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Chief Counsel's Office
Comment Processing
Docket ID: OCC–2023–0008
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

James P. Sheesley, Asst. Executive Secretary
Comments/Legal OES (RIN 3064–AF29)
Federal Deposit Insurance Corporation
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Ann E. Misback, Secretary
Docket No. R–1813, RIN 7100–AG64
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Supplemental Comment Letter: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity; OCC Docket ID: OCC–2023–0008; Board Docket No. R–1813, RIN 7100–AG64; FDIC RIN 3064–AF29; 88 Fed. Reg. 64028 (Sep. 18, 2023)

Dear Ladies and Gentlemen:

Due to recent, directly applicable research and data from the Federal Reserve Bank of New York supporting the above-captioned proposed rule ("Proposal"), Better Markets[1] files this supplemental comment letter in support of the Proposal issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Fed"), and the Federal Deposit Insurance Corporation ("FDIC"), collectively ("Agencies").[2]

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity; RIN 1557-AE78, RIN 3064-AF29, RIN 7100-AG64; 88 Fed. Reg. 64028 (Sept. 18, 2023), https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant.

We continue to strongly support the Proposal for the many reasons set forth in our original comment letter,[3] just as we have consistently supported the need for higher bank capital requirements for more than a decade.[4] The Proposal would make several necessary enhancements to more accurately reflect risk at large banks and shift the burden of that risk to the banks as well as their shareholders and away from the public. The changes would also improve the consistency, transparency, comprehensiveness, and risk-sensitivity of capital ratio calculations for these large banks. Simply put, these changes, fully supported by data and analysis, would be a significant step in reducing the threats from too-big-to-fail banks and the very real risk of future taxpayer-funded bailouts.

Now there is ***clear and unmistakable additional support for the Proposal*** in new research from the Federal Reserve Bank of New York that examines why banks fail.[5] This research is the most comprehensive of its kind, containing data from more than 37,000 banks and 5,000 bank failures that occurred in the United States between 1865 and 2023.[6] The research documents three key facts about failing banks:

- First, failing banks have more nonperforming loans and deteriorating solvency several years before failure.
- Second, failing banks rely on noncore funding that is both expensive and risk-sensitive.
- Third, failing banks experience a boom and bust in assets in the decade before failure; therefore, losses are often inflated because they follow a period of rapid growth.

This analysis provides yet more evidence of the utter lack of support for the "broad and material changes" that were initially demanded by Fed Chair Powell and that are now being promoted if not demanded by the Fed itself, as explained in Fed Vice Chair Michael Barr's speech

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3 Better Markets Comment Letter, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* (Jan. 16, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Comment-Letter-Regulatory-Capital-Rule-1-16-24.pdf.

4 *See, e.g.*, Dennis M. Kelleher, *Ten Actions Necessary to Prevent Large Bank Failures, Strengthen the Financial System, and Protect Main Street Families*, Better Markets (May 9, 2023), https://bettermarkets.org/wp-content/uploads/2023/05/Better_Markets_Policy_Brief_SVB_Banking_Crisis_Responses_5-9-2023.pdf; Dennis Kelleher, Tim P. Clark, & Phillip Basil, *Protecting Our Economy by Strengthening the U.S. Banking System Through Higher Capital Requirements*, Better Markets (Dec. 22, 2022), https://bettermarkets.org/wp-content/uploads/2022/12/BetterMarkets_Strengthening_US_Banking_System_12-22-2022.pdf; Better Markets Comment Letter, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Oct. 22, 2012), https://bettermarkets.org/wp-content/uploads/2023/11/OCC-FRS-FDIC-CL-Reg-Capital-Implementation-of-Basel-III-etc.-20121022.pdf.

5 Press Release, Federal Reserve Bank of New York, *New York Fed to Publish Research Series Examining Bank Failures Throughout History* (Nov. 15, 2024), https://www.newyorkfed.org/newsevents/mediaadvisory/2024/1115-2024.

