January 16, 2024

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

Ann E. Misback, Secretary
Attention: Docket No. R–1813, RIN 7100–AG64
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: 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:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal") issued by the Office of the Comptroller of the Currency ("OCC"), 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 (Sep. 18, 2023), https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant.

The Proposal would revise capital measures and definitions for large banks to more accurately reflect the risk at these banks and shift the burden of that risk to the banks as well as their shareholders and away from the public. As proposed, the changes would only be applicable to large banking organizations, defined as those with total assets of $100 billion or more, and banking organizations with significant trading activity ("covered firms"), or just 37 bank holding companies with 62 insured depository institutions.[3] The changes would improve the consistency, transparency, comprehensiveness, and risk-sensitivity of capital ratio calculations for these large banks. It would not change capital ratio calculations for smaller, less complex, banking organizations.

We strongly support the implementation of the Proposed rule, just as we have consistently supported higher capital requirements for more than a decade,[4] though we believe it does not go far enough to strengthen capital levels at the largest banks. While the Proposal contains several technical changes to improve the calculations of both the numerator and denominator of capital ratios to make them more sensitive to risk and better reflect actual capital available to banks for absorbing losses, it does not strengthen or change the required capital ratio levels that banks must maintain.[5] In other words, the Proposal makes the calculations of the capital ratios more robust, with changes to better measure the risks banks face that are long overdue, but it does not actually increase the required minimum capital ratios. Bank capital will be better measured under the Proposal, which may lead to increased capital at large banks, but minimum capital requirements will still not have been "strengthened."

In addition, we believe that any economic costs associated with the Proposal are de minimis, will not impact economic growth, and that the industry's many arguments against the Proposal lack merit, as we discuss in detail below. We will only mention one salient point here:

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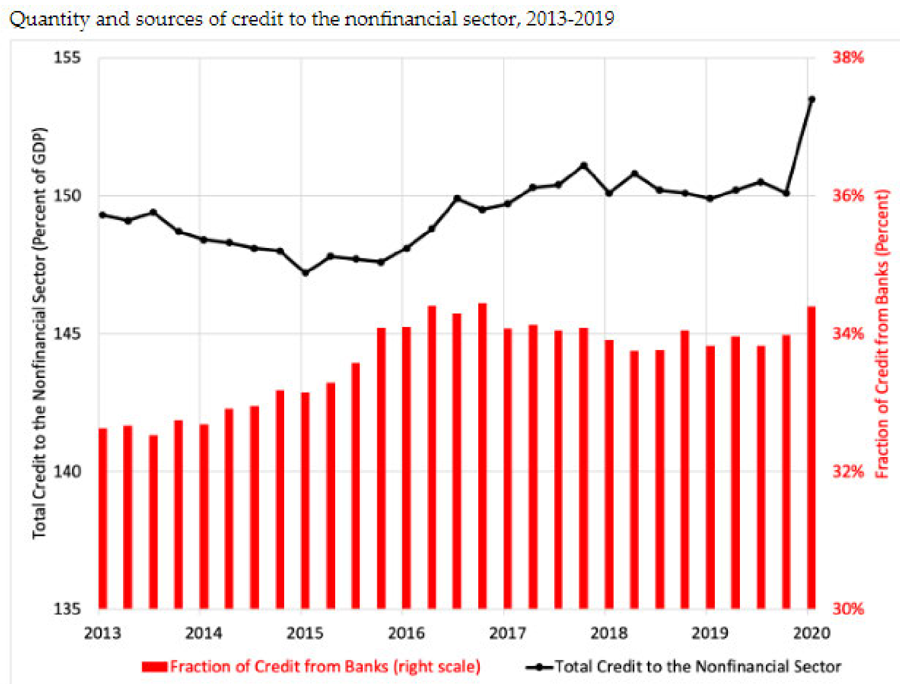
[3] *Id.* at 64167.

[4] *See, e.g.*, 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; 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; 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] According to the Basel Committee on Banking Supervision, minimum risk-based capital requirements are as follows: (1) Common Equity Tier 1 must be at least 4.5% of risk-weighted assets (RWA); (2) Tier 1 capital must be at least 6% of RWA; (3) Total capital must be at least 8.0% of RWA. In addition, a Common Equity Tier 1 capital conservation buffer is set at 2.5% of RWA for all banks. Banks may also be subject to a countercyclical capital buffer or higher loss absorbency requirements for systemically important banks. *See, e.g.*, Bank for International Settlements, *Risk-based capital requirements: Calculation of minimum risk-based capital requirements* (2020), https://www.bis.org/basel_framework/chapter/RBC/20.htm?inforce=20230101&published=20201126#fn_RBC_20_1_1.

the increased capital in the Proposal will not harm the economy. Compelling recent data proves this: regulators have required that banks increase their capital materially since the crash of 2008 and the enactment of the Dodd-Frank Act in 2010 and yet, at the same time, those very same banks have increased their lending to the nonfinancial sector of the economy (see Chart 1).[6] In other words, higher capital levels are actually associated with ***higher amounts of lending by banks***. Professor Stephen Cecchetti, shows that capital levels and lending are ***positively correlated*** (see Chart 2).[7] From 2010 through 2023, the data clearly show that ***for every 1 percentage point increase in capital, bank lending increases by 2 percentage points***.

Chart 1



Source: BIS.

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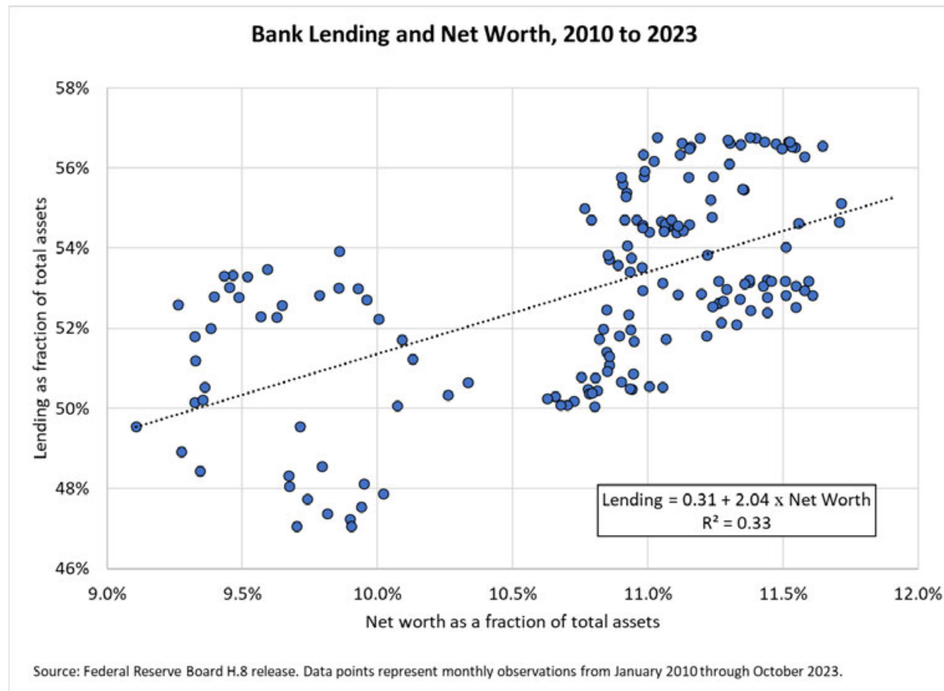
6 Stephen G. Cecchetti & Kermit L. Schoenholtz, *Setting Bank Capital Requirements*, MONEY AND BANKING (Oct. 12, 2020), https://www.moneyandbanking.com/commentary/2020/10/11/setting-bank-capital-requirements.

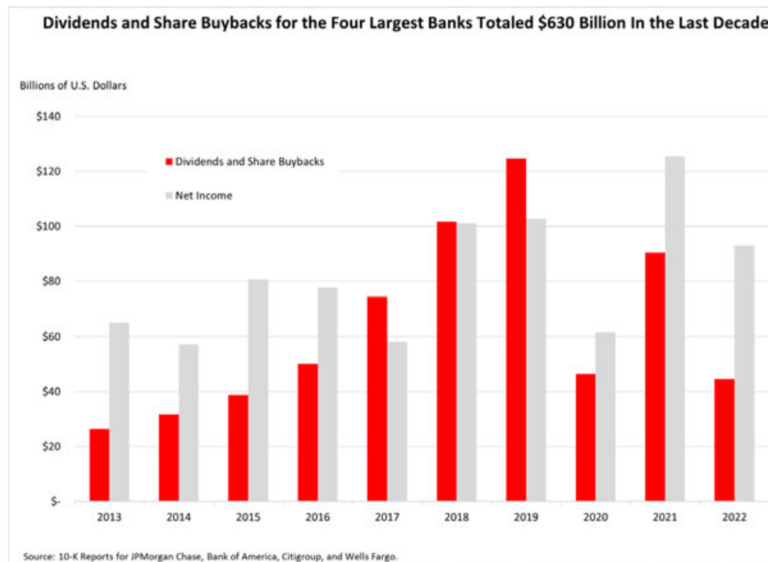
7 Stephen G. Cecchetti, *The US Debate About the Final Basel III Accord*, Peterson Institute for International Economics Financial Statements virtual event series, at 7:35 (Dec. 13, 2023), https://www.piie.com/events/us-debate-about-final-basel-iii-accord.

