

Basel III Endgame Evolution

Strategic Implications for Retail Banking

March 31, 2026

On March 19, 2026, the federal banking agencies issued a package of proposed changes to the regulatory capital requirements for banking institutions of all sizes, from the largest GSIBs and super-regional banks to community banks. This package of proposals (the “[Proposed Rules](#)”) is a second full attempt at implementing the 2017 “Basel III Endgame” international framework—following the agencies’ initial package of proposals in July 2023 (the “[2023 NPR](#)”)—to better reflect credit, trading and operational risk in the calculation of regulatory capital ratios. As summarized in our [initial memorandum](#), the Proposed Rules would mark the culmination of a nearly decade-long effort to complete the fundamental overhaul of bank capital requirements initially spurred by the 2008-2009 financial crisis.

As part of our [series of industry-focused client memoranda](#), this alert examines the expected impacts of the re-proposal on market participants within the [mortgage, credit card and retail banking industry](#).

The proposed recalibration of bank capital requirements would implement a structural shift in the banking agencies’ approach towards mortgage and consumer finance, pivoting away from the gold-plated surcharges and punitive risk weights of the 2023 NPR in favor of a framework that prioritizes alignment with international standards and the restoration of risk-based regulatory tailoring to “better support the flow of credit to households” and reduce incentives for these activities to “migrate outside of the regulated banking sector.” Reductions in capital charges for residential mortgage loans (and the elimination of capital deductions for mortgage servicing assets), as well as for most consumer loans (other than credit cards), are expressly intended to expand bank lending in these areas.

The following analysis highlights key aspects of the re-proposal to assist mortgage and consumer finance market participants as they navigate the effects of these revised bank capital rules on their business and strategic planning.

Return to Regulatory Tailoring

While the 2023 NPR would have largely collapsed regulatory “tailoring” efforts by applying a one-size-fits-all “expanded risk-based approach” (“ERBA”) to every bank with at least \$100 billion in assets, the Proposed Rules would restore the threshold for mandatory ERBA compliance to banks in Categories I and II (and, to a modified extent, those with significant trading or derivatives activity), generally consistent with the thresholds for “advanced approaches” and market risk requirements under existing capital rules.¹ Banks of any size would be permitted to opt in to ERBA standards.²

With this return to regulatory differentiation, as a general matter banks with under \$700 billion in total assets³ would continue to be subject to simpler calculations of capital and risk-weighted assets under a “Standardized” approach, and be exempt from the new operational risk framework (among others) which would have imposed additional capital charges on fee income from various business lines including mortgage servicing and card issuance. For banks subject to either capital approach, the proposed amendments are expected to provide broad regulatory capital relief (with common equity tier 1 capital requirements expected to decline by 2.4% for the largest banks subject to the ERBA, 3% for large regional banks subject to the simplified Standardized Approach, and nearly 8% for Standardized Approach banks under \$100 billion in asset size).

Residential Mortgage Lending

LTV-BASED RISK WEIGHTING SCALES

For balance-sheet mortgage loan exposures, both proposed capital approaches would replace the flat 50% risk-weighting currently applicable under existing capital rules for performing first-lien residential mortgage loans with a more granular, risk-sensitive system based on loan-to-value ratios and whether the loan is dependent on cash flows generated by the underlying real estate.⁴

Both approaches would undo the 20-percentage-point risk weight “gold plating” over the international Basel standards that had been proposed in the 2023 NPR across the spectrum of LTV bands. Compared to the ERBA scale, the Standardized Approach scale would include a five-percentage-point risk-weight “add-on” to each LTV band to account for operational risk associated with mortgage lending activities, but the two scales are intended to

¹ Category III and IV banks would, however, be required to recognize AOCI in regulatory capital, subject to a five-year phase-in period.

² The Proposed Rules estimate that several Category III and IV banks, and about one-third of smaller banks, would see significant reductions in capital requirements by opting in to the ERBA standards.

³ Category II banks that would be subject to Operational Risk, Market Risk, and CVA Risk frameworks also include banks with \geq \$75 billion in cross-jurisdictional activity, regardless of asset size. Market Risk and CVA Risk frameworks would also apply to banks that are not in Category I or II but have significant trading activity (and, in the case of the CVA Risk framework, significant OTC derivative exposures).

