provide the supplemental information for Schedule L 30 days after filing Schedule L. This would help ease operational burden as the same resources are used to produce Schedule L and many of the supplemental data requests.

Similarly, the Federal Reserve proposes to introduce supporting documentation for FR Y-14Q, Schedule F,[411] which would effectively shift FR Y-14A supporting documentation requirements that are proposed to be eliminated to the FR Y-14Q. This shift increases documentation frequency from annual to quarterly and some additional requirements refer to stress loss drivers, which are not reported in Schedule F. The Federal Reserve should not require this supporting documentation in the FR Y-14Q.

In addition, the Federal Reserve proposes to remove Appendix A "Supporting Documentation" from the FR Y-14A so as not to capture information that is no longer needed and to reduce reporting burden.[412] According to the proposal, the information was previously critical to assess the data systems and modeling methodologies that firms used to report the FR Y-14A, but as these systems and frameworks have matured, much of the supporting documentation has become outdated or is not needed by supervisors to make such assessments.[413] However, the proposal provides that "supervisors may request similar information to what is currently required from Appendix A from firms through supervisory channels, as deemed appropriate and on a targeted basis, in support of the annual capital plan review."[414] With respect to such targeted requests, we encourage the Federal Reserve to clarify expectations around response times from firms. The Federal Reserve's timing expectations should reflect that the type of supporting documentation that firms have typically provided as part of Appendix A is not always in a

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410 *See* Draft FR Y-14Q Instructions at 316.

411 Proposal at 51,934.

412 *Id.*

413 *Id.*

414 *Id.*

readily available format and thus may take more time to produce than is typical for other types of requests.

C. The Federal Reserve should rename Schedule B in light of the proposed changes to the schedule and make certain other changes to the schedule to improve collection of information on hedging.

Schedule B is currently referred to as the Securities schedule. However, the proposal indicates that Schedule B.2 would be revised to "capture all qualified accounting hedges, including portfolio layer method and all designated accounting hedges."[415] This change would significantly expand reportable items beyond simple "securities." The proposed new data collection seems necessary for comprehensive stress testing, but the Securities schedule would then be inappropriately named.

In addition, the Federal Reserve should make certain other changes to the schedule to improve collection of information on hedging:

- *Add field to Schedule B.2 to capture all qualified accounting hedges*: The Federal Reserve should add a new field in the FR Y-14Q Schedule B.2, which is proposed to be revised to capture fair value hedges, to report the "clean present value" of each related swap at the start of the projection horizon to ensure that both sides of the hedge relationship are captured, providing a materially accurate representation of net amortization and net interest income for hedged securities.

- *Clarify purpose and scope of Schedule B.2*: Although the proposal states that the purpose of the changes to Schedule B.2 is to capture all qualified accounting hedges,[416] it appears that the purpose of the changes to Schedule B.2 is to capture accounting hedges for interest rate risk. The Federal Reserve should clarify whether it intends to collect information on all accounting hedges, including revenue and expense cash flow hedges of FX risk and net investment hedges. If the new Schedule B.2 includes all qualified accounting hedges, including cash flow hedges, the Federal Reserve should also clarify whether it intends to collect information on closed cash flow hedges. The Federal Reserve should also consider adding "net investment hedge" as an option for Field 15 (Type of hedge) given the expansion of the schedule.

- *Supplement Schedule B.3 with a separate schedule or expand Schedule B.3 to accurately model fair value hedge relationships*: The proposal states that the purpose of the proposed addition of Schedule B.3 is to "more comprehensively map hedging relationships."[417] However, firms also enter into fair value hedges to cover interest rate risks related to long-term debt ("LTD"). There is no place on the current FR Y-14 report to capture information relating to the hedged LTD. The Federal Reserve should consider introducing a separate

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415 *Id.* at 51,936.

416 *Id.*

417 *Id.*

schedule (Schedule B.4, as discussed in Section IV.Q.2), or expanding Schedule B.3 to report long-term debt so the Federal Reserve can model these fair value hedge relationships adequately if the goal is to map all hedging relationships.

D. The Federal Reserve should clarify the proposed instructions with respect to Schedule F and not require firms to decompose certain funds.

The proposal states that the Federal Reserve is revising Schedule F to "capture data on hedges from any firms with reportable hedges."[418] The general instructions for Schedule F would be updated to state "[f]or Schedule F submission types . . . firms with hedge positions meeting the definitions of FVO Hedges, AL Hedges, or PE Hedges . . . may report those under the applicable hedge submission type. However, submissions are not required."[419] The Federal Reserve should clarify what it means by "submissions are not required."