Chart 2



The capital increases in the Proposal are negligible relative to the capital increases the banks have already comfortably accommodated while increasing their lending. Moreover, they have during the same time period materially increased their dividends and share buybacks (see Chart 3).

Chart 3



The facts and data show that the material capital increases on the banks since the crash have not impacted their ability to increase lending to the real economy, shower their shareholders with outsized returns, and still use leverage to increase their return on equity (ROE) and thereby pay very high bonuses and compensation. In 2021, pay and benefits at the four largest banks totaled $142 billion in 2021, a 15% increase from $124 billion in 2020.[8] In 2022, CEO compensation for just the eight GSIBs was $211 million, hundreds of times higher than the median employee's annual total compensation.[9] It has to be recognized that the banks' core argument is that the country is threatened by the Proposal causing the banks to be ***overcapitalized*** when it is clear that (1) those threats didn't materialize recently when there were much greater capital increases required (and when, by the way, the banks made the same "sky is falling" claims that did not come to pass), and (2) the country is threatened by ***undercapitalized*** banks as materialized in 2008 and again in 2023. Moreover, even if one were to conclude that based on independent data there was some resulting diminution of economic activity, one would have to quantify that diminution and weigh it against the catastrophic costs of a financial crash, contagion, bailouts, and economic calamity, as happened in 2008[10] and to a lesser extent in 2023.

The many claims made by the industry against the Proposal cannot change those facts and cannot withstand independent scrutiny, which as discussed below, demonstrates that the Proposal should be finalized as proposed. We urge the Agencies not to be distracted from their statutory mandate to protect the financial system from undercapitalized banks by the baseless, self-interested arguments of those very same banks to operate with as little equity as possible to continue privatizing the benefits of such actions while socializing the risks, losses, and consequences. The Agencies should move forward to approve the Proposal as promptly as possible.

BACKGROUND

Bank capital is essential because it protects American families, small businesses, the financial system, and the economy from bank failures, losses, and taxpayer bailouts. Well capitalized banks are those that are strong enough to continue providing credit through the economic cycle, in good times and bad, which keeps the economy growing, creates jobs, and reduces the depth, length, and cost of recessions.[11] The 2008 Crash is estimated to have cost the American people more than $20 trillion in lost production and other costly and adverse

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[8] Joshua Franklin & Imani Moise, *Top Wall Street Banks Paid Out $142bn In Pay and Benefits Last Year*, FIN. TIMES (Jan. 20, 2022), https://www.ft.com/content/9bdef7a6-69f1-4f42-b27d-74dd34db4804.

[9] *Fact Sheet About the Eight Global Systemically Important Banks in the U.S.*, United States Senate Committee on Banking, Housing & Urban Affairs, https://www.banking.senate.gov/imo/media/doc/wall_street_oversight_hearing_fact_sheet_20232.pdf.

[10] *See* Better Markets, *The Cost of the Crisis* (July 2015), https://www.bettermarkets.org/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

[11] *See, e.g.*, Kelleher, Clark & Basil, *supra* note 4.

consequences such as unemployment, lost savings, homelessness, and foreclosures.[12] Capital levels at the large Wall Street banks proved to be grossly insufficient to absorb losses when banks' loans and other investments decreased in value in 2008, and the result was bank failures and costly bailouts, and the worst global financial and economic crisis since the Great Depression.[13]

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.[14] 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 for Supervision ("VCS") Michael 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:

> 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.[15]

Contrary to the industry's claims, higher capital levels are good for the economy, the banking system, and the American people. Senior officials at both the Fed and the FDIC have emphasized this direct relationship between strong capital levels and a strong economy. Just prior to the release of the Proposal, Fed VCS Barr spoke at the Bipartisan Policy Center in Washington, DC and stated:

> Everyone in America depends on a safe and stable financial system. By strengthening capital standards, we are ensuring that businesses have credit to grow and hire workers, and deal with the ups and downs in the economy. Stronger capital standards mean workers can depend on getting their paychecks and families can

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12 *See, e.g.*, Better Markets, *The Cost of the Crisis*, *supra* note 10; Tyler Atkinson, David Luttrell, & Harvey Rosenblum, *How Bad Was It? The Costs and Consequences of the 2007–09 Financial Crisis*, Federal Reserve Bank of Dallas (July 2013), https://www.dallasfed.org/pubs/historical/~/media/documents/research/staff/staff1301.pdf.

13 *Id.* at 73.

14 Better Markets Comment Letter, *supra* note 4.

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

> save and borrow to plan for the future. ***Our goal is a financial system that works for everyone, and having strong capital rules is essential for that.***[16]

FDIC Chairman Martin Gruenberg, at a speech at the Peterson Institute for International Economics, also emphasized several benefits of higher capital:

> ***[S]tronger capital improves the resilience of our largest banks and enhances their ability to lend through the economic cycle.*** History has proven that insufficient capital can lead to harmful economic results when banks are unable to provide financial services to households and businesses, as occurred during the 2008 financial crisis. Ensuring adequate amounts of bank capital provides a long-term benefit to the economy by enabling banks to play a counter-cyclical role during an economic downturn rather than a pro-cyclical one.[17]

Gruenberg emphasized how capital supports the real economy, rather than constraining it:

> Further, equity capital is not locked away in a manner that inhibits its use to support the real economy. Rather it is deployed in numerous ways that benefit the bank, its stakeholders, and the economy. Equity capital funds a bank's operations, is allocated to make loans to local communities, and can be distributed to shareholders when appropriate with sound financial performance.[18]

Finally, and importantly, Gruenberg cautioned[19] against interpreting banks' performance during the COVID-19 pandemic as evidence of sufficient capital levels. Appropriately, he pointed to the massive federal government support, in excess of $10 trillion which "helped 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] Better Markets shares this view and stated in a recent report:

> In reality, 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. . . . Additionally Congress supported the economy through emergency fiscal measures, which also helped banks by reducing the level of potential business and consumer loan defaults. . . . In fact, this support not only prevented losses, but it also led to much higher

[16] Board of Governors of the Federal Reserve System, *Holistic Capital Review* (July 10, 2023), https://www.federalreserve.gov/newsevents/speech/barr20230710a.htm.

[17] 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.

[18] *Id.*

[19] *Id.*

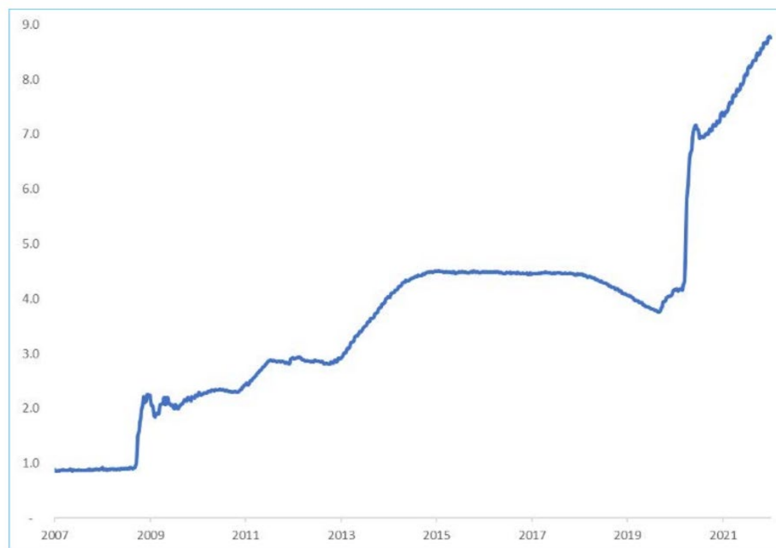
[20] *Id.*

earnings—in 2021 the net income of the four largest banks was 120% higher than in 2019.[21]

The Fed alone expanded its balance sheet by injecting $3 trillion into the financial markets—in which the largest banks are the dominant participants—in just the first 90 days of the COVID-19 pandemic (see Chart 4) and provided massive funding to banks and bank-owned securities dealers, including through repurchase agreements (repos).[22]

