ZEPHYR IDP™
Institutional De-Risking Protocol

Submitted to:

The Secretariat, Basel Committee on Banking Supervision
Bank for International Settlements · Centralbahnplatz 2 · CH-4051 Basel, Switzerland
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Re: Consultative Document — Consolidated Version of Basel Committee Guidelines and Sound Practices (February 2026)
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SUBMITTED BY

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PUBLICATION

Ernest Nicholson requests that this comment letter be published on the BIS website in the normal course of the consultation process.

Executive Summary

The Basel Committee's consolidated guidelines consultation arrives at a moment of systemic urgency. The global AI infrastructure buildout — projected to require $5.2 trillion in investment by decade's end, with an estimated $1.5 trillion in external bank financing needed by 2028 — is proceeding without an established pre-commitment governance framework governing how banks assess, price, and manage the risks of specialised lending to AI infrastructure projects.

This submission introduces the Zephyr Institutional De-Risking Protocol (Zephyr IDP™) as a practitioner-developed, pre-commitment diagnostic framework specifically designed to address this gap. It respectfully proposes that the Basel Committee consider incorporating pre-commitment AI infrastructure project finance governance standards into its consolidated guidelines, with particular reference to the specialised lending, counterparty credit risk, operational risk, and sustainability risk modules currently under consultation.

THE CORE SUBMISSION

The risk that will define the next generation of banking supervision is not AI risk inside banks — it is the risk carried by banks financing AI infrastructure built without adequate pre-commitment governance. The Basel Framework's specialised lending risk weight categories (Strong, Good, Satisfactory, Weak) provide the correct supervisory architecture for this problem. Zephyr IDP provides the practitioner framework that makes those categories operationally meaningful for AI infrastructure project finance.

I. The Supervisory Gap: AI Infrastructure Project Finance

The Basel Framework's specialised lending guidelines were developed for power plants, chemical processing facilities, transportation infrastructure, and telecoms. AI data centers are the defining new specialised lending asset class of this decade — but they are not covered by guidelines that reflect their unique risk profile. Three structural features distinguish AI infrastructure project finance risk from traditional specialised lending:

1. Non-linear risk transmission. AI infrastructure projects involve interlocking contracts — permitting, grid interconnection, construction, and offtake — such that a single failure in one dimension cascades across the entire capital structure. This non-linearity is not captured in standard credit risk models calibrated to conventional project finance.

2. Technology obsolescence risk within a single lease cycle. GPU generations refresh every 2–3 years. A data center designed to fixed hardware specifications today may be economically stranded within the term of its initial financing arrangement. This creates asset impairment risk of a pace and character for which the Basel specialised lending framework has no current precedent.

3. The elastic asset label problem. “AI infrastructure” currently describes assets ranging from fully contracted, investment-grade hyperscale campuses to speculative “powered shells” with no confirmed tenants. Without a standardized pre-commitment diagnostic framework, banks underwrite development-stage risk at stabilized asset pricing — precisely the mispricing dynamic that Basel III’s risk-sensitive frameworks were designed to prevent.

The consequences of this gap are already visible. Between 30% and 50% of the approximately 16 gigawatts of new US data center capacity planned for 2026 is expected to face delays or cancellation, with transformer shortages, insufficient power supply, sociopolitical resistance, and funding gaps cited as primary causes. Each of these failure modes is addressable through pre-commitment due diligence. None is currently required under the Basel guidelines governing the banks financing these projects.

II. The Zephyr IDP Framework: A Pre-Commitment Diagnostic for AI Infrastructure

Zephyr IDP is a practitioner-developed framework that structures the institutional investor’s first engagement with an AI infrastructure project around six diagnostic pillars, each corresponding to a distinct risk vector that determines whether a project achieves “Strong” or “Good” classification under the Basel specialised lending framework. The framework operates at the pre-commitment stage — before the term sheet, before capital is deployed, at the only moment when all structural variables remain open for governance.