Descriptions in this client alert of provisions applicable to banks with “ \geq \$700 billion in assets” would also apply to these other banks that have less than \$700 billion in assets but also significant cross-jurisdictional, trading and/or derivatives activities.

⁴ Mortgages insured by a U.S. government agency, such as the FHA, VA or USDA, would continue to receive a 20% risk weight, consistent with the current capital rules.

result in essentially the same all-in risk-weight for each LTV band after including the separate, standalone operational risk capital charge applicable to ERBA banks.

LTV Ratio	ERBA		Standardized	
	Not Cash-Flow-Dependent	Cash-Flow-Dependent	Not Cash-Flow-Dependent	Cash-Flow-Dependent
≤50%	20%	30%	25%	35%
50% < LTV ≤60%	25%	35%	30%	40%
60% < LTV ≤80%	30%	45%	35%	50%
80% < LTV ≤90%	40%	60%	45%	65%
90% < LTV ≤100%	50%	75%	55%	80%
>100%	70%	105%	75%	110%

As shown in the table above, compared to the flat 50% risk-weight under current rules, the Proposed Rules would apply an equal or lower risk weight to mortgages with up to a 90% LTV under the Standardized Approach, or up to a 100% LTV under the ERBA, for non-cash-flow-dependent mortgages. Cash-flow-dependent mortgages would receive an equal or better risk weight compared to current standards up to an 80% LTV, under both the Standardized Approach and ERBA. Notably, the agencies estimate that 97% of banks’ residential mortgage loan exposures would *not* be considered “cash-flow-dependent.”

The effects of this risk-weighting scale for a particular bank will depend on the composition of that bank’s mortgage loan portfolio. However, the banking agencies estimate that, for performing first-lien mortgages on owner-occupied housing, the Proposed Rules would reduce the average risk weight on current balance sheet mortgage portfolios by 30% (from 50% to approximately 35%) across Standardized Approach banks, and by 10% (from 50% to approximately 45%) across ERBA banks (on an all-in risk weight basis).⁵

Further, the dynamic nature of the LTV-based risk weighting system may bolster the risk-weighting benefits over time compared to the static, one-time risk weight assignment under current capital rules. Specifically, while a mortgage retains its original risk weight until payoff under current rules, the Proposed Rules would allow a mortgage loan to migrate into lower bands on the LTV scale as it is amortized, resulting in progressively reduced risk weights over the life of the loan as the borrower pays down loan principal. The Proposed Rules provide that the bank would continue using the value of the property at origination, without requiring an updated appraisal on the property to transition the loan to lower LTV bands.

⁵ Agency data implies an average “all-in” risk weight for ERBA banks’ existing balance-sheet mortgage loans of ~39.5% attributable to credit risk (using the scale of LTV bands), and an ~5.5% risk weight add-on attributable to mortgage lending operational risk across Category I and II banking organizations.

PRACTICAL EFFECTS OF MORTGAGE LOAN RISK-WEIGHT AMENDMENTS

According to the banking agencies, these risk-weighted asset reductions could translate to up to \$643 billion in additional balance sheet lending capacity attributable to the reduced capital requirements for residential mortgage loan assets for Standardized Approach regional and community banks. Applying the same lending-capacity projection method used in the Standardized Approach proposal to banking-agency data in the ERBA proposal, we estimate that the projected risk-weighted asset reductions could translate to up to \$218 billion in additional balance sheet lending capacity attributable to the reduced capital requirements for residential mortgage loan assets for GSIBs and other ERBA banks.⁶

This capital recalibration should be a factor toward reducing, if not reversing, the continued migration of mortgage origination to non-banks in the post-crisis period (which is one of the stated goals of the Proposed Rules). According to banking agency and FSOC data, banks' market share of mortgage originations was nearly 60% in 2014, but has since dropped to approximately 36% (as of Q2 2025). With the proposed changes to mortgage risk weights (together with the additional mortgage-associated operational risk charges discussed below), the re-proposal should reduce balance-sheet and regulatory pressure on banks to retrench from the mortgage market or sell off mortgage portfolios to less-regulated entities.

The mortgage-related capital amendments may also provide an additional incentive toward scale, as the new operational costs of having to separately delineate mortgages by their LTV ratios and cash-flow dependencies "may be material" for smaller banks (according to the banking agencies). Thus, while all banks may gain ground in mortgage lending against nonbanks, regional and mid-sized banks subject to the Standardized Approach may experience the most mortgage-related capital efficiencies when considering the ~10 percentage point all-in risk weight advantage of their current mortgage portfolios over GSIBs' mortgage portfolios,⁷ and their economies-of-scale advantage over community banks.

