

THE JOURNAL OF FEDERAL AGENCY ACTION

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U.S. Banking Agencies Propose New Rules to Reduce Regulatory Capital Requirements for Banks

Jeffrey D. Haas, Paul M. Aguggia, Shawn M. Turner,
Dimitri Nionakis, and Rolland A. Hampton*

In this article, the authors highlight several key elements of three interconnected proposals by federal banking agencies to implement reforms undertaken by the international Basel Committee on Banking Supervision in response to the global financial crisis.

The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (collectively, the Agencies) have jointly issued¹ three interconnected Notices for Proposed Rulemaking (collectively, the 2026 Proposals) to implement reforms undertaken by the international Basel Committee on Banking Supervision (BCBS) in response to the global financial crisis.

The 2026 Proposals formally rescind the Agencies' 2023 Basel III Endgame Framework (2023 Framework) and, as explained² by Vice Chair Michelle Bowman, are intended to "modernize" the U.S. regulatory capital framework for banking organizations of all sizes and notably bring certain activities such as mortgage origination and servicing back within the Agencies' regulatory perimeter.

Combined, the 2026 Proposals exceed 1,500 pages and address nearly every section of the existing regulatory capital requirements. This article highlights several key elements of the 2026 Proposals, with a particular focus on distinctions from the 2023 Framework and the Agencies' current capital rules.

Category I and II Banking Organizations Will No Longer Be Required to Calculate Risk Weights Using Dual Methodologies

Under the current capital framework, Category I and II banking organizations are required to calculate two separate sets of

risk-based capital ratios under what is known as the Dual Stack Approach. The Dual Stack Approach requires one calculation using the Standardized Approach (generally applicable to all banking organizations) and a separate calculation using the Advanced Approaches (specifically applicable to each banking organization's own internal model). Banking organizations are consequently bound by the more stringent of the two calculations.

Under the 2026 Proposals, capital ratio calculations under the Dual Stack Approach would no longer be required. The Advanced Approaches would be eliminated and in its place Category I and II banking organizations would be subject to a single set of risk-based capital ratio requirements calculated using the Expanded Risk-Based Approach (ERBA). The ERBA introduces standardized requirements for credit risk, equity risk, operational risk, market risk and credit valuation adjustment (CVA) risk.

Only Category I and II Banks Face Mandatory Application of the Proposed ERBA

The 2021 Proposals would make the ERBA—which introduces standardized requirements for market risk, operational risks, CVA risk, and credit risk and securitization—available on a voluntary basis to banking organizations that are not classified as Category I or II. Category III and IV banking organizations would therefore not be obligated to implement the ERBA's multifaceted capital framework.

Although the decision to opt in the ERBA would be optional, the Agencies' analysis suggests that some Category III and IV banking organizations whose balance sheets would benefit from greater risk sensitivity may benefit from opting in the ERBA framework as a result of the ERBA's differentiated risk-weight treatments for traditional banking exposures, including mortgage, corporate and retail.

Market Risk Requirements

The 2026 Proposals would revise and expand the market risk capital framework. The revised market risk framework would apply to Category I and II banking organizations regardless of the volume of their trading activity. For other banking organizations, the market risk framework would apply when an organization has

(1) more than \$5 billion in average trading assets and liabilities (measured using four-quarter averages rather than point-in-time amounts), or (2) trading assets and liabilities equal to or higher than 10 percent of total assets.

Notably, the 2026 Proposals raise the existing dollar threshold from the market risk framework from \$1 billion to \$5 billion, reducing the number of institutions subject to market risk capital requirements.

Operational Risk Capital Requirements

The current Standardized Approach (SA) does not include a discrete operational risk charge as it is implicitly embedded in credit risk weights. Under the proposed ERBA framework, operational risk would for the first time carry an explicit, separately calculated capital requirement for Category I and II banking organizations.