01 Demand Validation	Distinguishes contracted, investment-grade offtake from speculative demand projections — preventing the capital misallocation that characterized the 1990s fiber overbuild. Under the Basel specialised lending framework, demonstrated offtake is a primary determinant of "Strong" classification.
02 Power & Entitlement	Evaluates whether grid interconnection agreements, utility PPAs, and land permits are secured before commitment. Projects without confirmed power face construction timelines of 2–5 years, creating binary construction risk that Basel's specialised lending framework would classify as materially impairing repayment capacity.
03 Counterparty Integrity	Assesses single-tenant revenue concentration and structural protections. The Aligned Data Centers/Applied Digital pattern — where a single hyperscaler represents the majority of revenue — exemplifies the binary default risk that Basel III's Large Exposures framework was designed to constrain.
04 Technology Flexibility	Tests whether facility design accommodates GPU generation cycles (2–3 years) and power density evolution (currently scaling to 40–100+ kW per rack). Rigid specifications create stranded asset risk within a single lease cycle — a material impairment to the long-term cash flow assumptions underlying project finance valuations.
05 Capital Stack Alignment	Ensures leverage ratios reflect the actual development stage rather than stabilized asset assumptions. The proliferation of SPV structures and GPU-collateralized facilities creates

06 **Community & Governance**	off-balance-sheet leverage that currently falls outside standard Basel III risk-weight assessment — a structural gap this consultation provides an opportunity to address. Embeds Agency (communities' ability to exercise real choice in AI infrastructure deployment affecting them) and Ownership (communities' control over outcomes) as architectural requirements. Projects lacking pre-commitment community governance are demonstrably more exposed to regulatory intervention, permitting delays, and reputational risk — all of which impair bank lending quality under Basel's operational risk framework.

III. The Connection to the Basel Consolidated Guidelines Consultation

This submission responds specifically to the Committee's invitation to comment on the consolidation and accessibility of its guidelines and sound practices. Zephyr IDP's six pillars map directly to existing Basel framework modules currently under consolidation:

Zephyr IDP Pillar	Relevant Basel Framework Module
Demand Validation	Specialised Lending (SL) — CRE 31-35: demand risk classification criteria for project finance
Power & Entitlement	Operational Risk — OPE: infrastructure dependency and construction risk; SL "Strong" classification criteria
Counterparty Integrity	Counterparty Credit Risk (CCR) — CRE 51-54; Large Exposures (LEX): single-name concentration
Technology Flexibility	Specialised Lending: asset obsolescence as impairment to cash flow sustainability; Pillar 2 ICAAP guidance
Capital Stack Alignment	Leverage Ratio (LR); off-balance-sheet SPV treatment; CRE 40 (Securitisation framework for SPV structures)
Community & Governance	Pillar 2 supervisory review; ESG/sustainability risk guidance; Operational Risk — reputational and regulatory risk

IV. The Capital Markets Mechanism: Risk Weights and the Cost of Capital

The most direct supervisory leverage point for pre-commitment AI infrastructure governance is the Basel specialised lending risk weight framework. Under current Basel III standardised approach rules, a project that demonstrates the characteristics of "Strong" classification — robust financial strength, stable political and legal environment, transaction characteristics that ensure certainty of repayment, and strength of the sponsor — receives materially lower risk weights than a project classified "Satisfactory" or "Weak."

A project that completes the Zephyr IDP diagnostic prior to commitment demonstrates, in documented and auditable form, precisely the characteristics that Basel's specialised lending framework uses to assign "Strong" or "Good" classification. The commercial implication is direct: lower risk weights reduce bank capital requirements, reduce the cost of debt to the project, and improve equity returns for institutional investors. Pre-commitment governance is not a compliance overhead — it is a cost of capital reducer.