UNADDRESSED INDUSTRY REQUESTS

While the Proposed Rules introduce substantial capital relief for bank mortgage lending due to the proposed risk-weight amendments, several aspects of mortgage capital treatment that had been widely criticized in the wake of the 2023 NPR remain unaddressed, and might be focal points in the new proposal's comment period.

⁶ Based on (i) bank-agency projected residential mortgage loan risk-weighted assets of \$855 billion for ERBA banks, compared to \$953 billion of residential mortgage loan risk-weighted assets for ERBA banks under current capital rules (implying a total reduction of ~\$98 billion in residential mortgage loan risk-weighted assets, and an average ~44.8% ERBA risk weight for residential mortgage loan exposures, including risk weight attributable to mortgage lending operational risk), and (ii) the lending capacity projection formula described in the Standardized Approach, equal to the asset class RWA Reduction *divided by* its Average Proposed Risk Weight). Without accounting for the offsetting operational risk capital requirements, the projected increase to balance sheet lending capacity attributable to the reduced capital requirements for residential mortgage loan assets for GSIBs and other ERBA banks would be approximately \$249 billion.

⁷ Based on the agencies' projections that current mortgage portfolios of Category III and IV banks would have an average risk weight of ~35% when applying the proposal's LTV-based risk weight classes, compared to ~45% for GSIB mortgage portfolios, as discussed above in footnote 5 and accompanying text.

- *Definition of Cash-Flow-Dependent Mortgages*: The Proposed Rules use a highly conservative test that would deem a mortgage loan (except on a borrower's principal residence) to be "cash-flow-dependent" (and thus subject to elevated risk-weighting bands) if the bank considers *any* cash flows generated by the underlying real estate—*e.g.*, from lease or rental payments or from the sale of the property—in its underwriting of the borrower's repayment ability. A number of public commenters following the 2023 NPR called on the agencies to narrow the scope of "cash-flow-dependent" mortgages (*e.g.*, to incorporate the Basel standard's "materiality" threshold for a bank's consideration of property-generated proceeds to result in the loan being risk-weighted as a "cash-flow-dependent" mortgage), despite the agencies estimating that "cash-flow-dependent" mortgages would constitute only ~3% of residential mortgage exposures. The Proposed Rules largely retain the standards for "cash-flow-dependent" mortgages from the 2023 NPR, but seek further public comment as to whether the agencies should impose any quantitative thresholds on the definition of a "cash-flow-dependent" mortgage.
- *Effect of Mortgage Loan Modifications*: Residential mortgage loans and other retail loans with reduced prospects of payment—including those that are at least 90 days past due, are in nonaccrual status, or have been restructured or modified—are generally subject to an elevated 100% risk weight under current capital rules. The Proposed Rules would retain this elevated 100% risk weight for non-cash-flow-dependent residential mortgages that are past due, in nonaccrual *or have been restructured or modified* (and would apply an even higher 150% elevated risk weight for defaulted cash-flow-dependent mortgages). Consistent with current capital rules, these elevated risk weights would continue to apply to any restructured or modified mortgage loan for the remaining life of the loan, regardless of the borrower's ability to demonstrate a sustained period of repayment performance after the workout.

For other (non-mortgage) retail loans, however, restructurings or modifications alone do *not* necessarily trigger elevated risk weighting. Thus, unlike a mortgage, a previously distressed consumer loan may exit its elevated risk weighting following a loan workout once it is no longer 90 days past due and is removed from nonaccrual status. This dissimilar treatment of mortgage loan workouts faced sharp criticism following the 2023 NPR for its tendency to incentivize foreclosures over equitable loan modifications, and the banking agencies have requested further comment on alternative approaches to distressed loans.

- *Aggregation of Sequential Lien Exposures*: Under existing capital rules, a bank that holds both a first-lien and second-lien residential mortgage exposure on the same property must combine the liens and treat them as a single exposure. This treatment generally provides *favorable* capital treatment to the junior-lien exposure under existing capital rules, because it allows the junior-lien exposure to receive the 50% risk weight available to first-lien mortgages rather than the 100% junior lien risk weight. The proposal's application of this same rule to an LTV-based risk-weighting scale creates the possibility for second-lien mortgages to "taint" the risk weight of the first-lien mortgage held by the same bank, pushing the total exposure into a higher risk-weight band than the first-lien would occupy on a standalone basis. Despite

industry requests for an option to treat sequential liens separately to avoid this outcome, the Proposed Rules retain the mandatory aggregation requirement, specifying that banks “must combine” such exposures for risk weighting purposes.