In addition, the Schedule F instructions are proposed to be clarified to ensure all Funds are reported in the worksheet corresponding to their underlying asset class and risk exposures.[420] However, it is not practical to decompose all positions in funds including ETFs and Mutual Funds. Instead, firms should be allowed to treat non-decomposed funds as a single name Equity and report in Equity worksheet. To support supervisory objectives while minimizing implementation burden, we recommend adding an additional reporting section within Schedule F.1 (Equity by Geography) for non-decomposed positions in Funds by asset type (see mock-up template below). This would allow firms that cannot perform full decomposition to classify each position in Funds according to its predominant asset type (*e.g.*, Equity, Corporate Credit, Municipal, Government, Commodities), enabling the Federal Reserve to more precisely isolate and apply shocks aligned with the underlying risk factors of those asset types. This approach would promote appropriate risk-factor and shock-size alignment while materially reducing operational complexity and improving consistency across firms. In lieu of an additional reporting section in Schedule F.1, firms could also provide the same information as described above via special collection for informational purposes. Alternatively, firms may use a beta approach to report the PnL grid from non-decomposed positions in funds into the more appropriate Equity slide stress bucket (*e.g.*, if the SPX and TLT ETF beta is 0.5, -20% stressed PnL in Equity worksheet will report -10% stressed PnL from TLT).

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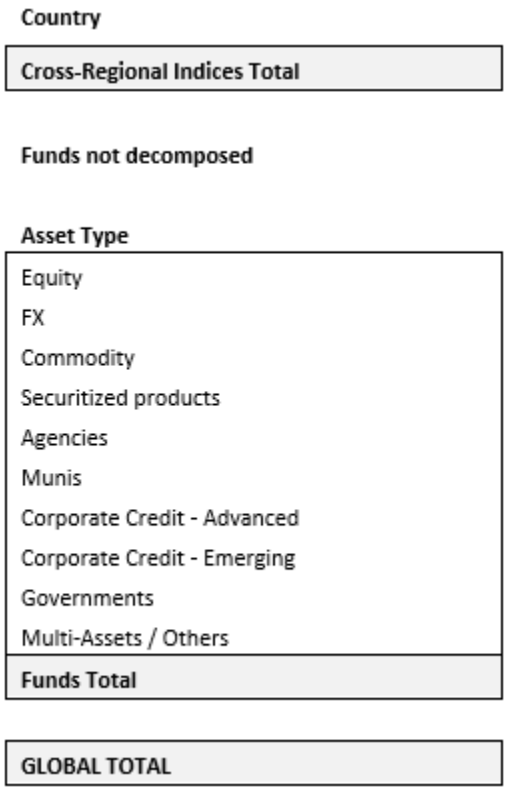
418 *Id.*

419 Draft FR Y-14Q Instructions at 6.

420 Proposal at 51,936.

Figure 6: Mock-up of Equity by Geography - Funds Category Table



E. The Federal Reserve should institute a materiality threshold for the submission of the new Schedule D.3 to the FR Y-14M and clarify certain aspects of the schedule.

The current instructions for the FR Y-14M do not offer an opportunity for firms to exclude submission of Schedule D.3. However, for many firms, the revenue and loss sharing agreements ("RLSA") as a proportion of their total credit card loan population is immaterial. As a result, firms with immaterial RLSA populations take on the burden of data submission for no reporting benefit. The general instructions of FR Y-14M/Q provide guidance for firms subject to Category I, II or III standards to define material portfolios as those with asset balances greater than $5 billion or asset balances greater than 5% of Tier 1 capital on average for the four quarters preceding the reporting quarter. A similar materiality threshold should be applied for Schedule D.3. For example, a material RLSA (individually, not collectively) requiring inclusion in Schedule D.3 would be an RLSA with month-end balance greater than $5 billion or greater than 5% of the total month-end credit card balance on average for the six months preceding the reporting month.

Further, a significant portion of the information proposed to be collected on Schedule D.3 remains static throughout the year and monthly reporting would not provide meaningful information to the Federal Reserve. In addition, the frequency of profit share calculations varies among firms, but generally these are not performed on a monthly basis. Typically, the frequency is dictated by the partner agreement calendar and is at a quarterly or annual frequency. An annual collection of this information as of the jump-off date

would allow the Federal Reserve to consume the data necessary for its purposes, while saving firms from monthly reporting of largely static data.

The FR Y-14M instructions should clarify how to submit RLSA data as a line item or how to aggregate RLSA data, if that is preferred. The current general instructions do not provide guidance on the actual data submission itself. If each partner's RLSA is to be submitted, then a line item number should be added to assign a partner RLSA ID (similar to the reference # in schedule D.1 for each card account). If data is to be submitted in aggregate, the Federal Reserve should provide clear guidance on how to aggregate the RLSAs.

The instructions also should be revised to allow firms time to include the metrics for added RLSA. The instructions state to "only include those agreements which cover 90% of their end of month receivables reported in this schedule." This guidance would require firms to reassess each month, resulting in addition and/or removal of RLSAs. When the RLSA distribution changes, firms would need time to include the metrics for the added RLSA.

The Federal Reserve should make RLSA reporting standards consistent across firms. Firms currently reflect RLSAs in different ways within regulatory reports; for example, by adjusting pre-provision net revenue or recognizing impacts in charge-offs and loss reserves. Because this diversity in reporting methodologies can create inconsistencies in supervisory projections, the Federal Reserve should harmonize RLSA reporting standards across all firms to facilitate consistent, comparable data submissions. Further, clear guidance on classification and accounting treatment will enhance the reliability and comparability of data underpinning stress test projections.