6 Sergio Correia, Stephan Luck, & Emil Verner, *Failing Banks*, FEDERAL RESERVE BANK OF NEW YORK STAFF REPORTS (Sept. 2024), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1117.pdf.

last September.[7] Those changes would substantially but baselessly weaken parts of the Proposal that are directly related to these three facts. For example:

- Credit Risk: The risk weights for certain loans will be reduced relative to the Proposal according to the Speech.
    - However, the research shows that deterioration in credit quality is a direct cause of bank failures so reducing risk-weights for loans and thus the capital requirements for these loans is imprudent, illogical, and unfounded.
- Operational Risk: The revisions described in the Speech include no longer considering a firm's operational loss history.
    - However, the research shows that the causes of bank failures build over time, so ignoring historical risk exposures is a clear mistake.

The Federal Reserve Bank of New York's research adds to the already large and robust body of work that supports the need to increase capital requirements.[8] Moreover, the expansive scope and long-run historical perspective of this research distinguish it from other work on the subject, thus motivating us to write this supplementary comment letter. Simply put, we urge the Agencies to ***listen to the economic and financial experts' data, research, and conclusions; follow their policy recommendations; reject baseless pressure to weaken the Proposal; and finalize the Proposal along the lines as proposed***.[9]

COMMENTS

The evidence, including the New York Fed's recently unveiled research, fully supports the Proposal as written and without any dilution. Moreover, that research details several key policy implications that the Agencies should incorporate in a final rule.

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[7] *See* Michael Barr, *The Next Steps on Capital*, Board of Governors of the Federal Reserve System (Sept. 10, 2024), https://www.federalreserve.gov/newsevents/speech/barr20240910a.htm (the "Speech").

[8] *See* Kelleher, Clark & Basil, *supra* note 4, at 10; *see also* Anat Admati & Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It - New and Expanded Edition* (Jan. 9, 2024); Federal Reserve Bank of Minneapolis, *The Minneapolis Plan To End Too Big To Fail* (Nov. 16, 2016), https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-2016.pdf?la=en; Jihad Dagher, Giovanni Dell'Ariccia, Luc Laeven, Lev Ratnovski, & Hui Tong, *Benefits and Costs of Bank Capital*, IMF Staff Discussion Note (Mar. 2016), https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf; Basel Committee on Banking Supervision, *An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements* (Aug. 2010), https://www.bis.org/publ/bcbs173.pdf.

[9] We note that the Speech did not have robust or substantial data or analytics supporting the "broad and material changes" weakening the Proposal. It would appear that the proposed changes are the result of industry political pressure to weaken the proposal regardless of facts, data, and sound policy.

I. Actions to Prevent Bank Failures and Mitigate Their Damage Can and Should Be Implemented *Before* a Risky Event Occurs.

Evidence from more than 37,000 banks and 5,000 bank failures between 1865 and 2003 shows that bank failures and banking crises unfold predictably:

> This deterioration is typically gradual, taking place over several years. During those years, ***the realization of credit risk reduces income and erodes capital buffers, pushing banks slowly toward the brink of default***. At times, the deterioration of a bank's solvency is preceded by a boom phase during which failing banks likely take more risks at the margin than their peers. ***The erosion of a bank's profitability and capitalization ultimately results either in a bank run or a supervisory decision to close the bank***. . . . Importantly, ***both depositors and supervisors seem to be slow to react*** to information about bank fundamentals, thus making bank failures highly predictable.[10]

The research thus shows that bank failures are indeed predictable, occurring after years of risky lending or other activities. Capital requirements that are too low effectively ***underprice*** these risky activities, enabling banks to continue making outsized profits from them. The burden of these risks is shifted to Main Street Americans and taxpayers who end up shouldering the risk and cost of bank failures when they inevitably occur.

This tradeoff is unacceptable and unfair. And it is unnecessary: Because the telltale signs of impending bank failure are identifiable well in advance, there is no justification for regulatory inaction. As the researchers state,

> The fact that bank failures are predictable supports the prompt and active use of corrective measures, such as limiting dividend payouts and the use of noncore funding for poorly capitalized banks.[11]

II. Banks Must Be *Required* to be Well-Capitalized.

The Proposal and its application of appropriately strong capital rules to ***all*** Category I-IV firms accurately recognize that systemic risk potential is not limited to just the Global Systemically Important Banks ("GSIBs"). GSIBs certainly present a significant risk to the financial system, but the failures of large banks that were not GSIBs in spring 2023 demonstrated the ability of the smaller covered firms to endanger the economy and the financial system and drain the FDIC's Deposit Insurance Fund. Moreover, history shows that banks will not voluntarily maintain sufficient levels of capital to head off these systemic risks; they must be required to do so.