- *Credit Risk Benefits of Private Mortgage Insurance*: The Proposed Rules, as currently drafted, would require banks to calculate mortgage loan amounts (for purposes of determining the applicable LTV and risk-weight band) without making any adjustments for credit loss provisions or private mortgage insurance. Following the 2023 NPR, industry participants had argued that the lack of capital credit for PMI would inflate the cost of low-down-payment mortgages, which are often designed primarily to benefit low-income borrowers or first-time homebuyers. While the Proposed Rules do not commit to any PMI-related adjustments, the agencies seek comment on the appropriate role of PMI as a credit risk mitigant.

Mortgage Servicing

REMOVAL OF MSA CAPITAL DEDUCTION REQUIREMENTS

Under current capital rules, banks are required to *deduct* mortgage servicing assets from regulatory capital, dollar-for-dollar, to the extent that the bank’s MSAs exceed certain thresholds of the bank’s capital base: highly punitive “sin buckets” of 10% (individually) and 15% (in the aggregate with certain other exposures) of the bank’s CET1 capital in the case of the largest “Category I” and “Category II” banks, and an only somewhat less-punitive 25%-of-CET1 individual limit for all other banks.

Mortgage bankers have long blamed these punitive bank capital rules for driving an “exodus” of banks from the mortgage servicing market. According to FSOC data, banks serviced ~80% of outstanding mortgages in 2013 (and 96% of mortgage balances in 2008), but that servicing market share has since plummeted to approximately 41% (as of Q2 2025).⁸

The 2023 NPR would have eliminated the simplified capital deduction approach for Category III and IV banks (instead requiring those banks to make MSA capital deductions using the stricter “sin bucket” approach currently applicable to advanced-approaches banks), and thus would have exacerbated the capital-rule discouragement of banks from servicing mortgages and purchasing MSAs. This change would have disproportionately affected banks that more heavily rely on an originate-to-distribute (“OTD”) mortgage business model, since originate-to-hold portfolio lending does not result in the creation of separate MSAs for capital purposes.

Not only would the Proposed Rules undo the 2023 NPR’s tightening of capital deduction requirements for regional banks, but they would also take a significant further step of completely removing *any* requirement to deduct MSAs from regulatory capital for *all* banks. As drafted, the Proposed Rules would apply a 250% risk weight

⁸ FSOC 2025 and 2024 Annual Reports.

to all MSAs (equal to the risk weight currently applicable to MSAs that are not deducted from regulatory capital), but seek public comment on whether another risk weight would be more appropriate for MSAs.

Tellingly, the banking agencies confirmed that none of the ERBA banks had any capital deductions for MSAs as of Q2 2025, and projected that the MSA deduction elimination would have virtually no impact on risk-weighted asset levels for Standardized Approach banks.⁹ Both of these data points directly indicate that banks currently manage their MSA portfolios to remain below existing capital deduction thresholds.

Accordingly, although the elimination of MSA deduction requirements would not materially affect bank capital ratios immediately, this development may incentivize banks to re-enter or grow their presence in the mortgage servicing business. As the banking agencies recognized, banks' reentry into the mortgage servicing market could allow them to better "maintain their relationship with borrowers by retaining customer-facing relationships even after transferring the underlying loans." Eliminating the deduction requirement may also contribute to a more active, liquid and diverse secondary market for MSAs with a greater number of banks willing to participate.

OPERATIONAL RISK FOR MORTGAGE SERVICING

Consistent with the Basel international standards, the Proposed Rules would introduce a standardized capital requirement for operational risk applicable to banks subject to the ERBA framework. This framework would replace the internal models-based "Advanced Measurement Approach" to operational risk (currently applicable to Category I and II banks under "advanced approaches" standards) with a standardized methodology based on the "business indicator," a financial statement proxy for a bank's volume of different component businesses.