THE PROPOSED SUPERVISORY MECHANISM

The Basel Committee's consolidated guidelines should consider establishing, or commissioning a working paper on, pre-commitment due diligence standards for AI infrastructure specialised lending — analogous to the due diligence standards that exist for project finance in the energy and transportation sectors. Such standards would provide a basis for banks to assign more risk-sensitive classifications to AI infrastructure loans, improve Pillar 3 disclosure comparability, and reduce the systemic risk of AI infrastructure financing proceeding without adequate governance architecture.

V. The Systemic Risk Dimension

The Financial Stability Board's October 2025 report on AI adoption in financial institutions identified model risk, data quality, and governance as the primary AI-related vulnerabilities capable of posing risks to financial stability. This submission respectfully adds a fourth vulnerability that falls outside the FSB's current scope: the systemic risk arising from banks financing AI infrastructure built without pre-commitment governance.

The AI infrastructure buildout exhibits characteristics of prior technology buildout cycles — the 1990s fiber overbuild, the 2000s leveraged real estate cycle — in which individual projects appeared sound at the deal level while the aggregate capital stack was building systemic fragility. The distinguishing feature of those cycles was not bad assets. It was assets structured without adequate pre-commitment risk governance, financed by institutions whose risk-weight frameworks were calibrated to the average of the market rather than the risk profile of the individual project.

At $1.5 trillion in projected external financing by 2028, AI infrastructure is approaching the scale at which individual project failures can become systemic. The Basel Committee's consolidated guidelines consolidation is the appropriate instrument to establish the pre-commitment governance standards that prevent that outcome.

VI. Responses to the Three Consultation Questions

Question 1: Whether the consolidated guidelines achieve the objective of improving accessibility of the Committee's outputs.

The consolidation is a significant improvement in accessibility and is strongly supported. The modular format mirrors the Basel Framework standards structure and will substantially reduce navigation complexity for practitioners and supervisors alike. One respectful suggestion: the consolidated guidelines would benefit from an explicit module or annex addressing specialised lending due diligence standards for digital and AI infrastructure assets — a category whose risk profile is materially distinct from the infrastructure categories reflected in current guidance.

Question 2: Whether the consolidated guidelines achieve the objective of substantially reducing the volume of guidance.

The reported 75% reduction in volume is appropriate. The consolidation correctly prioritizes principles over prescription. However, the principles governing specialised lending risk classification — and in particular, the criteria distinguishing "Strong" from "Weak" project finance — should be expanded to address AI infrastructure's unique risk vectors, even if that expansion adds modest volume in a targeted annex.

Question 3: Any other comments on the consolidated guidelines.

The Committee's work programme for 2025–26 identifies the digitalization of finance as a key theme and commits to continued horizon scanning of AI-related issues. This submission respectfully proposes that the Committee's analytical work on digitalization extend beyond AI's use within banks — which is already well-served by the Committee's 2024 report and the FSB's monitoring work — to encompass the risks carried by banks financing the physical infrastructure of AI. This is the supervisory gap that Zephyr IDP was designed to address, and it is the gap most likely to generate systemic consequences if it remains unaddressed through this consolidation cycle.

Conclusion

The Basel Committee's consolidated guidelines consultation is the right instrument, at the right moment, to establish the pre-commitment governance standards that AI infrastructure project finance currently lacks. The Zephyr Institutional De-Risking Protocol offers a practitioner-developed, pillar-based framework that maps directly to the Basel specialised lending, counterparty credit risk, operational risk, and sustainability risk modules under consolidation.

The Committee is respectfully invited to consider: (i) the incorporation of AI infrastructure project finance governance standards into the specialised lending module of the consolidated guidelines; (ii) the commissioning of a dedicated working paper on pre-commitment due diligence standards for AI data center financing; and (iii) the recognition of practitioner-developed frameworks such as Zephyr IDP as a reference methodology for banks seeking to assign risk-sensitive classifications to AI infrastructure specialised lending exposures.

The undersigned is available to provide further information, technical detail, or briefings to the Committee Secretariat at its convenience.

Respectfully submitted,

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