Chart 4

Federal Reserve Total Assets *(billions of dollars)*



Source: Federal Reserve Release H.4.1

Importantly, leverage capital ratios at the largest banks have declined sharply in recent years (see Chart 5).[23] The average Tier 1 leverage ratio for global systemically important banks ("GSIBs"), for example, peaked in mid-2016 and has declined since then. Although the average GSIB leverage capital ratio rose slightly in 2023, **GSIB leverage capital ratios still remain near the 2010 levels**. Similarly, large banks that are not GSIBs and regional banks have lower average leverage capital ratios than pre-pandemic levels. Community banks, in contrast, have the highest

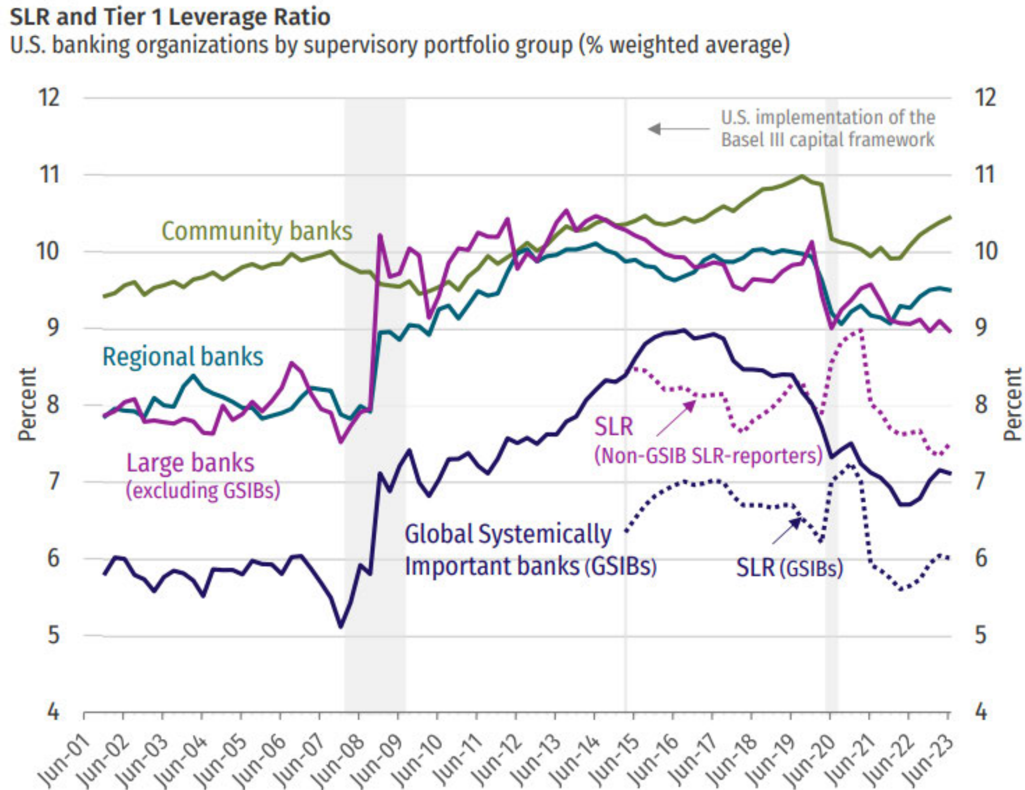
21 Kelleher, Clark & Basil, *supra* note 4.

22 *Id*. at 9.

23 Sabrina Pellerin, *Bank Capital Analysis Semiannual Update, Federal Reserve Bank of Kansas City Bank Capital Analysis* (Nov. 15, 2023), https://www.kansascityfed.org/Banking/documents/9905/Bank_Capital_Analysis_Report_-_2Q_2023_-_final.pdf.

average leverage capital levels of any bank size group and higher capital levels than those reported at the time of the 2008 Crash:

Chart 5



Notes: Tier 1 capital as a percent of total leverage exposure (for SLR) and as a percent of average total assets (for Tier 1 Leverage ratio). SLR reported only by banking organizations that generally have assets greater than $250 billion or on-balance sheet foreign exposures above $10 billion. Portfolio groups are established by the federal banking agencies and reflect the group banking organizations were in as of August 29, 2023.
Sources: Federal Reserve Y-9C Reports, FFIEC Call Reports, and S&P Global Market Intelligence LLC.

Economists, academics, and many bankers agree that capital requirements must increase from current levels. Economists Anat Admati and Martin Hellwig[24] found that capital levels of at least 20-30% of total assets would make banks substantially stronger without sacrificing economic growth. The Federal Reserve Bank of Minneapolis[25] estimated that increasing bank capital levels to 23.5% of risk-weighted assets and 15% of total assets would substantially reduce the likelihood of future taxpayer-funded bailouts while strengthening the economy by making the banking and

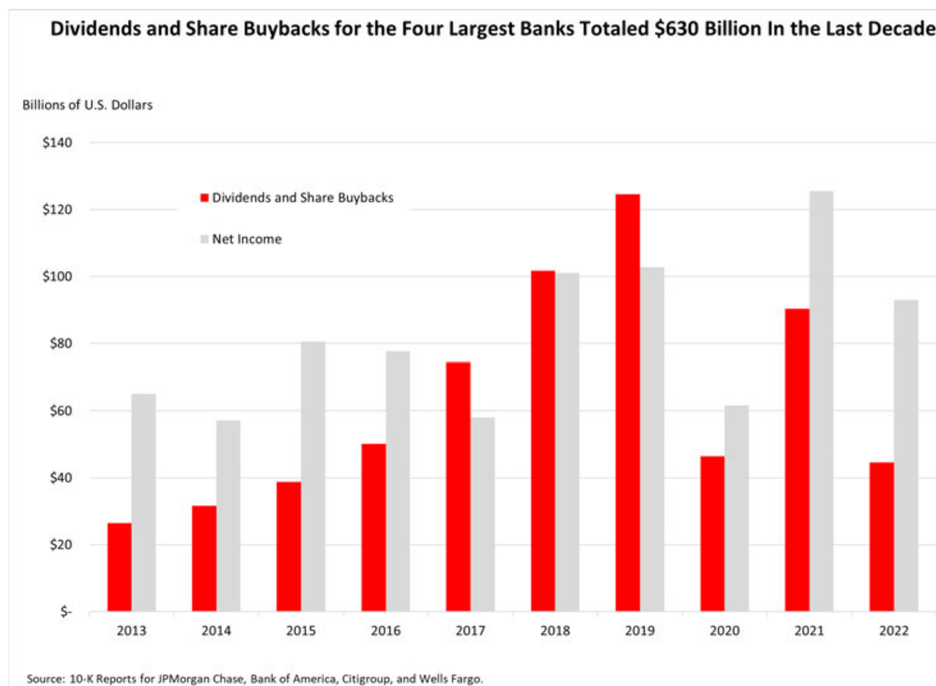
24 ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT - NEW AND EXPANDED EDITION (Jan. 9, 2024).

25 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.

financial system more resilient. Even many bank risk management professionals,[26] who manage bank risk for a living, believe that current capital minimums are insufficient and should be significantly increased. In summary, higher capital requirements have not hurt banks or borrowers, and it is difficult to find any social costs associated with increasing capital requirements and improving the resilience of the financial system. In fact, the biggest threat to Main Street families comes from undercapitalization, which can incentivize banks to engage in high-risk activities and without question increases the likelihood and potential severity of bank failures, devastating economic and financial crashes, and taxpayer bailouts.

Banks' practice of disbursing earnings to shareholders in the form of dividends and common stock buybacks also demonstrates that they have ample funds to increase capital. The largest banks regularly pay out enormous amounts of money to shareholders, all of which are outflows of capital that would otherwise be available to protect the bank.[27] To illustrate, in the last decade, the four largest banks paid out $630 billion to shareholders (see Chart 6). In other words, banks are choosing to make these payouts that benefit investors ***instead of using (at least some portion of) the funds to increase capital and protect financial stability and the American people***.

Chart 6



Furthermore, VCS Barr said that "most banks already have enough capital today to meet the new requirements. For the banks that would need to build capital to meet the requirements,

26 Stephen G. Cecchetti & Kermit L. Schoenholtz, *What Risk Professionals Want*, MONEY AND BANKING (Mar. 11, 2019), https://www.moneyandbanking.com/commentary/2019/3/10/what-risk-professionals-want.

27 *Id.*

assuming that they continue to earn money at the same rate as in recent years, we estimate [they] would be able to build the requisite capital through retained earnings in less than 2 years, even while maintaining their dividends." [28] In other words, most of the covered firms have anticipated the proposed changes and effectively adjusted their business plans and operations so that they will not be disrupted. They could even continue dividend payouts at current levels. Therefore, to support financial stability and reduce the likelihood of future taxpayer-funded bailouts, the new rules could and should be finalized and implemented even more quickly than proposed.