While the 2023 NPR included a punitive scalar—the "internal loss multiplier"—that could have increased (but never decreased) operational risk capital charges based on a firm's ten-year loss history, the Proposed Rules eliminate this multiplier (effectively setting it to one). Instead, the Proposed Rules incorporate historical losses as a direct (dollar-for-dollar) additive input to the Business Indicator's noninterest component. As a result, despite removing the 2023 NPR's loss multiplier, the Proposed Rules would still adjust operational risk capital requirements upward by the amount of a firm's average operational losses over a three-year period.

The Proposed Rules also recalibrate the measurement of the "business indicator" to mitigate impacts of operational risk capital charges on fee-based businesses like asset management and custody services. For example, while the 2023 NPR would have measured services income and expenses on a gross basis without any netting or cap (for purposes of determining the scale of a bank's service-related operational risk), the Proposed Rules measure service-related operational risk using fee income and expenses on a net basis. The Proposed Rules

⁹ Capital items deducted from the capital ratio numerator are also removed from the RWA denominator. If banks had meaningful MSAs in excess of the deduction thresholds, the removal of the capital numerator deduction requirement would have also been expected to cause a corresponding increase to the amount of MSAs subject to a 250% risk-weighting for the RWA denominator.

would also simplify the “business indicator” calculation by collapsing the separate business indicator subcomponents from three to two (interest and non-interest components).

For ERBA banks, this operational risk framework would, for the first time, expressly impose capital charges against noninterest income, including mortgage servicing fees and gains on mortgage sales or securitizations. The agencies estimate that this noninterest fee income from residential mortgage activities would generate approximately \$26 billion in additional operational risk-weighted assets (~25% of the total projected operational risk-weighted assets attributable to residential mortgage activities) for ERBA banks.

These new capital charges could be especially concentrated among banks that rely primarily on OTD mortgage models with limited loan retention periods (and thus limited associated interest income). The Proposed Rules’ new operational framework could thus create a financial incentive for GSIBs and other ERBA banks to “tilt” their mortgage exposures toward on-balance sheet portfolio lending and away from OTD models (according to the banking agencies), despite the capital benefits resulting from the eliminated MSA deduction requirements.

Credit Cards

RELIEF PRIMARILY FOR “TRANSACTOR” CARD ACCOUNTS

Currently, credit card balances (as well as other consumer credit exposures) are generally subject to a standardized 100% risk weight. The Proposed Rules would reduce this flat risk-weight for credit card balances to 90% for Standardized Approach banks. For ERBA banks, the Proposed Rule would apply a more risk-sensitive treatment of credit card balances (and other consumer loans), and would remove the 2023 NPR’s “gold plating” (which would have increased risk weights for each category of credit card and other retail exposures by 10 percentage points over the Basel international standards).

Consistent with the Basel III Endgame’s shift toward greater risk sensitivity and granularity for loan exposures, the ERBA would segment the capital treatment of credit card exposures between lower-risk “transactor” exposures with strong and consistent monthly repayment histories, which would receive a preferential 45% risk weight, and other retail card exposures that do not meet these repayment history criteria (which would receive either a 75% or 100% risk weight).¹⁰

The preferential “transactor” risk-weighting applies only to credit cards that have been fully repaid at each scheduled repayment date over a trailing 12-month period. The Proposed Rules do not include exceptions for card accounts with immaterial monthly balances, skipped payments due to bank promotions or grace periods, or missed payments due to simple human error, each despite a number of requests from commenters for the rules to accommodate card accounts that exhibit “transactor” behavior but fail to satisfy the full monthly payment criteria.

¹⁰ As noted below, an exposure must satisfy the “regulatory retail” criteria as an initial matter to qualify for the preferential “transactor” risk weight. The criteria to qualify as a “regulatory retail” exposure is further described below under “Other Consumer Lending.”

LOW-UTILIZATION CREDIT CARDS AND CHARGE CARDS

While current capital rules apply a “credit conversion factor” to capture the off-balance sheet risk of future draws against a bank’s loan commitment, undrawn commitments that are “unconditionally cancelable”—such as many credit cards—are assigned a 0% CCF under the general risk-based capital rules (so that the bank is not required to incur capital charges against the unused portions of such credit card lines). The Proposed Rules introduce a 10% CCF for unconditionally cancelable commitments, adding a significant new capital burden for card issuers despite warnings from a number of commenters following the 2023 NPR that this new requirement could incentivize banks to close infrequently used card accounts or reduce credit card limits.