Under this framework, risk-weighted assets for operational risk would equal 12.5 times the business indicator component (BIC). The BIC is derived from financial statement inputs, including interest income, interest expense, interest-earning assets, and categorized noninterest income and expense. The resultant 12.5 factor would be applied so that the resulting risk-weighted assets generate capital requirements equivalent to an 8 percent total capital charge against the measure of operational risk exposure.

Credit Valuation Adjustment Risk Requirements

The 2026 Proposals introduce an explicit capital requirement for CVA risk, which is the risk of loss arising from changes in the fair value of derivatives due to changes in the creditworthiness of a derivative counterparty. The CVA risk framework would apply to (1) all Category I and II holding companies, (2) depository institutions that are subsidiaries of Category I or II holding companies and have significant trading activity, and (3) other banking organizations with significant trading activity and at least \$1 trillion in notional derivative exposure.

The proposal provides two methods for calculating CVA risk capital requirements. The Basic Approach for CVA (BA-CVA) recognizes only the credit spread component of CVA risk and is the simpler of the two measures. The SA for CVA (SA-CVA) accounts

for both the credit spread and exposure components of CVA risk and allows a banking organization to recognize hedges for the exposure component.

Only a banking organization that uses SA for Counterparty Credit Risk (SA-CCR) would be eligible to use SA-CVA. Organizations using the current exposure methodology for counterparty credit risk would be required to use BA-CVA. In addition, a banking organization must receive prior supervisory approval to use the SA-CVA approach.

CVA risk positions would be defined to exclude client-facing derivative transactions and cleared transactions. Banking organizations have the option to exclude eligible credit derivatives for which they already recognize credit risk mitigation benefits in their counterparty credit risk capital requirements.

Credit Risk and Securitization Requirements

The ERBA would largely incorporate the existing treatments for credit risk mitigation, including collateral haircut approaches for eligible margin loans and repo-style transactions, as well as guarantees and credit derivatives with certain modifications to increase risk sensitivity. The collateral haircut approach would be revised to adjust market price volatility haircuts and introduce a modified formula reflecting netting and diversification benefits.

The 2026 Proposals would also introduce eligible prepaid credit protection arrangements as a new category of recognized credit risk mitigants, available across all exposure types, including securitizations. The securitization framework would be updated to replace the Simplified Supervisory Formula Approach with a materially similar SA (SEC-SA), remove the gross-up approach, introduce a 100 percent risk weight floor for senior tranches of nonperforming loan securitizations, and establish a 15 percent floor for SEC-SA calculations. Credit-enhancing, interest-only strips would be deducted from Common Equity Tier 1 (CET1) capital.

Revised Standardized Approach Will Provide Meaningful Relief to Community Banks

The 2026 Proposals would revise the U.S. SA to risk-based capital for banking organizations not subject to the ERBA and that

have not elected to use the community bank leverage ratio (CBLR) framework.

The SA proposal makes significant modifications to the current definition of “regulatory capital,” including the elimination of the mortgage-servicing asset deduction and requirement for Category III and IV banking organizations to include elements of Adjusted Other Comprehensive Income (AOCI) when calculating CET1 capital. The SA additionally introduces several enhancements to improve the risk capture of off-balance sheet exposures, consistent with the treatment proposed in the ERBA.

The Agencies estimated that the SA proposal would decrease CET1 by approximately 8.6 percent for covered depository institutions and 6.8 percent for covered holding companies relative to the current SA, assuming no AOCI impact.

Elimination of Mortgage Servicing Asset Deduction

One of the most consequential proposed changes for banking organizations lies in the 2026 Proposals’ capital treatment of mortgage exposures and mortgage servicing assets (MSAs). Under the current rules, banking organizations are allowed to hold MSAs up to delineated thresholds (10 percent individual and 25 percent aggregate) of the banking organization’s CET1 capital without penalty, though MSAs held in excess of delineated thresholds must be fully deducted from CET1.