SUMMARY OF THE PROPOSAL

With this Proposal, the Agencies will implement changes that will strengthen various components of the capital ratios to increase comparability, both with other banking organizations and across international jurisdictions; reduce complexity; and better reflect a range of risk exposures. It makes changes to the required deductions from capital, which will generally reduce the numerator of the capital ratio. It also makes several changes that, all things equal, will lead to increased risk-weighted assets. This increase in the denominator of the capital ratio calculation will generally require covered firms to have more regulatory capital to maintain the same risk-based capital ratios. However, the minimum required capital ratios will not change.

The Proposal components generally fall into three segments:

1. ***Structural*** Changes (changes to the scope and framework for applying the capital rules)

2. ***Capital Calculation*** Changes (changes that affect the value of capital or the "numerator" of the capital ratio)

3. ***Risk-Weighted Asset Calculation*** Changes (changes that affect the value of risk-weighted assets or the "denominator" of the capital ratio, including how banking organizations measure credit risk, market risk, operational risk, and credit risk associated with derivatives trading activity or "CVA" risk)

Structural Changes

Currently, and in the Proposal, covered firms are grouped into Categories I, II, III, and IV:[29]

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28 Board of Governors of the Federal Reserve System, *Holistic Capital Review*, *supra* note 16.

29 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, *supra* note 2, at 64031 n.11.

Category	Definition
Category I	U.S. **global systemically important bank holding companies** and their depository institution subsidiaries.
Category II	Banking organizations with **at least $700 billion in total consolidated assets** or **at least $75 billion in cross-jurisdictional activity** and their depository institution subsidiaries.
Category III	Banking organizations with **total consolidated assets of at least $250 billion** or **at least $75 billion in weighted short-term wholesale funding, nonbank assets, or off-balance sheet exposure** and their depository institution subsidiaries.
Category IV	Banking organizations with **total consolidated assets of at least $100 billion** that do not meet the thresholds for a higher category and their depository institution subsidiaries.

One of the key changes in the Proposal is an alignment of capital calculations and application methodologies for all covered firms. As the historical record of banking industry stress and failures in both 2008 and 2023 shows, systemic risk is not limited to just the largest banks in Category I and II. All covered firms have the potential to disrupt the financial system, cause contagion, and result in bailouts. Therefore, many items in the Proposal apply to all banking organizations in Categories I through IV. Additionally, the countercyclical capital buffer ("CCyB") and Supplementary Leverage Ratio ("SLR") will be extended to apply to Category IV banking organizations.

Capital Calculation Changes

The Proposal standardizes and aligns several capital calculations for covered firms.

The most notable change to the capital calculation from the current rule relates to accumulated other comprehensive income ("AOCI"). AOCI includes net unrealized losses on available-for-sale securities, which have grown and become a significant concern as interest rates have risen and the value of securities have declined relative to their book value. Currently, Category III and IV banks were allowed to opt out of recognizing AOCI in regulatory capital and most took advantage of this option, which allows them to overstate banks' net worth. Under the proposed rule, however, all covered firms must recognize AOCI in regulatory capital. This change will help ensure that regulatory capital ratios for all covered firms, not just those in Category I and II, more accurately reflect banking organizations' capacity to absorb losses.

The Proposed rule would also apply current treatment for Category I and II firms to those in Category III and IV for recognition and calculation of, or deductions from, regulatory capital for capital issued by a consolidated subsidiary to third-party investors ("minority interests") as well as mortgage servicing assets ("MSAs"), certain deferred tax assets ("DTAs"), and significant investments in unconsolidated financial institutions.

Risk-Weighted Asset Calculation Changes

The Proposal contains several changes to the overall framework for calculating risk-weighted assets as well as the technical components of specific risk-weighted asset ("RWA") calculations.

- Credit Risk: Credit risk results from the possibility that a borrower or other counterparty will fail to perform its obligation. Loans are a significant source of credit

risk for covered firms, but other products, activities, and services including investments in debt securities and credit derivatives as well as off-balance sheet activities, such as letters of credit, unfunded loan commitments, and the undrawn portion of lines of credit also expose covered firms to credit risk.

The Proposal replaces the "Advanced Approaches" method and bank internal models that can currently be used to calculate RWAs for credit risk with a more risk-sensitive method called the Expanded Risk-Based Approach ("ERB"). All covered firms would be required to calculate credit risk levels using the new ERB as well as the Standardized Approach. Compared to the Standardized Approach, the ERB is more granular and risk-sensitive because it includes more credit risk drivers such as loan and counterparty characteristics for corporate and real estate loans. The ERB also introduces new exposure types, specifically retail lending which includes revolving credit exposures—such as credit card loans, term loans and leases—such as auto loans, and loans to small- and medium-sized businesses.

- Market Risk: Market risk results from exposure to price movements caused by changes in market conditions, market events, and issuer events that affect asset prices. Losses resulting from market risk can negatively affect a covered firm's capital strength, liquidity, and profitability.

  Consistent with the elimination of the Advanced Approaches for credit risk, the Proposal eliminates the ability to use internal models to calculate market risk and introduces a standardized measure. This standardized market risk measure captures losses on credit and equity positions in the event of issuer default, losses from other non-default stress factors, and any other known risks that are not already captured by the first two components, such as gap risk, correlation risk, and behavioral risks.

- Operational Risk: Operational risk results from inadequate or failed internal processes, people, and systems, or from external events. The Agencies believe that operational risk is inherent in all banking products, activities, processes, and systems.

  A new standardized approach for operational risk measures covered firms' business volumes, such as activities that produce interest, lease, or dividend income; fee-based services; and trading activities. It also introduces a requirement to account for the array of potential operational risks. This shift to a standardized approach and the wider application to all covered firms results in a more transparent and comparable risk measure among covered firms.

- CVA Risk: Under current accounting rules, covered firms are required to recognize derivatives at their fair value, using mark-to-market accounting, on the balance sheet (i.e., apply mark-to-market accounting) and reflect certain valuation adjustments in the measurement of fair value. One such valuation adjustment is CVA, which reflects the risk that the counterparties to OTC derivatives may default on their obligations prior to the expiration of the contract.

The current capital rules require the calculation of CVA RWAs as part of the Advanced Approaches, which apply solely to Category I and II banking organizations. Under the Proposed Rule, Category I-IV banking organizations would also be required to recognize and protect against CVA risk.

Overall, to ensure that covered firms do not have lower capital requirements than smaller, less complex banking organizations, the Proposal maintains the current requirement to calculate risk-based capital ratios under both the new ERB and the Standardized Approach and uses the one that leads to the higher required capital charge.

SUMMARY OF COMMENTS

We applaud the Agencies for the long overdue Proposal for more robust capital calculations and measurements and we urge their prompt finalization and implementation. The proposed enhancements in the rule to the measurement of both banks' risks and their available loss-absorbing capital will be a benefit for all Americans and make the financial system safer. However, there are still aspects of the Proposal that can and should be improved, including strengthening the Fed's supervisory stress test and increasing minimum required capital ratios.

Our specific comments in response to the Proposal are summarized as follows:

- The application of the Proposed rule to all Category I-IV banking organizations is the right approach, fully supported by the data, and appropriately recognizes the risk that all covered firms present. Contrary to critics of this change who argue that the new rules eliminate tailoring and introduce a blunt, one-size-fits-all approach, Better Markets believes that the expansion of the application of capital rules to all Category I-IV firms appropriately recognizes the range of risks that covered firms face—and pose to the financial system—and allows for a better relative sizing of capital in relation to these risks. Expansion of the supplementary leverage ratio and countercyclical capital buffers to Category IV firms is also appropriate.

- The consistency of risk measurement for the purpose of calculating risk-based regulatory capital requirements, through the reduced use of opaque and inconsistent internal models to measure credit, market, and operational risk, is a meaningful improvement from prior capital rules. Importantly, the Agencies must ensure that they are sufficiently equipped to assess the effectiveness of any internal models that are still allowed. By their very nature, internal models are not comparable across firms and can introduce unnecessary complexity and opacity to the risk measurement process. Standardized models, together with robust public disclosure and reporting rules, enhance the transparency of a covered firm's capital adequacy, individually and relative to its peers, for the benefit of banking supervisors, market participants, and the general public.[30]

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[30] *See* Basel Committee on Banking Supervision, *Analysis of Risk-Weighted Assets for Credit Risk in the Banking Book* (July 2013), https://www.bis.org/publ/bcbs256.pdf.

- Recognition of AOCI in regulatory capital for all covered firms is a critical improvement that will increase the understanding and improve the measurement of large banks' loss absorbing capital. As demonstrated by the bank failures in early 2023, recognition of unrealized losses on available-for-sale securities is absolutely necessary to appropriately value a covered firm's regulatory capital.