For “charge cards” with no pre-set spending limit, the Proposed Rules would determine the “undrawn amount” based on the card’s highest daily drawn amount over a 2-year look-back period. This method would be simpler and less punitive than the 2023 NPR’s method for determining a charge card’s undrawn amount (which was based on the cardholder’s average spend over the 2-year look-back period multiplied by a factor of 10x).

OPERATIONAL RISK FOR CARD FEE REVENUE

The Proposed Rules would somewhat mitigate the expected operational risk capital charges for card fee income compared to the 2023 NPR by measuring noninterest fee income and expenses on a *net* (rather than gross) basis, as noted above. However, the Proposed Rules specifically exclude card activities from the scope of “low-risk” businesses for which a 70% operational risk discount is available (*e.g.*, investment management, investment services, and non-lending treasury services) when calculating Business Indicator volume.

Further, ERBA card issuers would still need to separate their “interest” income from their “noninterest” fee revenue—including from interchange fees, membership fees, transaction-related discount revenue, and rewards, marketing, and card member services expenses—for purposes of calculating operational risk charges, despite arguments from commenters that card fees should be included in the “interest component” due to their similarity to interest on a loan (particularly for charge cards and “transactor” cards). Because the operational risk “interest component” is subject to a cap based on the bank’s interest-earning assets while the “noninterest component” is uncapped, this distinction between interest and fee revenue could result in higher capital charges for card issuers whose business model relies more heavily on transaction and membership fees than interest charges.

Other Consumer Lending

LOWER CREDIT RISK BUT HIGHER OPERATIONAL RISK

The Proposed Rules would apply a flat 90% risk weight to general non-card retail exposures (*e.g.*, auto, student, or personal loans)—down from 100% under current capital rules—for Standardized Approach banks, while applying a more risk-sensitive treatment to the retail exposures of ERBA banks.

Specifically, the ERBA would assign a 75% risk weight to a bank’s qualifying “regulatory retail” exposures (including card exposures that do not qualify as “transactor” exposures, as described above) if the bank’s total

exposures to a single retail borrower and its affiliates do not exceed a \$1 million aggregate limit, indexed to inflation.¹¹ Both on-balance sheet exposures and the full notional amount of off-balance sheet exposures would apply towards the \$1 million “aggregate limit” threshold.¹²

Retail exposures that do not satisfy the “regulatory retail” criteria (*i.e.*, that exceed the aggregate limit threshold) would be assigned a 100% risk weight under the ERBA. Significantly, the Proposed Rules specify that if a retail exposure to a single borrower and its affiliates (other than mortgage loans) exceeds the \$1 million threshold, then *none* of the bank’s exposures to that borrower would qualify as “regulatory retail” exposures.

This all-or-nothing eligibility for the favorable 75% retail risk weight has the potential to pose significant cliff effects for ERBA banks. While a consumer loan with a balance of exactly \$1 million would generate \$750,000 in risk-weighted assets, an additional \$1 of loan exposure would cause the bank’s risk-weighted assets to spike by \$250,001. This cliff effect is even steeper for “transactor” exposures which, by definition, must satisfy the “regulatory retail” criteria. Given the even more preferential 45% risk weight for “regulatory retail” exposures that satisfy the additional “transactor” eligibility requirements, crossing the \$1 million exposure “aggregate limit” threshold would more than double the bank’s capital charge against retail exposures to that borrower.

Notably, while retail loan risk-weighted assets would decrease by 10% compared to the current rules under the Standardized Approach, retail lending would represent the only loan category for which all-in risk-weighted assets would *increase* under the ERBA. Agency data included in the Proposed Rules implies an average credit risk weight for retail loans of ~91%, roughly in line with the Standardized Approach risk weight. However, the standalone operational risk capital requirement is projected to add an additional 18% risk-weight charge for ERBA banks’ retail lending, resulting in a combined 9% increase to their retail loan risk-weighted assets.¹³ The high operational risk capital charge for retail lending reflects the agencies’ view that higher-volume businesses (such as retail lending) present more opportunities for operational risk to manifest, including through compliance gaps or internal control deficiencies.

¹¹ The exposure must also be to an individual or a small- or medium-sized entity (with annual revenues or sales of no more than \$50 million (indexed to inflation)), and not secured by real estate.

