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CONGRESSMAN BRAD SHERMAN

SERVING THE SAN FERNANDO VALLEY & PARTS OF THE WESTSIDE

November 28, 2023

The Honorable Martin J. Gruenberg
Chairman of the Board of Directors
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Mr. Michael J. Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street, S.W.
Washington, D.C. 20219

The Honorable Michael S. Barr
Vice Chair for Supervision
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Comment on Regulatory Capital Rule (88 FR 64028, Docket ID OCC–2023–0008)

Dear Vice Chair Barr, Chairman Gruenberg, and Mr. Hsu:

By year-end 2022, Silicon Valley Bank (SVB) reported assets of $28.5 billion in available-for-sale securities and $91.3 billion in held-to-maturity securities, when valued on an amortized costs basis, according to its Federal Financial Institutions Examination Council (FFIEC) call report. However, the fair market value of SVB's securities portfolio was $26.0 billion for available-for-sale securities and $76.2 billion for held-to-maturity securities, *meaning its unrealized losses were $2.5 billion and an astonishing $15.1 billion*, respectively. In fact, the purportedly 209-billion-dollar bank would have been valued below $195 billion if marking-to-market its held-to-maturity securities and recognizing all unrealized securities losses.

The Federal Reserve's report on SVB's failure rightly notes the drastic increase in SVB's unrealized losses in its securities portfolio, for both available-for-sale and held-to-maturity securities, that coincided with rising interest rates, and how such an abnormally large share of its securities portfolio was in the held-to-maturity bucket. The report concludes, in part, that the cause of SVB's failure was its inability to manage liquidity and interest-rate risk, stemming from its long-term securities portfolio.[1]

[1] Board of Governors of the Federal Reserve System. "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank." April 2023. See especially pages 17 to 24. https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf

Since SVB opted out of the Accumulated Other Comprehensive Income (AOCI) requirement, none of the unrealized losses from the bank's available-for-sale securities were included within its regulatory capital, although such losses were indeed reflected in its financial statements under generally accepted accounting principles. The proposed revised capital rule (88 FR 64028) would only require covered institutions to recognize unrealized losses on those *available-for-sale* securities – only a small fraction of SVB's total unrealized losses on securities – within their regulatory capital.

FDIC-insured institutions reported cumulative assets of $23.7 trillion at the end of Q1 2023. That number reflects $231.6 billion in unrealized losses on available-for-sale securities – although like SVB, most institutions other than the Global Systemically Important Banks (G-SIBs) have opted out of the AOCI requirement, and these losses are therefore not presently reflected in the banks' regulatory capital. **But what is not reflected in either banks' financial statements *or* their regulatory capital are unrealized losses on held-to-maturity securities, which totaled $284.0 billion across FDIC-insured institutions by March 2023.** Unlike small business loans, government-backed securities, while carrying almost no credit risk, have significant interest rate risk, despite receiving an asset risk weight of zero percent under current regulatory capital standards.

During the House Financial Services Committee's November 15th, 2023 hearing titled "Oversight of Prudential Regulators," I asked witnesses – representing each of the agencies promulgating this proposed rule – why they were not requiring large banks to recognize any portion of unrealized losses on held-to-maturity securities. **I encourage the agencies to consider also addressing unrealized losses on held-to-maturity securities in the finalized capital rule.**

I am including the transcript from the hearing within this comment letter, as the below elaborates upon the need to ensure our system of banking regulation does not encourage banks to amass an enormous asset portfolio of securities – and held-to-maturity securities in particular – at the expense of making loans to small businesses:

> **Mr. SHERMAN:** If our standards are too low, we end up with bailouts and bankruptcies. But if our standards are unnecessarily high, we slow economic growth.
>
> It concerns me to hear your opening testimony when you describe how these regulations are in response to the 2008 crisis. It's a little late to be writing regulations in response to the 2008 crisis. The question is, will I still be alive when you write regulations responding to the 2023 crisis? And that 2023 crisis is a direct result of you underestimating the problems of interest rate risk.
>
> You've worked hard on these regulations, but as I'll point out to you, they discriminate against the environment, they discriminate against first-time homebuyers, and they discriminate against small business.
>
> Now, one of the ways they discriminate against small business is: with a small business, the bank has very little interest rate risk; they're short-term loans or they're adjustable

rate. You buy a 30-year bond: it might be very credit worthy – it might not have any credit risk. It has all that interest rate risk.

I'm flabbergasted that it's taken until now for you to propose regulations to say that banks have to recognize unrealized losses on held-for-sale [available-for-sale] securities. That's flabbergasting to think that you would take an asset that the bank paid a million dollars for, that the market tells you is worth only 600,000, and count it as a million. But half these securities are in that hold-to-maturity account, and you're not doing anything about it.

Are any of you thinking of causing banks to recognize unrealized losses – and I urged this back when you were here back in March, just a few days after Silicon Valley Bank – and mark-to-market the losses on *all* securities? Are any of you considering that? Mr. Barr?

Mr. BARR: Thank you, Mr. Sherman. You raise an important question. First of all, as I said at the beginning, we're open for comment on all the issues you've raised otherwise...

Mr. SHERMAN: You've just heard my comment.

Mr. BARR: And with respect to unrealized losses, the proposal is focused on available-for-sale securities, as you point out. It's the rule we have for G-SIBs. We don't have that for other large banks. This would apply that approach to other large banks.

Mr. SHERMAN: OK. You're doing a tiny step forward when you had a massive crisis thought to be a risk to our entire economy – and you invoked that law – and you're taking this tiny step, and you're leaving on the balance sheet assets at a million that you know are worth 600,000. But in doing so, you're discriminating against small business. Every time a bank is incentivized to buy that long term debt on the securities market, that's money they can't lend to a local pizzeria.

Sincerely,

BRAD SHERMAN
Member of Congress
Ranking Member, Subcommittee on Capital Markets