The Federal Reserve's shift towards portfolio-level reporting for RLSAs will also increase standardization across firms, as agreement-level reporting can introduce greater errors and discrepancies across firms. Although agreement-level reporting may theoretically increase precision, portfolio-level reporting supports the Federal Reserve's goal to capture the aggregate economic impact and stress sensitivity of RLSAs on credit losses and revenues across firms. Portfolio-level data collection also significantly reduces firms' operational and compliance burdens and simplifies reporting requirements without sacrificing supervisory insight. The level of detail in portfolio-level reporting will allow the Federal Reserve to simplify their processes and apply consistent and transparent modeling methodologies across firms.

Finally, the Federal Reserve notes that it is considering a modeling approach that would account for RLSAs at the portfolio level and one that would account for RLSAs at the agreement level.[421] Whichever approach the Federal Reserve adopts will require sufficient time for system development, data sourcing, and procedural integration. Therefore, the timeline for implementation must extend beyond September 30, 2026 to be 12 months following finalization of the proposal.

Between the two alternative approaches the Federal Reserve is considering, we recommend the first alternative, the portfolio level alternative. The second alternative, the agreement level alternative, would require the Federal Reserve to collect the effective and contract rates of RLSAs in lines 20-37 of

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421 *Id.*

Schedule D.3. The effort to obtain these rates is high, while the added value of collecting this information is low. The Federal Reserve will obtain adequate information by employing the first alternative and will still improve their modeling. In addition, the effective partner share rate is not defined. The lack of a documented definition may lead to ambiguity amongst the responders.

Schedule D.3 also should be revised at the line item level in the following areas.

- *Add line number to correspond profit sharing RLSAs to FR Y-9C:* For RLSAs that are classified as profit sharing, there is no reporting line number in the proposal to capture the integer code corresponding to the line item in which the partner's share of profit sharing is reflected on the reporting firm's FR Y-9C. Adding a line number to correspond the line item on the Schedule D.3 and the FR Y-9C will streamline reporting. However, the linking to FR Y-9C reporting should not be required monthly, as the FR Y-9C is submitted quarterly.

- *Gross charge-offs and gross recoveries:* The proposal would include gross charge-offs, which include principals and interest and fee charge-offs, on lines 10-11. However, reporting gross charge-offs does not align with accounting principles for principal charge-offs vs. interest and fee charge-offs. Principal charge-offs are classified as "losses subject to sharing" and the associated "loss share amount," but interest and fee charge-offs are "contra-revenue subject to sharing" and the associated "revenue share amount." In addition, the proposal does not indicate whether reported recoveries should be gross recoveries, consistent with gross charge-offs, or principal recoveries. If gross recoveries, this raises the same issue as described above with respect to gross charge-offs.

F. The Federal Reserve should make changes to the proposed reporting of private equity exposures.

Currently, the Federal Reserve projects private equity exposure for firms that are required to submit Schedule F.24 (Private Equity), which means Category I, II, and III firms with substantial trading operations (average aggregate trading assets and liabilities of $50 billion or more, or equal to 10% or more of total consolidated assets).[422] The Federal Reserve proposes to revise the thresholds for reporting private equity exposure on Schedule F.24. For Category I, II, and III firms, a material portfolio would be one with asset balances greater than $5 billion or asset balances greater than 5% of tier 1 capital on average for the four quarters preceding the reporting.[423] For Category IV firms, a material portfolio would be one with asset balances greater than $5 billion or asset balances greater than 10% of tier 1 capital on average for the four quarters preceding the reporting.[424] However, the Federal Reserve does not propose how to define "material portfolio." For example, a firm's aggregate PE assets could meet the proposed thresholds, but not if its assets are broken out into lines of business. However, if Schedule F.24 is intended to include

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422 *Id.* at 51,935.

423 *Id.*

424 *Id.*

aggregate assets, then there would be no "leftover" assets to include in Schedule K. The Federal Reserve should therefore clarify the definition of "material portfolio" for purposes of Schedule F.24.

We recommend new line items be created in FR Y-14Q Schedule F.24 as follows in which to report the deduction amounts rather than providing them as an offset to aggregated carrying value amounts for respective sector and country group exposures:

- New line to capture a single aggregate number representing capital in unconsolidated financial institutions in excess of applicable 10% CET1 first deduction threshold; and

- New line item(s) to capture the embedded goodwill and carrying value for each investment that has embedded goodwill, to allow the Federal Reserve to model goodwill on a standalone basis, as described in Section IV.M.1.

We also recommend the following changes to reduce reconciliation challenges and overall reporting burden:

- *Collapse Rows Relating to Global Industry Classification Standard ("GICS") in Sub-Schedules F.24 and F.25:* Firms often assign clients a North American Industry Classification System ("NAICS") code during onboarding and must spend significant resources to manually map NAICS codes to the GICS taxonomy. This mapping must be regularly reviewed and validated for any GICS or NAICS updates. To eliminate production and control burden, the Federal Reserve should collapse all rows referring to GICS codes in sub-schedules F.24 (if retained) and F.25 into a single row (*e.g.*, "all other") while keeping non-industry rows (*e.g.*, tax credits, BOLI/COLI, and stable value wraps) as needed. In the alternative, the Federal Reserve should provide a mapping of NAICS codes to GICS codes to reduce firms' reporting burden.

- *Remove Private Equity tab from 14Q Schedule F:* Private equity exposures and their associated hedges should be included, by their underlying asset class, in a separate version of Schedule F and should be as of the nine-quarter scenario jump-off date, not the GMS as of date.