¹² Compared to the 2023 NPR, the Proposed Rules would not apply any “granularity limit” criterion for an exposure to qualify as “regulatory retail” (which would have precluded the favorable 75% risk weight to the extent that any single exposure exceeded 0.2% of the bank’s total regulatory retail portfolio).

¹³ The relatively modest ~9% decrease in average credit risk-weightings for retail loans reflects the impact of the new 10% CCF risk-weighting for unconditionally cancelable commitments. The relatively high operational risk charge for retail lending—representing nearly half of the projected operational risk-weighted assets for ERBA banks across all loan types—is driven by comparatively higher interest margins on most retail lending (with higher interest income in turn resulting in a higher operational risk “Business Indicator”).

SIMPLIFIED DEDUCTION FRAMEWORK FOR DEFERRED TAX ASSETS

Banks are generally required to hold allowances for loan losses. Increases in loan allowances generally give rise to increases in “temporary difference DTAs,” which are created by the difference in timing between accounting-standard recognition of expected loan losses and tax-rule deductions for charged-off loans.

Current rules require capital deductions for “temporary difference DTAs” that exceed certain thresholds of the bank’s capital base in a framework equivalent to that described above for MSAs. The 2023 NPR’s proposal to eliminate the simplified capital deduction approach for Category III and IV banks would have likewise applied to “temporary difference DTA”-related capital deductions, and would have disproportionately affected banks more heavily focused on credit card and consumer lending (which generally have larger loss allowances and therefore often have larger “temporary difference DTAs”).

The re-proposal maintains the simplified DTA deduction approach for Standardized Approach banks, relieving Category III and IV banks of the additional capital deduction burden that the 2023 NPR would have imposed and avoiding the pro-cyclical effects of adverse economic conditions creating both heightened loan loss reserves as well as increased DTA-based capital deductions resulting from those reserves.

Mortgage and Consumer Loan Liquidity Sources

LOAN WAREHOUSE FACILITIES

Banking organizations are significant funders of nonbank mortgage lenders via warehouse lines of credit. Under existing bank capital requirements, on-balance sheet portions of warehouse facilities are generally treated as corporate exposures subject to the flat 100% risk-weighting described above, while undrawn portions are subject to the “credit conversion factor” rules described above (which generally apply varying capital charges against undrawn portions based on the maturity of the facility).

Under the proposed Standardized Approach, on-balance sheet loans under mortgage warehouse facilities would receive a 5-percentage-point reduction to existing risk weights (subject to a flat 95% risk weight for corporate exposures). Banks subject to the ERBA framework would continue to apply a 100% credit risk weight to drawn warehouse facilities, unless the borrower is *investment grade* (based on the bank’s qualifying internal credit risk rating system). If a bank determines a warehouse line borrower to be “investment grade,” the bank would be able to assign a preferential 65% credit risk-weighting to the warehouse line.¹⁴

For all banks, the Proposed Rules would change the risk weighting approach for undrawn commitments from a series of graduated factors to a single 40% credit conversion factor (regardless of original maturity, except for commitments that are unconditionally cancelable). This flat CCF would double the capital charge against the

¹⁴ A bank would be required to make the “investment grade” rating assessment at the obligor level, and would not be permitted to take into account exposure-level loss mitigation factors—such as credit enhancements, transaction structure, and collateral—which are often features of mortgage warehouse facilities.

undrawn portion of most loan warehouse facilities compared to current rules (which assign a 20% CCF to a typical warehouse line with a 12-month maturity that is not unconditionally cancelable), and may impede the ability of non-bank lenders to secure excess or low-utilization bank warehouse facilities (*e.g.*, to pre-position additional funding capacity to support potential future spikes in loan application volume).

PRIVATE-LABEL ASSET-BACKED SECURITIZATIONS

Compared to the 2023 NPR, the Proposed Rules would reduce bank capital charges for securitizations such as non-agency RMBS and other consumer loan ABS by lowering the applicable supervisory capital calibration parameter and by implementing certain other improvements for high-quality, lower-risk securitizations.

In particular, the Proposed Rules would restore the applicable “p-factor” supervisory calibration parameter to 0.5 (down from the 1.0 proposed in the 2023 NPR), effectively reducing the supervisory surcharge on securitizations to account for risks not fully captured by the underlying assets, such as concentration and correlation risk.