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10 Sergio Correia, Stephan Luck, & Emil Verner, *Why Do Banks Fail? Bank Runs Versus Solvency*, FEDERAL RESERVE BANK OF NEW YORK, LIBERTY STREET ECONOMICS (Nov. 25, 2024), https://libertystreeteconomics.newyorkfed.org/2024/11/why-do-banks-fail-bank-runs-versus-solvency/ (emphasis added).

11 *Id*.

By requiring each firm to have enough capital to protect itself, the Agencies are protecting the entire banking system and the American public. For example, in the Fed's review of supervision and regulation of Silicon Valley Bank ("SVB"), Fed Vice Chair Michael Barr stated,

> [A] firm's distress may have systemic consequences through contagion—where concerns about one firm spread to other firms—even if the firm is not extremely large, highly connected to other financial counterparties, or involved in critical financial services.[12]

The threat of the contagion effect was echoed in FDIC Chairman Gruenberg's reflections on the March 2023 decision to declare a systemic risk exception.[13] The dangerous consequences of contagion spreading throughout the banking system are clear: firms covered by the Proposal together had more than $16 trillion in total assets, a staggering sum that is certainly large enough to cause havoc in the banking system if confidence in the financial soundness of these firms is questioned and contagion effects spread the concerns to other banks.

Moreover, the Agencies have consistently and clearly stated their concerns about operational risk;[14] OCC reports show that half of the large banks it supervises have inadequate controls over operational risk.[15] There is recent detailed reporting that operational risk is growing at the GSIB.[16] This evidence heightens the concern about operational risk's detrimental effects on Main Street Americans and the financial system at large. It also increases the urgency to appropriately allocate capital to protect against these effects.

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12 Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* 89 (Apr. 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

13 Federal Deposit Insurance Corporation, *Remarks by Chairman Martin J. Gruenberg on "Oversight of Prudential Regulators" before the Committee on Financial Services, United States House of Representatives* (May 16, 2023), https://www.fdic.gov/news/speeches/2023/spmay1523.html.

14 *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, SEMIANNUAL RISK PERSPECTIVE 8-11 (Fall 2024), https://www.occ.gov/publications-and-resources/publications/semiannual-risk-perspective/files/semiannual-risk-perspective-fall-2024.html; FEDERAL DEPOSIT INSURANCE CORPORATION, RISK REVIEW 59-60 (2024), https://www.fdic.gov/analysis/risk-review/2024-risk-review/2024-risk-review-full.pdf.

15 *See, e.g.*, Hannah Levitt & Katanga Johnson, *Secret Bank Ratings Show US Regulator's Concern on Handling Risk*, BLOOMBERG (July 21, 2024), https://www.bloomberg.com/news/articles/2024-07-21/secret-bank-ratings-show-us-regulator-s-concern-on-handling-risk.

16 *See, e.g.*, AnnaMaria Andriotis, *How Morgan Stanley Courted Dodgy Customers to Build a Wealth-Management Empire*, WALL STREET J. (Nov. 25, 2024), https://www.wsj.com/finance/banking/morgan-stanley-wealth-management-investigation-f317c71d.