- The addition of specific lending categories and risk measurements for the credit risk segment of the RWA calculation will appropriately strengthen the measurement of risk. As noted earlier, the ERB includes new retail lending categories such as credit card, mortgage, auto, and small business loans. Historical experience has shown that these loan portfolios are a meaningful source of credit risk and are therefore important to include in covered firms' credit risk measure.

- A three-year transition period is unnecessary and too long because it leaves room for known risks to materialize and harm the banking system. As stated earlier, most covered firms already have enough capital to meet the new required levels. It is a mistake to wait a full three years to fully implement the new standards.

- Giving specific estimates in advance for banks' capital requirements undermines the credibility and effectiveness of the Fed's supervisory stress tests. These new capital rules will work in tandem as part of the broader set of requirements for and oversight of the largest banks, along with programs like the Fed's stress tests, which is a direct input into the large banks' capital requirements. To give estimates of what capital ratios would be after the new rules are in place implies that the results of future stress tests are both knowable and known. The Fed must ensure that future stress test scenarios and results are not manipulated and/or watered down to meet these estimates.

- The Proposal does not achieve the stated purpose of significantly reducing complexity. While this is not necessarily feasible given the complexities of banks, the Agencies must ensure that banking supervision staff and management are adequately trained and equipped to understand the set of proposed rules to accurately judge covered firms' compliance with them. The firms that will be subject to the Proposal run extremely complex operations, some with trillions of dollars in assets. These institutions can, without question, be expected to understand the new rules and fully comply to protect the American people's hard-earned savings and enhance financial stability for the benefit of the economy and financial system more broadly.

COMMENTS

I. THE APPLICATION OF THE PROPOSED RULE TO ALL CATEGORY I-IV BANKING ORGANIZATIONS IS THE RIGHT APPROACH, FULLY SUPPORTED BY THE DATA, AND APPROPRIATELY RECOGNIZES THE RISK THAT ALL COVERED FIRMS PRESENT.

The expansion of appropriately strong capital rules to all Category I-IV firms accurately recognizes that systemic risk potential is not limited to just the GSIBs. While GSIBs certainly do present significant risk to the financial system, 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 or drain the FDIC's Deposit Insurance Fund. Ever since the deregulatory actions that were put in place during the Trump administration that applied less stringent rules to Category III and IV firms, in comparison to Category I and II firms, Better Markets has advocated for higher capital levels for any firm with more than $100 billion in total assets.[31] These institutions are not community banks; they are complex institutions with multiple business lines and enough size and complexity to cause severe damage to the banking system as a whole if they experience critical levels of stress.

By requiring each individual covered firm to have enough capital to protect itself against its individual risk, the Agencies are more effectively 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"), VCS 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.[32]

The power of the contagion effect has been echoed in FDIC Chairman Gruenberg's reflections on the March 2023 decision to declare a systemic risk exception.[33] And the dire consequences of contagion spreading ***throughout*** the banking system are clear: As of June 2023, covered firms together had more than $16 trillion in total assets, a staggering sum that certainly is large enough to cause havoc in the banking system if confidence in the financial soundness of

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[31] *See, e.g.,* Better Markets Comment Letter, Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements (Jan. 22, 2019), https://www.bettermarkets.org/sites/default/files/Better%20Markets%20Comment%20Letter%20Capital%20and%20Liquidity%20Proposal.pdf.

[32] 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.

[33] 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.

these firms is questioned and contagion effects spread the concerns to other banks. There should be no doubt that the proposed capital rules should apply to all covered firms.

Expansion of the supplementary leverage ratio and countercyclical capital buffers to Category IV firms is also appropriate. We applaud the Agencies for not reducing leverage ratios to which firms would be subject, and for instead bringing further alignment among all covered firms to enhance resilience throughout the banking system.

II. THE CONSISTENCY OF RISK MEASUREMENT, THROUGH REDUCED USE OF INTERNAL MODELS TO MEASURE CREDIT, MARKET, AND OPERATIONAL RISK, IS A MEANINGFUL IMPROVEMENT FROM PRIOR CAPITAL RULES. BUT THE AGENCIES MUST ALSO ENSURE THAT THEY ARE SUFFICIENTLY EQUIPPED TO ASSESS THE EFFECTIVENESS OF ANY INTERNAL MODELS THAT ARE STILL ALLOWED.

One of the key strengths of the Proposal is the consistency and transparency that it provides by allowing less use of covered firms' internal models and requiring wider use of standardized measures of risk. For credit, market, and operational risk, covered firms must use these standardized models. The models remain sensitive to the firm's individual business and risk exposures, but they measure risk and apply capital rules in a consistent way.

Credit Risk

Research has shown that there has been material variability in credit risk measures that result from banks' use of internal models. For example, analysis from the Bank for International Settlements ("BIS") showed that for an identical portfolio of loans, the amount of modeled capital that is required by **internal models varied as much as 15-20 percent in either direction**.[34] This amount of difference is unacceptable for measuring something as important as credit risk for the largest and most complex banking firms. For something as large and consequential as credit risk, the Agencies should unquestionably require the best-known available measure, and internal models clearly fail that test. Furthermore, as VCS Barr explained ahead of the Proposal's release, "Experience suggests that banks tend to underestimate their credit risk because they have a strong incentive to lower their capital requirements."[35]

Market Risk

Similarly, the Proposal introduces a much-needed standardized approach for market risk, which will enable increased transparency and comparability for covered firms' trading activities. However, the Proposal does allow covered firms to use internal models to measure market risk for certain trading desk operations, with prior approval from the firm's federal banking supervisor. Use of internal models is only allowed when the supervisor finds that the covered firm is

[34] Basel Committee on Banking Supervision, *supra* note 30.

[35] Board of Governors of the Federal Reserve System, *Holistic Capital Review, supra* note 16.

conducting "robust testing" that results in model results that are "sufficiently conservative and accurate for purposes of calculating market risk capital requirements."[36] With this flexibility, the Agencies must ensure that supervisory staff is fully able to understand the complexity of firms' models and gauge their effectiveness.

Operational Risk

Covered firms' operational risks are also significant and the measurement of them is enhanced in the Proposal by requiring the use of standardized models and metrics. In the current rule, Category I and II firms calculate operational risk using internal models, based on the firm's choice of modeling assumptions and data. Not surprisingly, the variability and subjectivity of the inputs to internal models leads to unpredictability and variability of the outputs as well. Standardized models will improve confidence in the validity of the modeled outputs, increase transparency of the risk-based capital ratios, and allow for comparisons of capital adequacy across banking organizations.

Not only can operational risk result in large costs for banks, but it often has severe and damaging effects on consumers who are harmed by the risky operations. Bank CEOs and even some regulatory officials, however, have attempted to downplay the severity of operational risk and dismiss the need for capital allocation for it. This is not only irresponsible and dangerous but also inconsistent with the facts and data. For example, Morgan Stanley CEO James Gorman attacked the Proposal, claiming banks were being punished for diversifying into fee-based businesses, a practice that on the surface would seem to reduce risk.[37] Nevertheless, Morgan Stanley and other large banks continue to engage in illegal, discriminatory, and fraudulent conduct that not only harms consumers but also increases banks' operational risk and costs.[38] Furthermore, FDIC Vice Chairman Travis Hill attempted to make operational risk seem too broad to measure with his statement, claiming "operational risk is an amorphous concept, a catch-all category that

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36 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, *supra* note 2, at 64032.