Beyond the reduced “p-factor” calibration parameter, the proposal would also introduce a “look-through approach” to securitization exposures, allowing a bank to cap the securitization’s risk weight at the weighted-average risk weight of the underlying exposures (subject to the supervisory risk-weight floor). The Proposed Rules would reduce the supervisory risk-weight floor for most securitizations from 20% to 15%, which the agencies note should be particularly beneficial for more senior tranches of securitization exposures—*e.g.*, AAA-rated CMO securities—for which the risk-weighting “floor” would be more likely to be binding.¹⁵

The banking agencies expect these changes would incentivize banks to hold more securitized assets and encourage the sale of loan pools to securitization structures. The banking agencies project that the Proposed Rules would reduce risk-weighted assets attributable to securitization exposures by an estimated \$21 billion for Standardized Approach banks, resulting in up to \$91 billion of additional Standardized Approach bank balance sheet capacity for securitizations. These changes should promote secondary market liquidity for mortgage- and consumer loan-backed securities, offering greater funding flexibility for both bank and non-bank originators.

AGENCY MORTGAGE-BACKED SECURITIZATIONS

Consistent with current capital rules, the securitization framework described above would apply only to exposures that involve tranching of credit risk. In contrast, mortgage-backed pass-through securities (such as agency MBS guaranteed by Fannie, Freddie or Ginnie), which feature various maturities but do not involve tranching of credit risk, are not subject to the capital rules’ securitization framework. Instead, Fannie- and Freddie-issued securities would continue to be risk-weighted at 20%, while Ginnie-guaranteed MBS would continue to be risk weighted at 0% (as Ginnie’s guarantee is backed by the “full faith and credit” of the U.S. government).

¹⁵ For ERBA banks, the Proposed Rules would adjust the market risk capital charge for traded RMBS in part based on the quality of the underlying mortgages.

The Proposed Rules also clarify the treatment of Uniform Mortgage-Backed Securities (single-class MBS issued by either Fannie Mae or Freddie Mac to facilitate a more liquid market for MBS traded on a “to-be-announced” basis), allowing banks to treat these securities as if issued by a single obligor, and thus recognize capital benefits from hedging and offsetting exposures across GSE securities.

Aside from the credit risk-weighting treatment of agency RMBS (which would generally remain consistent with current capital rules), the elimination of MSA-deduction requirements (as described above) may enhance bank participation in Ginnie Mae securitizations. Because Ginnie Mae securitizations require mortgage lenders to pool together mortgage loans while retaining responsibility for administering and servicing the mortgage pool (unlike Fannie and Freddie securitizations of conforming mortgages which do not require lenders to retain servicing responsibility), these Ginnie Mae securitizations generate significant MSAs (and, under current rules, punitive capital deductions, particularly for Category I and II banks subject to the lower “sin bucket” deduction thresholds). In turn, these capital deductions have, to a large extent, disincentivized banks from participating in Ginnie Mae securitizations (with the share of bank-originated mortgages in new Ginnie Mae-guaranteed MBS issuances falling from ~50% in 2013 to ~10% in 2020).¹⁶ By removing the MSA deduction requirement, the Proposed Rules would remove a critical regulatory deterrent to banks participating in, and retaining MSAs in connection with, Ginnie Mae securitizations.

¹⁶ Congressional Budget Office, “Ginnie Mae and the Securitization of Federally Guaranteed Mortgages,” (January 2022).

For further information regarding this memorandum, please contact any member of the Firm's [Financial Institutions Practice](#), or any of the contacts listed below:

NEW YORK CITY

Louis H. Argentieri
+1-212-455-7803
louis.argentieri@stblaw.com

Timothy Gaffney
+1-212-455-7182
timothy.gaffney@stblaw.com

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Sven Mickisch
+1-212-455-2944
sven.mickisch@stblaw.com

Matthew Nemeroff
+1-212-455-3459
matthew.nemeroff@stblaw.com

Ravi Purushotham
+1-212-455-2627
rpurushotham@stblaw.com

WASHINGTON, D.C.

Amanda K. Allexon
+1-202-636-5977
amanda.allexon@stblaw.com

Brian D. Christiansen
+1-202-636-5940
brian.christiansen@stblaw.com

Spencer A. Sloan
+1-202-636-5870
spencer.sloan@stblaw.com

James D. Fine
+1-202-636-5593
james.fine@stblaw.com

PALO ALTO

Makala M. Kaupalolo
+1-650-251-5273
makala.kaupalolo@stblaw.com

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.