- Remove private equity positions from Schedule F.23 IDR: Jump to Default tab and reflect as such accordingly in instructions.

- *Incorporate SBIC Funded and Unfunded rows into Schedule F.24:* To reduce ongoing reporting burden while maintaining transparency around Small Business Investment Company ("SBIC") exposures, we recommend that the Federal Reserve incorporate SBIC-specific Funded and Unfunded rows into F.24 Private Equity. This change would allow firms to report SBIC interests directly within the standardized F.24 framework and would eliminate the need for the recurring SBIC Special Data Collection. While the special collection has required additional detail—such as license type and fund asset debt/equity weighting—capturing these elements within the F.24 schedule would introduce unnecessary operational burden and complexity without materially improving risk

assessment, so the Federal Reserve should not include these additional items in Schedule F.24.

The Federal Reserve also proposes a December 31 as-of date for Schedule F.24 and Schedule K. This date should align with the proposed jump-off date for the rest of the data, September 30, or should remain December 31 if the Federal Reserve adopts our proposal to maintain the December 31 jump-off.[425] Since Schedule F.24 has a different as-of date than the rest of Schedule F, it should be separated from Schedule F (Trading) and submitted as a separate instance of Schedule F.

The Federal Reserve proposes to require firms to report private equity carry value net of embedded goodwill or investments in the capital of unconsolidated financial institutions that are deducted from CET 1 (*i.e.*, if amounts are deducted, remove them from the carry value).[426] Non-advanced approaches firms currently are not required to deduct goodwill embedded in the valuation of significant investments in the capital of unconsolidated financial institutions. Further, non-advanced approaches firms are not required to deduct investments unless they exceed the 25% CET1 thresholds. Accordingly, the Federal Reserve should not use a different threshold for private equity reporting.

The Federal Reserve should also clarify whether to report original PE exposures that become securitizations. Private equity commitments may be treated as "securitization" exposures if the original exposure changes (*e.g.*, fund becomes levered and there is tranching of credit risk). The Federal Reserve should confirm that an original private equity exposure would no longer need to be reported on Schedules F/K if it becomes a "securitization" for Basel III regulatory capital purposes.

G. The Federal Reserve should reflect synthetic securitization risk transfer hedges in the supervisory stress test and update the FR Y-14 reports to collect the relevant data.

The Federal Reserve has undertaken a special data collection regarding synthetic securitization risk transfer hedges and has noted that it reflects these hedges in its stress tests.[427] However, precisely how the stress test accounts for these hedges is not specified. Synthetic securitization risk transfers are important credit risk mitigation tools that many firms use to reduce risk exposure. The Federal Reserve should recognize the credit risk mitigation of synthetic securitizations in the supervisory stress test or, if already recognized, explain the mechanics. Specifically, the Federal Reserve should disclose how it has reflected past special collection data regarding synthetic securitization risk transfer hedges in the stress test results.

Specifically, firms may purchase first-loss or other subordinated credit protection from third parties that references an on-balance sheet portfolio of loans (*e.g.*, residential mortgage loans or C&I

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425 *Id.* at 51,862.

426 *Id.* at 51,935.

427 *See* Federal Reserve, *2025 Federal Reserve Stress Test Results* at 10 (June 27, 2025) ("Synthetic securitizations are a form of loss mitigation in which a bank partially transfers credit risk on specific portfolios to outside investors through credit derivatives or guarantees. The Federal Reserve incorporated a richer dataset and considered this type of credit protection in modeling fair-value-option/held-for sale loan losses."), *available at* https://www.federalreserve.gov/publications/files/2025-dfast-results-20250627.pdf.

loans) or derivative counterparty exposures, including through credit default swaps, credit-linked notes, or other securitization transactions. This purchased protection is specifically structured to limit losses on any senior tranches retained by the firm purchasing the protection. The current FR Y-14Q, Schedule L and FR Y-14M do not provide firms with the ability to present data that would allow the supervisory models to capture the benefit of this tranched purchased credit protection on modeled losses for the underlying loan and derivative portfolios. Therefore, the Federal Reserve should create a new optional schedule that would allow the Federal Reserve to more appropriately calculate stressed losses on these loan and derivative portfolios. To improve the accuracy of its modelling for these exposures, this schedule should capture data on (i) loan or derivative portfolios with tranched credit protection; (ii) the amount and nature of non-pro rata protection purchased; (iii) whether the firm applies securitization capital treatment; (iv) the amount of subordination (*i.e.*, attachment and detachment point); and (v) the asset class.

H. The Federal Reserve should consider additional ways to streamline and reduce the burden of FR Y-14 reporting.

The Federal Reserve has taken steps to reduce the burden of FR Y-14 reporting on firms and should continue to consider additional ways to do so. One significant way to reduce burden would be to establish factors for firms to consider in developing materiality frameworks for FR Y-14M and FR Y-14Q reporting. This would allow the Federal Reserve to continue to collect data on material items, while minimizing burden on firms. Alternatively, the Federal Reserve could indicate which data elements are critical data elements and make reporting on non-critical elements optional or best efforts.