The 2026 Proposals would eliminate the current incrementally punitive MSA deduction framework in favor of a more traditional risk-weighted approach. Instead of being subject to threshold-based decisions, MSAs would instead receive a 250 percent risk weight. The elimination of the MSA deduction framework would notably also apply to banking organizations that are not subject to risk-based capital requirements, such as those subject to the CBLR framework.

The Agencies explain that this change is designed to promote mortgage origination and servicing by banking organizations. In particular, Vice Chair Bowman remarked³ that the Proposals would “reduce incentives for traditional lending activities—like mortgage origination, mortgage servicing, and lending to businesses—to migrate outside of the regulated banking sector.” The Agencies

solicited comments on whether 250 percent is the appropriate risk weight for MSAs.

Accumulated Other Comprehensive Income

The 2026 Proposals would require banking organizations with assets greater than \$100 billion (Category III and IV) to include AOCI in CET1 capital. Currently, only Category I and II banking organizations are required to include AOCI in CET1 capital, which generally has the effect of reducing a banking organization's CET1. Category III and IV banking organizations would be subject to a five-year transition period for phase-in recognition of AOCI in CET1 capital to avoid a large, immediate increase in capital requirements.

Treatment of Off-Balance Sheet Exposures

- *Revised Definition of Commitments.* The definition of “commitments” would be revised to identify which off-balance sheet exposures more clearly are subject to risk-based capital requirements. This clarification is intended to reduce ambiguity in the application of the framework and improve consistency across institutions.
- *Modified Credit Conversion Factors.* The proposal modifies the conversion factors applicable to certain credit and equity commitments, improving the alignment of capital requirements with the underlying exposure risk of those instruments. For example: Currently, commitments that are not unconditionally cancelable receive a 20 percent credit conversion factor if their original maturity is one year or less, while credit commitments with an original maturity of more than one year receive a 50 percent credit conversion factor. The 2026 proposals would subject all commitments that are not unconditionally cancelable to a 40 percent credit conversion factor, regardless of the maturity of the facility.
- *New Methodology for Commitments Without Preset Limits.* For commitments without fixed limits, a new exposure methodology is proposed under which the exposure

amount is based on the highest drawn amount over the previous 24 months. The exposure amount serves as an indicator of the amount of credit a banking organization is likely to extend to an obligor in the future. Designed to better approximate the future exposure of such commitments and generally aligns with the methodology proposed in the ERBA, this change is most pertinent to Category III banking organizations.

- *Unconditionally Cancelable Commitments.* The 2026 Proposals retain the zero percent credit conversion factor for unconditionally cancelable commitments for purposes of risk-based capital requirements. This treatment is unchanged from the current SA, preserving the existing capital treatment for this category of off-balance sheet exposure. For Category III banking organizations, the treatment of unconditionally cancelable commitments under the supplementary leverage ratio would not change.

Recalibration of GSIB Surcharge Framework

The Global Systemically Important Bank (GSIB) Surcharge Proposal aims to improve the capital framework's measurement of systemic risk and would make five key amendments to the FRB's GSIB surcharge rule and to the Systemic Risk Report (FR Y-15), including changes to (1) Method 2 coefficients, (2) short-term wholesale funding measure, (3) Data averaging indicators, (4) Method 2 score bands to reduce cliff effects, and (5) content of FR Y-15 Reporting and Systemic Indicator Changes. Under the proposal, the FRB estimates that GSIB surcharges would decrease by 40 basis points on average, with the aggregate dollar amount of GSIB surcharges falling by approximately \$23 billion, or 10 percent.

- *Method 2 Coefficients.* One-Time Adjustment and Annual Indexing: The proposal would make a one-time downward adjustment to the fixed Method 2 coefficients by a factor of 1.2 and thereafter index those coefficients annually based on a three-year moving average of nominal U.S. gross domestic product growth, with no upward adjustment if the moving average is negative. The 1.2 adjustment factor would equal the observed 20 percent difference between

the cumulative growth of aggregate Method 2 and Method 1 scores since the fourth quarter of 2019, rather than since 2015 (Alternative 3), when the rule was originally calibrated. Using the fourth quarter of 2015 as a starting point would have reduced all Method 2 systemic indicator coefficients by 40 percent.

