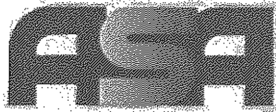

american securities association
America's Voice for Main Street's Investors

January 16, 2024

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Re: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity (88 FR 64028)

Ladies and Gentlemen:

The American Securities Association (ASA)[1] submits these comments in response to the jointly proposed Basel III capital standards issued by the Federal Reserve, Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (the Proposal).

I. General Comments.

The ASA believes the Proposal is unsupported by the data or evidence necessary to justify it, will raise the cost of borrowing for households, businesses, and municipalities, and if adopted, will serve as a deterrent to job creation and economic growth for years to come. The ASA urges the banking regulators to abandon the Proposal and instead prioritize targeted efforts that allow

[1] ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

the banking system to provide adequate credit to the economy while maintaining the safety and soundness of individual institutions.

II. <u>The Proposal inappropriately grants government agencies outsized control over the economy.</u>

The Proposal – as with previous iterations of the Basel accords – requires government regulators to determine the appropriate risk levels of particular asset classes, and then require banking institutions to hold more capital for assets they deem to carry greater "risk." This type of central planning through our financial system has repeatedly failed.

The Proposal is so overarching that it seeks to micromanage bank credit risk models by forcing all banks to adopt the same unproven standardized Basel framework. This, in and of itself, will create global systemic risk in our financial system because once a liquidity crisis hits one market, all markets will face the same problems at the same time, and no one but the central bank will be able to step in to make certain markets continue to function.

This centrally planned approach to regulation will undoubtedly fail because regulators do not know how to properly assess the actual credit and market risk of particular asset classes. There is no evidence that suggests any regulator in the U.S. or the Basel Committee itself has the expertise to model credit risk and black swan market events appropriately. This is why central banks continually intervene in markets with new "programs" to solve problems of their own making instead of allowing prices to clear as they would in a free market system.

The Proposal also inexplicably codifies the regulatory favoritism of certain assets (e.g. treasuries) over others (e.g. mortgages, municipal bonds, and corporate loans). If past is prologue, then this type of government intervention in the marketplace will only serve to increase borrowing costs for every unfavored asset class of loan because those loans will be forced to absorb unjustifiably high-risk weights. Additionally, liquidity for secondary market trading of unfavored asset classes will significantly decline, especially in times of crisis (See March 2020 for a real-world example of how Basel rules harmed treasury market liquidity and the knock-on effects that had across every other market).

As currently drafted, the Proposal could increase overall capital requirements for affected banks by over 20 percent.[2] Incredibly, the Proposal contains virtually no justification for why such a sharp increase in capital requirements is necessary and, in contravention of longstanding law, the Proposal does not publicly disclose the data used by the regulators to formulate the new

[2] https://www.wsj.com/articles/big-banks-could-face-20-boost-to-capital-requirements-c68c1e1b?mod=hp_lead_pos2&mod=article_inline

standards. In our view, this is a tacit admission by the banking regulators that there is no data to justify the Proposal.

When the Proposal was initially released, Federal Reserve Governor Bowman expressed her reservations at the Proposal's lack of analysis and adherence with existing law:

> "The proposed revisions under consideration have not been directed by Congress and are not compelled by a new evolution or identified weakness in the U.S. banking system. Although this proposal is intended to implement the Basel III agreement, in light of the many deviations from internationally agreed standards it is not clear that today's proposal would improve international consistency in capital requirements for large, internationally active banks."[3]

The ASA shares many of the Governor's concerns, and we believe that banking regulators, at a minimum, must conduct a comprehensive cost-benefit analysis prior to deciding whether to adopt any new revisions to the Basel framework.

III. <u>Regulators Have Repeatedly Failed to Properly Identify Systemic Risks</u>.

In addition to completely missing the buildup of risk ahead of the great financial crisis in 2008 and the European crisis of 2011-2012, regulators also missed the glaring risks associated with the Federal Reserve embarking on an unprecedented and aggressive rate hiking cycle. There is little coherence in the federal banking regulators' current approach towards addressing systemic risk, other than to impose onerous and unworkable new standards on banks.

It also must be said that just prior to the collapse of Silicon Valley Bank (SVB) and the stress in the regional banking system in early 2023, the Financial Stability Oversight Council (FSOC), which includes every regulator who approved this Proposal, identified its top risks to the

[3] Statement of Governor Michelle W. Bowman (July 27, 2023) Federal Reserve Board - Statement by Governor Michelle W. Bowman

financial system[4] and none of them were related in any way to SVB's failure or the failure of the other banking institutions following SVB's closure.

In other words, the same regulators now proposing unprecedented new capital standards for banks are the same ones who failed to identify any of the risks involved in the failure of several of the United States' regional banks.

The public is right to view the Proposal in this context and with a healthy dose of skepticism as the FSOC does not seem to have a clear grasp on actual risks to the financial system. Regulators failure to assess the actual risks to our system, coupled with the lack of substantive information to justify the Proposal is reason enough to abandon this Proposal and why its chances of surviving a legal challenge are as high as the Washington Wizards winning this year's NBA finals.

IV. **The regulators have not properly considered the Proposal's impact on municipalities and other borrowers.**

One asset class that will likely be severely affected by the Proposal – but thus far has received little attention from banking regulators – are municipal bonds. Municipalities in the municipal bond market issue bonds to provide funding for infrastructure, school systems, public safety, hospitals, the climate transformation, and the basic needs of every community in America. We note the funding of these projects is very important to this administration's fiscal agenda.

According to some analyses, the cost of capital for holding municipal bonds could increase by as much as 20 percent if the Proposal were adopted.[5] Institutions subject to Basel III will therefore be disincentivized from trading or holding these bonds. This will drive up borrowing costs for

[4] Financial Stability Oversight Council | U.S. Department of the Treasury; https://www.americansecurities.org/post/asa-to-congress-where-was-fsoc "The FSOC completely failed to warn the American people about actual risks in the banking system. Instead of including rising interest rates and their impact on asset prices as a top risk to banks, FSOC chose to identify risks dictated by politics. The FSOC's only job is to identify risks and emerging threats to the stability of the U.S. financial system—its credibility depends on sticking to that mandate"

[5] There are risks in Basel III endgame's treatment of municipal bonds. Justin Underwood, Bond Buyer (Nov. 30, 2023) There are risks in Basel III endgame's treatment of municipal bonds | Bond Buyer

municipalities ultimately raising costs or shrinking project scope for communities all over the country.

It is striking that banking regulators are proposing these changes even though the credit outlook for municipalities has not materially changed. Municipal bonds historically have an extremely low rate of default, particularly when compared to corporate bonds or other asset classes.[6]

Crowding out liquidity in the municipal, mortgage, and corporate bond markets will make the financial system *less* resilient during the next financial crisis, whatever its origins. At a minimum, the banking regulators should try to understand these markets and how they operates before fundamentally changing this critical source of funding at the behest of an unelected committee of central bankers in another country.

While our membership could benefit from larger banks leaving the municipal market in the short term, these rules would harm issuers and secondary liquidity over the longer term, and we strongly oppose that outcome.

V. <u>Conclusion</u>.

The Proposal should be abandoned in its entirety, and the Federal Reserve, FDIC, and OCC should instead undertake an effort to holistically examine current capital standards in the U.S. and whether they support robust economic activity while maintaining critical safety and soundness objectives. Adopting this Proposal in any form would be entirely unjustified and will inflict severe harm on the American capital markets, the broader economy, and job creation.

Sincerely,

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

[6] https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/fixed-income/moodys-investors-service-data-report-us-municipal-bond.pdf