In addition, the Federal Reserve should remove edit checks that tend to produce false positives and establish an acceptance threshold on the FR Y-14Q edits checks, similar to FR Y-14M reporting. Certain edit check items can produce a significant amount of false positive errors, requiring firms to dedicate significant resources to analyze false positives when the data is often correct. For example, firms often have to review thousands of false positive edit checks on Schedule H.1 of the FR Y-14 across client financial attributes for obligors that meet the criteria for exclusion from providing client financial data. To lessen the outsized burden on firms associated with false positives, the Federal Reserve should modify its required edit checks to exclude these obligors. Further, the Federal Reserve should establish an acceptance threshold for FR Y-14Q edit checks. This would reduce the burden of reviewing thousands of records to identify just one or two errors.

In addition, the Federal Reserve should limit the collection of historical FR Y-14Q data for firms newly reporting on the form. A new FR Y-14 reporter is currently required to furnish historical reports of the FR Y-14Q PPNR and Retail schedules for all periods from when it first submits the FR Y-14 back to March 2009 and January 2007, respectively. In its June 2024 proposal to amend the FR Y-14 reports, the Federal Reserve proposed to amend the FR Y-14Q instructions to require new reporters (or existing reporters that must begin filing a Retail schedule) to provide historical reports only for the five years preceding the first quarter that the firm is subject to reporting.[428] The Federal Reserve should adopt these amendments as part of any future changes to the FR Y-14 reporting instructions.

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[428] Federal Reserve, *Proposed Agency Information Collection Activities; Comment Request*, 89 Fed. Reg. 52,042, 52,043 (June 21, 2024).

Further, in line with the Federal Reserve's stated objective to reduce unnecessary information and data collections as part of firms' annual capital plan submissions, the Federal Reserve should streamline firms' FR Y-14A reporting. The Federal Reserve should remove the requirement to submit FR Y-14A Schedule F and limit the collection of multiple versions of FR Y-14A schedules related to Business Plan Changes for Supervisory Stress scenarios to those that have an explicit supervisory use case. For example, when the Federal Reserve calculates firms' SCBs, it excludes the impact of business plan changes and includes stylized capital actions. Further, the Federal Reserve's and firms' public disclosures demonstrate that they also exclude the impact of such business plan changes. As such, only the FR Y-14A version which incorporates these assumptions related to business plans is relevant for those elements of the exercise's stated objectives.

The Federal Reserve should also consider the following additional ways to streamline or improve reporting on specific items.

FR Y-14M

Frequency: To reduce burden, the FR Y-14M reporting should be required on a quarterly basis, rather than monthly.

Schedules A and B: The Federal Reserve should make the following changes to Schedules A and B of the FR Y-14M reports.

- *Reduce the reporting period for involuntary terminations of residential mortgage loans and home equity loans and lines of credit reported on Schedules A and B:* In the case of involuntary terminations, firms must report on Schedule A domestic first lien closed-end 1-4 family residential mortgage loans for up to 24 months following termination, or until line items 93, 94, 95, and 121 are available report. Similarly, for involuntary terminations of any first liens of home equity loans and home equity lines of credit reported on Schedule B, firms must report loans for up to 24 months following termination, or until the data in line items 99, 100, and 101 are available to report. In both schedules, if such data are available sooner, firms are not required to continue reporting these loans in the following months. To reduce the burden of maintaining non-active records in bank submissions, the Federal Reserve should reduce the reporting period in both Schedules A and B from 24 months to six months.

- *Remove certain fields:* The Federal Reserve proposes to retire field 51 ("Pre-Payment Penalty term") in Schedule B.1, which means that field 50 ("Pre-payment Penalty Flag") should also likely be retired.[429] The Federal Reserve had also previously proposed to remove field 96 "Troubled Debt Restructure Flag" from Schedule A and fields 55 "Troubled Debt Restructure Date" and 90 "Other Modification Action Type" from Schedule B in

[429] The Federal Reserve could also remove the fields from Schedule A.1, which also has the also has fields 46 "Pre-payment Penalty Flag" and 47 "Pre-Payment Penalty Term."

2024.[430] If the Federal Reserve does not use these fields for stress modeling, they should also be removed.

Schedule C: The Federal Reserve should consider eliminating Schedule C (Address Matching) of the FR Y-14M because it adds only one unique data field. The proposal would eliminate the Mailing Address fields,[431] which would leave Census Tract as the only unique field in this schedule. Because all other data is already included in the Y-14M Schedule A.1 and B.1, it should therefore not be required as a separate schedule.

Schedule D: The Federal Reserve should introduce a simplified mechanism for reporting duplicative data on Schedule D.2 and shorten the reporting period for closed or charged-off credit card accounts reported on Schedule D.

- *Provide a simplified mechanism for reporting duplicative data on Schedule D.2:* Line items 17 (Managed Recoveries), 18 (Booked Recoveries), 19 (Managed Principal Recovery Amount), 20 (Managed Interest and Fees Recovery Amount), 21 (Booked Principal Recovery Amount), and 22 (Booked Interest and Fees Recovery Amount) of Schedule D.2 require firms to report certain information related to managed and booked receivables. In circumstances when securitized receivables are brought back onto a firm's balance sheet, line items 17 and 18, 19 and 21, and 20 and 22 are duplicative of each other. To reduce reporting burden, the Federal Reserve should implement a simplification mechanism to avoid unnecessary duplication.