- *Short-Term Wholesale Funding.* The proposal would remove the RWA denominator from the short-term wholesale funding component of Method 2 and recalibrate that component so that it represents approximately 20 percent of aggregate Method 2 scores, rather than the roughly 30 percent weighting that has prevailed in practice.
- *Averaging Data Indicators.* The proposal would require U.S. GSIBs to calculate certain systemic indicators using averages of daily or monthly values rather than point-in-time measurements as of December 31.
- *Reducing Cliff Effects by Narrower Score Bands.* The proposal would narrow the Method 2 surcharge score bands from 100 basis point ranges associated with 50 basis point surcharge increments to 20 basis point ranges associated with 10 basis point increments. This change is not intended to alter the overall calibration of the Method 2 surcharge and would not change the score band ranges for Method 1.
- *FR Y-15 Reporting and Systemic Indicator Changes.* The 2026 Proposals would revise FRB FR Y-15 reporting instructions and refine indicator definitions and treatments for certain items with the intention to improve data consistency and comparability across banking organizations and align the inputs used in both Method 1 and Method 2 reporting. The 2026 Proposals would expand the definition of “financial institution” (including ETFs), incorporate SA-CCR to measure derivative exposures, add two trading-volume indicators to substitutability, include derivatives exposure in cross-jurisdictional activity and revise certain short-term wholesale funding reporting instructions. The 2026 Proposals would clarify, without changing the substance of the current rule, the mechanics governing when an adjusted GSIB surcharge becomes effective. It would also consolidate FR Y-15 reporting for foreign banking organizations onto the same Schedules A through G used by domestic firms.

Overall, the Agencies Seemingly Retreat from Heightened Risk-Weighting Standards

One of the most criticized aspects of the 2023 Framework was the enhancement of required risk-weighting standards above BCBS regimented minimums. The 2026 Proposals seemingly retreat from the enhanced risk-weighting standards propositioned in 2023 and, as Vice Chair Bowman explains, are “designed to address U.S.-specific implementation issues” and “includ[e] modest deviations from the 2017 Basel agreement.”

The FRB voted 6-1 to advance the 2026 Proposals, with Governor Michael Barr as the sole dissenting vote. Barr has publicly⁴ taken exception to the characterization of 2026 Proposals as “modest deviations” and suggests that the 2026 Proposals do not simply retreat from the 2023 Framework’s enhanced capital requirements but instead depart from BCBS agreed upon minimum capital requirements with “over 20 material downward deviations.” Whether and the extent to which the final rule incorporates changes from the BCBS Basel III standard will conceivably be dependent on feedback received during the now-passed comment period.

In Summary

- *Key Insight.* Proposed rules were reintroduced to replace the July 2023 Basel III Endgame Framework, which was widely criticized for heightened capital requirements beyond those regimented by the international BCBS, and include a new expanded risk-based approach for the largest, most internationally active Category I and II banking organizations, a revised Standardized Approach for U.S. banking organizations to report risk-weighted assets and a modified method for calculating capital under the GSIB surcharge framework.
- *Impact.* If collectively passed, the proposed rules would, among other things, eliminate the need for banking organizations to calculate risk weights using multiple methodologies in parallel and reduce the aggregate amount of Common Equity Tier 1 capital that banks are required to hold against losses up to an estimated 4.8 percent for Category I and II GSIB organizations, 5.2 percent for

Category III and IV regional banking organizations, and 7.8 percent for community banking organizations, among other changes.

- *Outlook.* Although impacts will vary by banking organization and asset class, generally, less stringent capital requirements should effectively provide banks with greater balance sheet flexibility to manage and redeploy capital for a variety of objectives such as increased lending, strategic investments, share buybacks, and acquisition considerations.

Notes

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