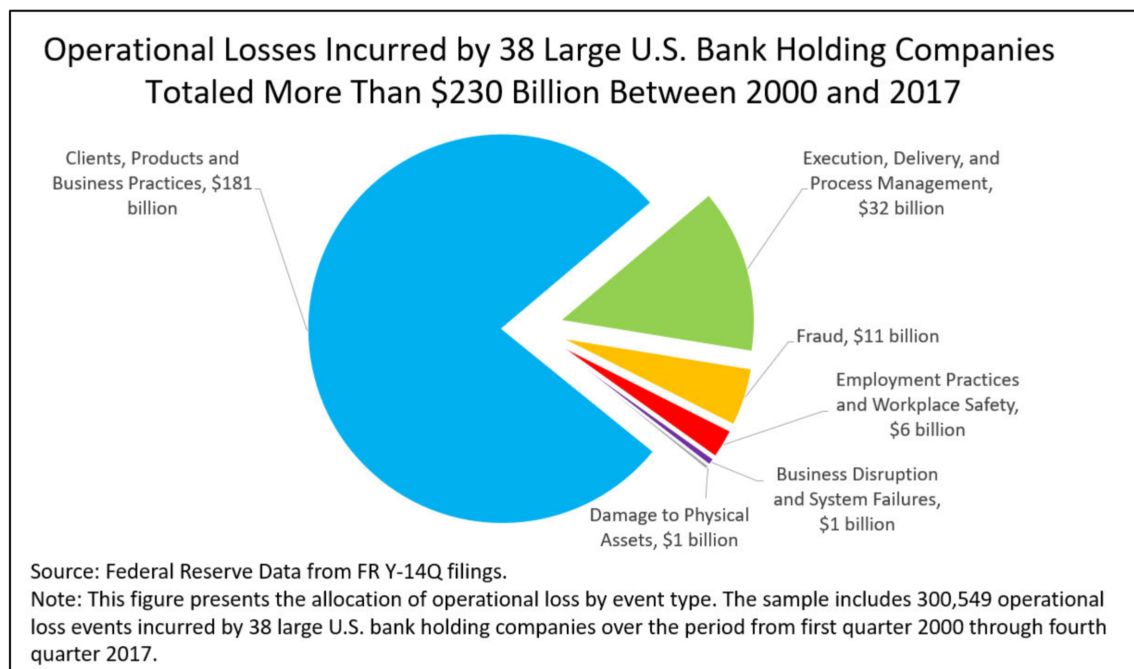
37 Kyle Campbell, *Operational Risk Emerging as Linchpin of Basel Capital Debate*, AM. BANKER (Dec. 7, 2023), https://www.americanbanker.com/news/operational-risk-emerging-as-linchpin-of-basel-capital-debate.

38 *See e.g.*, BETTER MARKETS, RAP SHEET REPORT: WALL STREET'S ONGOING CRIME SPREE — 490 MAJOR LEGAL ACTIONS AND NEARLY $207 BILLION IN FINES AND SETTLEMENTS (Oct. 12, 2023), https://bettermarkets.org/wp-content/uploads/2023/10/BetterMarkets_Wall_Street_RAP_Sheet_Report_10-2023.pdf; Ava Benny-Morrison, Sridhar Natarajan, & Austin Weinstein, *Morgan Stanley to Pay $249 Million to End Block Trade Probes*, BLOOMBERG (Jan. 12, 2024), https://www.bloomberg.com/news/articles/2024-01-12/morgan-stanley-to-pay-153-million-after-doj-block-trade-probe?sref=mQvUqJZj.

encompasses a large and highly variable set of risks, ranging from fraud to bad behavior to overzealous enforcement agencies to cyber attacks to asteroids."[39]

Data and results from several research studies show how misguided these claims are and underscore the need for allocating capital to protect against operational risk. Operational risk can indeed be defined and measured, and the results for the largest banks are astoundingly bad. **Between 2000 and 2017, more than 300,000 events totaling more than $230 billion in operational losses were reported by just 38 bank holding companies to the Federal Reserve in FR-Y14Q filings** (see Chart 7).[40]

Chart 7



A Federal Reserve Bank of Dallas study[41] analyzed this data and found that as a bank increases in size, it is exposed to more and more operational risk. Operational risk at the largest banks is particularly persistent over time and it is attributed to greater amounts of institutional

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[39] Federal Deposit Insurance Corporation, *Statement by Travis Hill, Vice Chairman, FDIC, on the Proposal to Revise the Regulatory Capital Requirements for Large Banks* (July 27, 2023), https://www.fdic.gov/news/speeches/2023/spjul2723b html.

[40] Filippo Curti & Marco Migueis, *The Information Value of Past Losses in Operational Risk*, Board of Governors of the Federal Reserve System: Finance and Economics Discussion Series 2023-003, (2023), https://doi.org/10.17016/FEDS.2023.003.

[41] Filippo Curti, W. Scott Frame & Atanas Mihov, *Are the Largest Banking Organizations Operationally More Risky?* Federal Reserve Bank of Dallas Working Paper 2016 (Mar. 3, 2020), https://doi.org/10.24149/wp2016.

complexity and moral hazard at these too-big-to-fail institutions. So, while Mr. Gorman's statement about the benefits of diversification within a large banking organization may seem logical at first, the data prove there can also be substantial downside from an operational risk perspective. Finally, researchers show that past operational losses ***are*** informative of future losses because inadequate risk controls and a high-risk appetite within the culture of a firm are factors that are unlikely to change quickly. All of these factors clearly support the need for a standardized measure of operational risk.

Furthermore, Better Markets has tracked enforcement actions that have resulted from inadequate operational risk management at the nation's six largest megabanks for several years in its 2023 Rap Sheet Report,[42] detailing the dollar amounts of penalties and enormous harm to the American public that this misconduct creates. Moreover, the Consumer Financial Protection Bureau ("CFPB") has been one of the most effective agencies in the federal government, identifying and holding banks accountable for operational failures that cause direct harm to consumers.[43] While the list is incredibly long, we will just mention a few examples:

- One of the best examples of widespread operational failure that resulted in damages and loss for 16 million Americans was detailed in the CFPB's December 2022 enforcement action against Wells Fargo.[44] Wells Fargo misapplied loan payments, wrongfully foreclosed on homes, illegally repossessed vehicles, incorrectly assessed fees and interest, and charged surprise overdraft fees. Not only did system and process failures occur at Wells Fargo in this case, but the bank was also aware of the problems for years before ultimately addressing the issues and made deceptive claims to mislead affected customers. That prolonged misconduct resulted in $3.7 billion in monetary sanctions. This followed yet another Wells Fargo scandal spanning multiple years involving fraud, identity theft, falsification of bank records, and unauthorized charging of fees in connection with opening millions of bank and credit card accounts that customers did not know about.[45] Penalties from this second scandal—another clear operational failure— cost the bank another $3.8 billion.

- More recently, operational failures at Citi were highlighted by its pattern of discrimination against applicants for certain credit card products, based on their

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42 BETTER MARKETS, RAP SHEET REPORT, *supra* note 38.

43 *See* Consumer Financial Protection Bureau, *Twelve Years Of Protecting Consumers and Honest Businesses* (Jul. 20, 2023), https://www.consumerfinance.gov/about-us/blog/twelve-years-of-protecting-consumers-and-honest-businesses/; Consumer Financial Protection Bureau, *Enforcement actions*, https://www.consumerfinance.gov/enforcement/actions/; *infra* notes 40–42.

44 Consumer Financial Protection Bureau, *CFPB Orders Wells Fargo to Pay $3.7 Billion for Widespread Mismanagement of Auto Loans, Mortgages, and Deposit Accounts* (Dec. 20, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-wells-fargo-to-pay-37-billion-for-widespread-mismanagement-of-auto-loans-mortgages-and-deposit-accounts/.

45 BETTER MARKETS, RAP SHEET REPORT, *supra* note 38.

surnames that were assumed to indicate Armenian descent.[46] Citi supervisors conspired to hide the operational failures by instructing employees not to discuss the discriminatory practices in writing or on recorded phone lines. Citi employees also lied about the basis for denial of credit, providing false reasons to deny applicants. These multiple operational failures occurred over six years and resulted in penalties of more than $25 million.

- Finally, Goldman Sachs' years-long involvement with the 1MDB criminal scheme has been called "one of the greatest financial heists in history" and provides a clear example of the potential scale and financial costs that operational failures can have for a bank, with direct implications for its capital levels.[47] As Better Markets details, the 1MDB scandal persisted over five years and cost the bank $3.9 billion in sanctions. Analysis of the scandal points to the enormous fees as a clear indicator of risk and inadequate internal controls. Goldman reported $600 million in fees from 1MDB for its work in connection with Malaysian bond issues−nearly equivalent to the total revenue that it earned from its entire global bond underwriting business over a calendar quarter. One reporter aptly stated,

> Whether or not you believe that Goldman Sachs Group Inc. deserved those high fees for its work with a scandal-ridden Malaysian investment fund, or that rogue bankers got it in this hot mess, one thing's for sure: The bank's internal checks just weren't good enough."[48]

One of the most criticized aspects of changes in operational risk measurement is the reliance on fees as an indicator of risk. However, this case provides clear evidence that high fees may indeed be an indicator of risky behavior.

All of these examples and the many more contained in the Better Markets' Rap Sheet Report cited above[49] clearly show how deficient processes and inadequate oversight led to severe operational losses and costs for the banks, along with massive harm to innocent consumers. More capital is indeed required to protect against losses that result from this risky behavior.

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[46] Consumer Financial Protection Bureau, *CFPB Orders Citi to Pay $25.9 Million for Intentional, Illegal Discrimination Against Armenian Americans* (Nov. 8, 2023), https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-citi-to-pay-25-9-million-for-intentional-illegal-discrimination-against-armenian-americans/.

[47] BETTER MARKETS, RAP SHEET REPORT, *supra* note 38.