- *Shorten, from 24 to 12 months, the reporting period for closed or charged-off credit card accounts reported on Schedule D:* Firms are required to report information on closed or charged-off credit card accounts for 24 months after closure or charge-off. The Federal Reserve should reduce the reporting period from 24 months to 12 months after closure or charge-off as banks typically do not expect to obtain significant recoveries from these accounts beyond 12 months following closure or charge-off.

FR Y-14Q

Schedule A: The Federal Reserve should revise the FR Y-14Q, Schedule A (Retail) delinquency status fields to streamline the unnecessary reporting burden and improve data quality. The number of delinquency status fields, and the number of days past due for the status fields, vary across the retail schedules and should be revised to be consistent. Further, the Federal Reserve should consider reducing the granularity of the FR Y-14Q Schedule A delinquency status field, aggregating to be more aligned to the FR Y-9C, Schedule HC-N. The FR Y-14Q Schedules A.1-A.10 delinquency status field should be reduced and revised to "01 – Current and 1-29 DPD," "02 – 30-89 DPD," and "03- 90 and more DPD," reducing the burden on firms for maintaining different delinquency status fields for different regulatory reporting purposes.

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[430] 89 Fed. Reg. at 52,048.

[431] Proposal at 51,934.

***Schedule B**:* The Federal Reserve should supplement and revise Schedule B (Securities) to improve modeling accuracy and remove undue data collection.

- *Add a dedicated "coupon rate" field to FR Y-14Q, Schedule B.1 (Securities 2)*: If vendor data is unavailable, the Federal Reserve can ensure it can source the actual coupon rate directly from regulatory reporting—improving data quality and modeling accuracy. If the Federal Reserve cannot source an external rating, it can use the internal rating as a fallback from credit cost.

- *Revise instructions to exclude irrelevant data categories for equity securities*: Several fields in Schedule B.1 are not relevant to equity securities. The Federal Reserve should revise the instructions for such fields to exclude data for equity securities such as "Amortized cost".

***Schedule F**:* The Federal Reserve should revise or streamline the following in Schedule F (Trading) to reduce undue burden on firms' data submission.

- *Permit the submission of Schedule F in either Excel or XML format:* Given the complexity of Schedule F's sub-schedules and the large volume of required data, the Federal Reserve should allow the submission of Schedule F in either XML or Excel format using the prescribed forms. This could reduce burden and the risk of reporting errors.

- *Remove fields from Schedule F that are not used in stress testing*: Certain data in FR Y-14Q Schedule F appears not to be used in the Federal Reserve's stress calculation (Trading P&L or Trading IDL) as disclosed in the model documentation. Reporting such data provides no clear benefit but increases reporting burden on firms due to complexity in sourcing, cleaning, and aggregating data from various systems. Some of the required reporting items are not risk-based and are therefore not used in BAU risk management, but require additional controls/governance for reporting.

***Schedules G.2 and G.3**:* The Federal Reserve must clarify certain points of Schedule G.2 (PPNR Net Interest Income) and G.3 (PPNR Metrics), add data fields to improve accuracy, and further streamline these schedules.

- *Report total noninterest-bearing domestic deposit amounts:* The Federal Reserve should revise Schedule G.2, line item 34A, Noninterest-bearing Demand, to require firms to report the total noninterest-bearing domestic deposit amount for all accounts and not just for demand deposits. The co-mingled interest-bearing and noninterest-bearing deposit amounts which are currently reported on the other line items 34B-34E (money market accounts; savings; NOW, ATS and other transactions accounts; and time deposits) impact and potentially provide less meaningful deposit repricing beta which are reported on Schedule G.3, line items 79-82. Currently, the reporting instructions require that the amounts that are reported in Schedule G.2 on line items 34B-34E are used to determine the average domestic deposit repricing beta, which are reported in Schedule G.3 on line items 79-82 for the respective account types. We believe that the co-mingled amounts which are reported on line items 34B-34E yield less meaningful repricing betas and do not reflect the true sensitivity of firms' interest-bearing domestic deposits. To remove the impact of noninterest-bearing amounts from the betas, we recommend that the instructions for Schedule G.2 line item 34A be changed so that

noninterest-bearing domestic deposits for all types of accounts are reported on this line and not restricted to noninterest-bearing demand deposits.

- *Revise Schedule G.2 to allow more granular detail for long term debt*. The Other Interest-Bearing Liabilities (47) line item of Schedule G.2 should be divided into two subdivided line items: one for instruments matching the CUSIP reported on the proposed new Schedule B.4 and one for all other.

- *Reduce reporting burden of Schedule G.2 and clarify Schedule G.2 instructions*: The Federal Reserve should reduce the reporting burden of Schedule G.2 and clarify instructions in Schedule G.2 related to the reporting of AFS and HTM securities. The granularity of data requested in Schedule G to model PPNR places a significant burden on firms to produce.