III. ***After a Banking Crisis or Risk Event*, Interventions Must Address Fundamental Solvency Issues.**

Following the 2008 Crash, several reforms to improve the regulatory capital framework were implemented. For instance, in 2013 and 2014, the Agencies adopted final rules to strengthen minimum requirements for banking organizations and limit capital distributions and discretionary bonus payments if a banking organization does not meet minimum standards. Better Markets advocated for those proposals in support of higher capital that more accurately reflected the risk in a banking organization's business model.[17] Ultimately, the final rule moved in the right direction, but several aspects still require revision to better protect the financial system. In a speech to the industry at the October 2023 American Bankers Association's Annual Convention, Fed Vice Chair Barr cited regulators' recognition of the shortcomings of the earlier versions of the Basel capital standards and the need for continued improvement and strengthening of them—particularly in the areas of operational and market risk:

> When the initial reforms were put in place, bank regulators acknowledged that these changes were a partial measure and that there were further elements of the capital rule that needed adjusting: Less reliance on internal models for credit risk; operational risk should be captured in a standardized way; and capital requirements did not fully capture market risk.[18]

The COVID-19 pandemic and related financial market stress revealed additional evidence of the need for higher capital requirements. For example, FDIC Chairman Gruenberg cautioned against interpreting banks' performance during the COVID-19 pandemic as evidence of sufficient capital levels.[19] Appropriately, he pointed to the massive federal government support—***more than $10 trillion***—which:

> [H]elped to bolster the financial health of bank customers, as well as the markets within which banks operate. These actions insulated banks from runs and losses, while some measures served to boost bottom line profits with minimal risk to capital.[20]

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17 Better Markets Comment Letter, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Oct. 22, 2012), https://bettermarkets.org/wp-content/uploads/2023/11/OCC-FRS-FDIC-CL-Reg-Capital-Implementation-of-Basel-III-etc.-20121022.pdf.

18 Board of Governors of the Federal Reserve System, *Capital Supports Lending* (Oct. 9, 2023), https://www.federalreserve.gov/newsevents/speech/barr20231009a.htm.

19 Federal Deposit Insurance Corporation, *Remarks by Chairman Martin J. Gruenberg on the Basel III Endgame at the Peterson Institute for International Economics* (June 22, 2023), https://www.fdic.gov/news/speeches/2023/spjun2223.html.

20 *Id*.

Better Markets shares this view and stated in a recent report:

> In reality, the large banks only had to be a "source of strength" for about two weeks after the onset of market stress in early March 2020. The Fed began providing unlimited support to the financial system in mid-March. Within just the first 90 days, the Fed expanded its balance sheet by $3 trillion to prop up financial markets—in which the largest banks are the dominant participants—and provided massive funding to banks and bank-owned securities dealers, including through repurchase agreements (repos).[21]

Finally, in spring 2023, SVB, Signature Bank, and First Republic Bank all failed because they did not have enough capital to absorb the losses from the enormous risks that management chose to take. In the case of SVB, for example, the financial market and depositors realized that the bank did not have enough capital to cover losses that were incurred from selling securities at a loss. Over the course of a matter of hours, uninsured depositors realized what was happening and pulled deposits out of the bank at the fastest rate in history. This all could have been avoided with a larger capital cushion, hedges, or other appropriate management actions.[22]

CONCLUSION

Simply put, Main Street Americans deserve, and the law requires, an approach to bank supervision that recognizes the risks exposed by past crisis periods and takes action to prevent the same problems from happening again in the future. That was obvious and fully supported by the evidence before the Proposal was made and in the Proposal itself. Moreover, valid, independent, and compelling data and research from the Federal Reserve Bank of New York discussed herein compels the Fed to revisit its unsupported and unwise demand for "broad and material changes" to the Proposal that will substantially weaken it.

We urge the Agencies to heed these lessons from the past, focus and rely on data and evidence rather than baseless industry demands, and make necessary changes reflected in the original Proposal to protect the American people from undercapitalized banks and the catastrophic—and avoidable—crises that they will cause in the future. If the Fed and fellow policymakers fail to take this action—especially in light of the data and evidence—history will surely judge them harshly.

[21] Kelleher, Clark, & Basil, *supra* note 4, at 8.

[22] *See* Dennis Kelleher, *One Year After Silicon Valley Bank's Failure, and the Banking System and Main Street Americans Are Still In Serious Danger* 3, BETTER MARKETS (Mar. 5, 2024), https://bettermarkets.org/wp-content/uploads/2024/03/BetterMarkets_Report_One_Year_After_SVB_Failure_03-05-2024.pdf.

We hope these comments are helpful as the Agencies finalize this Proposal.

Sincerely,

[redacted]

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