[48] Nisha Gopalan, *Rogue Bankers Don't Explain Goldman's 1MDB Mess*, BLOOMBERG (Dec. 21, 2018), https://www.bloomberg.com/view/articles/2018-12-21/rogue-bankers-don-t-explain-goldman-s-gs-1mdb-mess?sref=mQvUqJZj.

[49] BETTER MARKETS, RAP SHEET REPORT, *supra* note 38.

III. RECOGNITION OF AOCI IN REGULATORY CAPITAL FOR ALL COVERED FIRMS IS A CRITICAL IMPROVEMENT THAT WILL INCREASE THE UNDERSTANDING AND IMPROVE THE MEASUREMENT OF LARGE BANKS' LOSS ABSORBING CAPITAL.

Capital ratios should reflect a firm's loss absorbing ability at any point in time. The current rule only requires Category I and II firms to recognize the fair value of available-for-sale securities. This leaves a large and dangerous gap and reduces transparency for Category III and IV firms' ability to cover themselves in a stress situation.

The importance of this change was demonstrated in the bank failures in spring 2023. It was clear that unrealized losses in the failed banks' securities portfolio were a catalyst for failure. For example, the Federal Reserve's analysis of Silicon Valley Bank's failure shows that if the bank had been required to recognize unrealized losses on its available-for-sale portfolio, its reported regulatory capital would have been $1.9 billion lower.[50]

The Agencies' analysis in the Proposal shows that the change in recognition of unrealized gains and losses would have a meaningful impact for Category III and IV firms' capital.[51] U.S. firms in Category III would have to increase capital by an amount equivalent to a 4.6% increase in CET1 capital ratios and Category IV firms would have to increase capital by an amount equivalent to a 2.6% increase in the same metric. This illustrates that the CET1 ratios under the current rules are too low and by implementing the change, Category III and IV firms would have a more accurate measure of loss-absorbing capacity.

IV. THE ADDITION OF SPECIFIC LENDING CATEGORIES AND RISK MEASUREMENTS FOR THE CREDIT RISK SEGMENT OF THE RWA CALCULATION WILL APPROPRIATELY STRENGTHEN THE MEASUREMENT OF RISK.

Credit risk is one of the primary types of risk that covered firms face and the Proposal contains meaningful improvements to strengthen this measure and the capital protections related to it. As noted earlier, the new ERB includes several new loan categories for which credit risk will be measured, including retail lending categories such as credit card, mortgage, auto, and small business loans.

Higher risk weights are proposed for both real estate and non-real estate loan categories. At a high level, the Proposal is informed by the experience in the 2008 Crash, which prominently featured outsized risk in certain portfolios, particularly real estate, which led to bank failures. In the Proposal, residential mortgage loans with riskier characteristics, such as high loan-to-value

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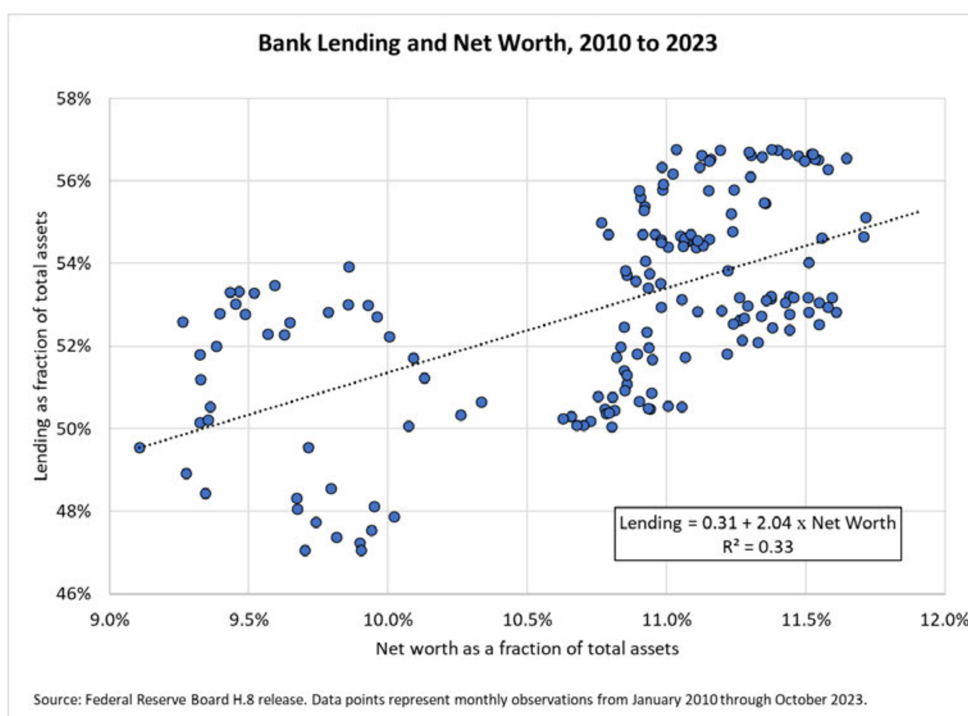
[50] Board of Governors of the Federal Reserve System, *supra* note 32.

[51] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity, *supra* note 2, at 64171.

("LTV") ratios or a dependence on cash flows, typically investor properties, do indeed have a higher risk of default, and thus a higher risk weight is reasonable.

Critics of these changes assert that higher capital requirements will restrict lending and, in turn, negatively affect the broad economy and specific borrowers. However, the data proves that this claim is false. The truth is that higher capital levels are actually associated with ***higher amounts of lending by banks***. Professor Stephen Cecchetti demonstrated this using monthly bank capital and lending data (see Chart 8).[52] He showed that when banks increase capital by retaining earnings, for example, banks will have more capacity to lend. Data in the chart from 2010 through 2023 show that ***for every 1 percentage point increase in capital, bank lending increases by 2 percentage points***.

Chart 8



Furthermore, critics of the Proposal have raised concerns about disproportionate negative effects on specific borrowers such as small businesses and minorities. We believe that the Agencies must certainly guard against such negative impacts if data supports that they exist. However, we believe that the data show that the Proposal's impact on these borrowers will be minimal because they make up a small and shrinking share of large banks' lending. Most importantly, the proposed capital rules will actually help ***all borrowers***, including small businesses and minorities because well-capitalized banks are able to lend no matter the economic environment.

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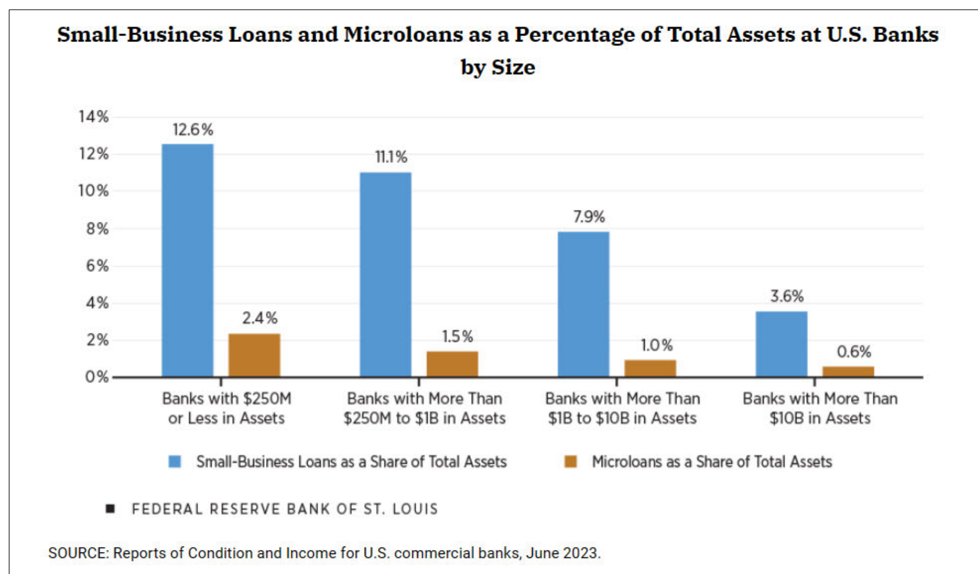
[52] Cecchetti, *supra* note 7.

Small business lending is not a major business line for the largest banks. In fact, analysis from the Federal Reserve Bank of St. Louis shows that the largest banks do the least amount of small business lending, relative to their size (see Chart 9).[53] Banks with $10 billion or more in total assets have the smallest amount of small business lending among any bank size group, only 3.6% of total assets, compared to more than 12% of total assets for banks with less than $250 million in total assets. Importantly, the Proposal does not affect these smaller banks, which are actually much more focused on serving small businesses. The 2020 FDIC Community Banking Study[54] further supports this point, stating that community banks alone account for 36 percent of all small business loans. That is more than double their 15 percent share of the banking industry's total loans. Put differently, community banks provide only 15 percent of all banking industry loans but provide 36 percent of small business loans.