    - *Amend Instructions in Schedule G.2 to Align with the FR Y-9C:* Firms must report average quarterly data on AFS and HTM investment securities at market value on line items 10-12. Firms are also required to report these metrics at amortized cost in the FR Y-9C, Schedule HC-K. To reduce burden on firms, the Federal Reserve should align these reporting fields and require reporting on line items 10-12 at amortized cost. In addition, the instructions for line item 11 specify that firms should report the "average balance of AFS/HTM balances in Agency RMBS, as defined in the FR Y-9C, Schedule HC-B, items 4.a.(1), 4.a.(2), 4.b.(1) and 4.b.(2), columns A and D." However, line items 10 and 12 do not include a reference to the specific FR Y-9C column. The Federal Reserve should revise the instructions to Schedule G.2 to explicitly provide the columns to reference on the FR Y-9C.

    - *Reduce the Memo Lines for Other Interest-Bearing Assets and Liabilities on Schedule G.2*: To reduce reporting burden on firms, the Federal Reserve should institute a higher cut-off than 5% for items that do not need to be reported on the memo lines for other interest-bearing assets and liabilities.

Schedules H.1 and H.2: The Federal Reserve should clarify certain points of Schedule H.1 (Corporate Loans) and H.2 (Commercial Real Estate Loans), add data fields to improve accuracy, and further streamline these schedules.

- *Increasing Scoping Threshold for Schedules H.1*: The Federal Reserve should increase the scoping threshold for Schedules H.1 from $1 million to $5 million. Based on how loss rates from the Corporate Model are applied to full balances reported in Schedule M, increasing the scoping threshold would likely have an insignificant impact on modeling results and would significantly reduce reporting burden.

- *Treatment of disposed and FVO/HFS facilities:* The Corporate Model documentation describes how disposed facilities and FVO/HFS facilities reported in Schedule H.1 are excluded before projecting losses, but the CRE Model documentation does not appear to address either population, as reported in Schedule H.2. The Federal Reserve should clarify whether disposed facilities and FVO/HFS facilities reported in Schedules H.1 and H.2 are treated consistently in these models.

- *Revise Instructions for Leveraged Loan Flag*: The Federal Reserve should align with the OCC and FDIC by rescinding the "Interagency Guidance on Leveraged Lending." The Federal Reserve should retain a field for leveraged loans (*e.g.*, Field 97/60 - Leveraged Loan Flag in Schedules H.1/H.2) for which the instruction should be revised and clarified to permit institutions to flag leveraged loans according to their internal risk management framework, developed in accordance with general principles outlined in the Interagency Statement on OCC and FDIC Withdrawal from the Interagency Leveraged Lending Guidance Issuances.

- *Decrease the number of required fields for disposed facilities*: Because disposed facilities will be excluded before projecting losses in the Corporate Model, the Federal Reserve can significantly decrease the number of required fields for disposed facilities to focus on the reason for disposition and other elements that may be useful in understanding the disposal (*i.e.*, Disposition Flag, Disposition Schedule Shift, Cumulative Charge-offs, etc.). For other required fields, there should be flexibility for banks to report data as of the prior period end or current period end depending on the nature of the disposition. If disposed facilities are excluded before projecting losses in the Commercial Real Estate Model, any updates to reporting requirements should align between Schedules H.1 and H.2.

- *Decrease the number of required fields for fronting exposures*: Because all fronting facilities will receive a 0% PD in the Corporate Model, the Federal Reserve can significantly decrease the number of required fields for Schedule H.1 fronting exposures to focus on key data elements like Committed Exposure and Utilized Exposure. Further, it should consider eliminating requirements related to obligor indicative data, obligor financial data, and other data elements for fronting exposures that will not impact stress test model results. Eliminating these requirements would significantly decrease reporting burden without impacting model results. Any updates in fronting requirements for Schedule H.1 should be consistently applied to Schedule H.2.

- *Reduce Schedule H.1 and H.2 reporting fields*: To reduce the burden on firms associated with the reporting of corporate loans, the Federal Reserve should amend Schedule H.1 to: (i) eliminate the requirement to report data on a commitment to commit facility and potential exposures on syndicated pipeline loans given the burden of collecting granular data on loans that are not fully booked or onboarded; (ii) decommission or consolidate Obligor Financial Data reporting fields 52-82 because most of the data fields are not indicative of the financial health of an obligor and the Corporate Model documentation indicates that this data will not be used in estimating the PD[432] and/or treat the submission of such fields for names marked as in default as "best efforts" or optional as such detail is not pertinent or readily available; (iii) align the reporting of past due loans on reporting field 32 with FR Y-9C; (iv) remove reporting fields 94 (Prepayment Penalty Flag), 111 (Obligor LEI) and 112 (Primary Source of Repayment LEI) as they are significantly burdensome; (v) allow industry practice for reporting certain fields, (e.g., for field 23 (Current Occupancy) allow rentable units to be used where applicable instead of only square footage); and (vi) no longer require the reporting of overdrafts on Schedule H.1 because it requires significant resources to collect this granular data, especially since overdrafts are not originated through usual loan

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[432] Credit Risk Models Documentation at 14–15.

protocols. Schedule H.2 should be amended to remove, align and simplify the same reporting items for CRE loans where relevant.

- *Reduce reporting frequency on Schedule H.4*: Schedule H.4 collects internal risk ratings as reported for loans on Schedules H.1 and H.2. Because the internal risk rating definitions are largely static, the Federal Reserve should reduce the frequency of required reporting on Schedule H.4 from quarterly to annually, or only require reporting when there is a change to an internal risk rating.

- *Align Schedule H with FR Y-9C*: Because the FR Y-9C instructions were updated to include all Margin Loans in Y9C HC-C Line 9b1, non-purpose margin loans are no longer in scope of Schedule H as they do not fall within the list of categories considered corporate loans per the Schedule H instructions. We therefore suggest the removal of the following paragraph from the H.1 instructions: "Report non-purpose loans reportable in the relevant FR Y-9C, Schedule HC-C categories outlined above and in Field 26 'Line Reported on FR Y-9C' regardless of whether those loans are 'graded.' For purposes of this schedule, non-purpose loans are loans collateralized by securities made for any purpose other than purchasing or carrying securities."[433]

- *Remove interest income tax status*: In the 2024 draft instructions, the Federal Reserve indicated that H.1 field 43 Interest Income tax status would be retired. While most of the 2024 instruction updates are on hold, we suggest retiring this field as it is not used by Federal Reserve.

- *Add an indicator for loans collateralized by agency mortgages*: As discussed in Section IV.A.2, the proposed approach to modeling LGD in the Corporate Model is not suitable for agency warehousing. To properly account for these loans, the Federal Reserve should add an indicator to the loan purpose field in Schedule H.1 for firms to identify loans that are collateralized by agency mortgages.

Schedule K: The Federal Reserve should eliminate reporting fields in Schedule K captured in other FR Y-14Q schedules. The Federal Reserve should decommission portions of Schedule K that are captured in other FR Y-14Q schedules (*e.g.*, Columns B, E, and F). These reflect de minimis positions and it is not clear how this data is useful in stress testing.

Schedule L: The Federal Reserve should refocus and clarify several points in Schedule L (Counterparty).

- *Refocusing Counterparty Risk:* The Federal Reserve should consider refocusing Counterparty Risk reporting by limiting the scope to top 100 counterparties as it represents a sizable portion of the overall CVA with material exposure rather than requiring 95% of Credit Valuation Adjustment (CVA) exposure.

- *Clarify Stressed LGD Equation*: CVA Model documentation Figure G-1 lists "Stressed LGD (PD) FR Scenario (Severely Adverse) CACBR498" as a $CVA_{95}(s)$ calculation input. Please confirm whether Figure G-1 should instead reference "Stressed LGD (CVA) FR Scenario (Severely Adverse)

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[433] Draft FR Y-14Q Instructions at 169.

CACBR495", which is described in Schedule L.2 report instructions as "LGD used to calculate CVA in the applicable stressed scenario."

- *Eliminate Select Reporting Fields*: To streamline firm reporting, the Federal Reserve should amend Schedule L to remove: (i) from sub-schedule L.5 the requirement that firms rank counterparties by exposures to client-cleared derivatives because client-cleared derivatives often involve the collection of initial margin and subject banks to minimal exposure; (ii) sub-schedule L.1.f, which requires firms to summarize the bottom 5% of CVA, because the information it provides is immaterial and burdensome to provide as it requires a lot of reference data to report in the required format; (iii) sub-schedules L.5.2, L.5.3, and L.5.4 because the required data is not useful in stress testing; (iv) the "Total Notional," "New Notional During Quarter," "Weighted Average Maturity," "% Gross Current Exposure with CSAs," and "Downgrade trigger modeled?" reporting items on sub-schedules L.1.a and L.1.b; (v) the "Mapping Approach," "Proxy Mapping Approach," "Proxy Name," "Market Input Type," "Ticker/Identifier" and "Source" columns of sub-schedules L.3.a and L.3.b; (vi) the "Counterparty Legal Entity Industry Code," "Counterparty Legal Entity Country," "Counterparty Legal Entity Internal Rating," and "Counterparty Legal Entity External Rating" columns of sub-schedules L.2.a, L.2.b, L.3.a, and L.3.b as they are repeated in sub-schedules L.1.a and L.1.b; and (vii) "Threshold CP," "Threshold BHC or IHC or SLHC," "CDS Reference Entity Type," and "5Y CDS Spread (bp)" in sub-schedule L.5.1, which the Federal Reserve acknowledged have provided "minimal value in . . . supervisory activities."[434]

FR Y-14A

Schedule A: The Federal Reserve should make the following changes to Schedule A.

- The Federal Reserve should consolidate reporting schedules on held-to-maturity and available-for-sale securities. Schedules A.3.f and A.3.g require firms to furnish information on projected amortized costs and provisions for credit loss for held-to-maturity and available-for-sale securities across the nine-quarter planning horizon—broken down into 17 classes of securities. Requiring firms to populate data across multiple schedules and perform cross-schedule reconciliations for the same class of security is cumbersome and imposes a significant burden on firms. The Federal Reserve should decommission these schedules and instead collect certain of this data on Schedule A.1.b by class of security.

- Schedule A.2.a should be decommissioned because it is duplicative of other information collections. Schedule A.2.a requires firms to provide projections of business-line level balances and losses on held-for-investment loans accounted for at amortized cost. Because much of the information collected on this schedule is also collected on other reporting forms, including the FR Y-9C, the Federal Reserve should decommission it.

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[434] 89 Fed. Reg. at 52,045.