Chart 9



Similarly, banks have been reducing their mortgage lending for decades as developments in primary and secondary mortgage markets, securitization, and technological innovation have evolved.[55] Mortgages have become relatively easy to provide and have low margins; consequently, nonbanks have increased mortgage lending dramatically while banks have reduced their participation in the market. In fact, nonbank lenders originated more than half of the total annual

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53 *See* Eldar Beiseitov, *Small Banks, Big Impact: Community Banks and Their Role in Small Business Lending*, Federal Reserve Bank of St. Louis (Oct. 20, 2023), https://www.stlouisfed.org/publications/regional-economist/2023/oct/small-banks-big-impact-community-banks-small-business-lending.

54 *See* Federal Deposit Insurance Corporation, *FDIC Community Banking Study,* at 4-1 (Dec. 2020), https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf.

55 *See* Kayla Shoemaker, *Trends In Mortgage Origination And Servicing: Nonbanks in the Post-Crisis Period*, 13 FDIC Q. 52, Chart 1 (Third Quarter 2019), https://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2019-vol13-4/fdic-v13n4-3q2019.pdf.

residential real estate loan volume in 2022, the latest data available.[56] Accordingly, while banks held nearly 70 percent of 1-4 family residential mortgage loans in the 1970s, they only hold about 20 percent of the total now.[57] Furthermore, the six largest megabanks hold only about 7 percent of outstanding 1-4 residential mortgages, well below their 35 percent share of total loans and more than 43 percent share of total assets in the banking industry. This reduction in mortgage lending isn't new, isn't being caused by higher capital requirements, and isn't focused on any one minority group.

However, despite making pledges and setting ambitious goals for increased mortgage lending in minority communities, the megabanks have fallen short and broken promises to support minorities' goals of homeownership. For example, in 2017, Wells Fargo, the megabank that has historically focused most on mortgage lending, announced $60 billion to create 250,000 Black homeowners within the next decade.[58] But, in 2021, Wells Fargo underwrote 42% fewer mortgages to Black buyers than in the year it announced its target. Even counting mortgages purchased from other lenders (which is of questionable utility), Wells Fargo backed successively fewer mortgage loans in each of the past five years, hitting a 15-year low in 2021. And that is the record of the "best" mortgage lending megabank. Of course, none of this even addresses the all too frequent charges of redlining and discrimination against the megabanks.

Even more disturbing are the inflammatory and misleading "studies" and claims[59] from organizations that appear to be independent of the banks, but which receive massive donations from megabanks. For example, one study about the potential impact of the new capital requirements on mortgage lending at first glance suggests that new rules will have a large and negative impact on lending.[60] However, the study fails to focus on the fact that the proposed rules will only affect a small fraction of all mortgage loans−only those made by the largest banks that would be risky enough to be subject to the new rules.

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[56] *See* Rica Dela Cruz & Gaby Villaluz, *Nonbank Lenders Shed Mortgage Market Share as Originations Plummet in 2022,* S&P GLOB. MKT. INTELLIGENCE (July 13, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/nonbank-lenders-shed-mortgage-market-share-as-originations-plummet-in-2022-76481554#:~:text=Nonbanks%20accounted%20for%2050.9%25%20of%20funded%20loans%20in,which%20booked%20%241.126%20trillion%20in%20mortgages%20in%202022.

[57] Shoemaker, *supra* note 55.

[58] Shawn Donnan, Ann Choi & Christopher Cannon, *Big US Banks Fall Short on Promises to Create Black Homeowners*, BLOOMBERG (Dec. 19, 2022), https://www.bloomberg.com/graphics/2022-black-home-loan-broken-promises/?sref=mQvUqJZj.

[59] David Dayen, *The Curious Partner in Big Banks' Drive to Weaken Capital Rules*, THE AMERICAN PROSPECT (Nov. 29, 2023), https://prospect.org/power/2023-11-29-curious-partner-big-banks-capital-rules/.

[60] Laurie Goodman & Jun Zhu, *Bank Capital Notice of Proposed Rulemaking*, URBAN INST. (Sept. 2023), https://www.urban.org/sites/default/files/2023-09/Bank%20Capital%20Notice%20of%20Proposed%20Rulemaking.pdf.

V. A THREE-YEAR TRANSITION PERIOD IS UNNECESSARY AND TOO LONG BECAUSE IT LEAVES ROOM FOR KNOWN RISKS TO MATERIALIZE AND HARM THE BANKING SYSTEM.

While the Proposal does not change the minimum required capital ratios, the amount of required capital for most firms would rise because of changes to the calculations of RWAs that would require more capital to maintain the same capital ratios. The Proposal states, however, that most covered firms already have enough capital to meet the new rules. Only five covered firms are estimated to currently have less capital than would be required under the new rules and Fed VCS Barr stated[61] that "assuming that they continue to earn money at the same rate as in recent years, we estimate that banks would be able to build the requisite capital through retained earnings in less than 2 years, even while maintaining their dividends." Therefore, it is a mistake to wait a full three years to implement the new standards. Waiting will only benefit the banks, allowing for additional shareholder dividends and executive bonuses, all while the American public and the financial system are exposed to the risk-taking at these large banks.

VI. GIVING SPECIFIC ESTIMATES IN ADVANCE FOR BANKS' CAPITAL REQUIREMENTS UNDERMINES THE CREDIBILITY AND EFFECTIVENESS OF THE FED'S SUPERVISORY STRESS TESTS.

Capital rules work as one element of the oversight of the largest banks, along with programs such as the Fed's stress tests. The Proposal states that with the implementation of the new rules, the CET1 ratio would increase, "by an estimated 19 percent for holding companies subject to Category I or II capital standards, by an estimated 6 percent for Category III and IV domestic holding companies, and by an estimated 14 percent for Category III and IV intermediate holding companies of foreign banking organizations."[62]

Issuing estimates of what post-stress test capital ratios will be after the new rules are in place reinforces the dangerous expectation that the results of future stress tests are already known and that all covered firms will pass the stress tests given a specific increase in capital. This cannot be known in advance as the banks' risk profiles may change and the scenarios used for the stress test will be dynamic, not decided and fixed in advance. Making such claims about the future undermines the credibility of the stress testing program.

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[61] Board of Governors of the Federal Reserve System, *Capital Supports Lending*, *supra* note 15.

[62] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, *supra* note 2, at 64169 n.464.

VII. THE PROPOSAL DOES NOT ACHIEVE THE STATED PURPOSE OF SIGNIFICANTLY REDUCING COMPLEXITY, AND THE AGENCIES MUST THEREFORE ENSURE THAT BANKING SUPERVISION STAFF AND MANAGEMENT IS ADEQUATELY TRAINED AND EQUIPPED TO UNDERSTAND THE SET OF PROPOSED RULES TO ACCURATELY JUDGE COVERED FIRMS' COMPLIANCE WITH THEM.

The Agencies state that the Proposal "reduces the complexity of the framework."[63] While the overall goals of resilience for the banking system and improved calibration of covered firms' risk to required capital are relatively straightforward, we do not believe the Proposal itself is simplified relative to prior versions of the Basel capital rules. However, given the complexity of the covered firms' operations as well as their size and influence within the overall banking system, simplicity is not necessarily feasible, required, or appropriate. The covered firms have trillions of dollars in assets and run multiple business lines, often with global reach. These institutions can certainly be expected to understand the new rules and fully comply in order to protect the American people's hard-earned savings and enhance the stability of the financial system more broadly.

Finally, the Agencies must ensure that supervisory staff are adequately trained to understand and empowered to enforce the new regulations. As has been detailed by Fed and FDIC Office of the Inspector General reports on SVB[64] and First Republic Bank,[65] the examination staff's identification of risk was not supported by upper Agency management, supervisory efforts were uncoordinated, and high-risk activities were not given appropriate attention by examination staff with relevant training and experience. For this Proposal to be effective, it must be paired with strong banking supervision, especially with respect to examinations and enforcement.

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63 *Id.*, *supra* note 2, at 64028.

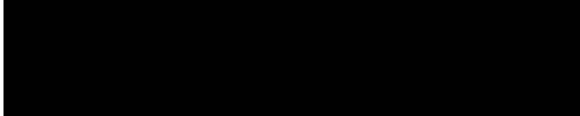
64 *See* Board of Governors of the Federal Reserve System, *supra* note 32; Office of Inspector General, Board of Governors of the Federal Reserve System, *Material Loss Review of Silicon Valley Bank* (Sept. 25, 2023), https://oig federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf.

65 *See* Federal Deposit Insurance Corporation, *FDIC's Supervision of First Republic Bank* (Sept. 8, 2023), https://www.fdic.gov/news/press-releases/2023/pr23073a.pdf.

CONCLUSION

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

Sincerely,



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