WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

September 21, 2023

Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution NW
Washington, DC 20551

Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Woodstock Institute has a 50-year history of advancing economic and racial justice within financial systems through research and advocacy. Through that expertise, we have learned at least one universal truth – when financial institutions go on a diet, low- and moderate-income borrowers and communities of color starve.

We support your goal of increasing the resilience of the banking system. However, we are concerned about the collateral damage associated with a 20% diet for systemically important global banks and a 10% diet for large banks. It will likely cause an increase in lending activity through less regulated institutions, regulatory arbitrage with foreign regulatory agencies, and no tangible diminution of systemic risk as it is currently being proposed. Worst of all, marginalized borrowers will likely end up footing the bill. All of this upheaval seems to be founded on a surprisingly vague 17-page analysis that fails to consider the impact of the proposed rule as mandated by the Administrative Procedures Act.

While "Basel III: Endgame" (aka Basel IV) has been under construction for some time, the recent failures of Silicon Valley Bank (SVB) and Signature Bank, combined with the bailout and sale of First Republic Bank, provides us with two important and timely lessons. The first lesson is that some large global banks aren't as systemically important as one may think, and some smaller banks may inflict quite a bit of damage should they fail. Over the years, Federal bank regulatory agencies have mis-stepped when identifying which banks are systemically important and which are not. There is a widely held assumption that size means risk, which is not only intellectually lazy, but wrong.

In the case of SVB, in preparation for a compliance examination of the bank when I worked at the Federal Reserve Bank of San Francisco, there was open discussion and recognition of the critically important role that the bank played in the technology and life-science sectors of the economy. (In the interest of transparency, I'll also note that a few years after the Fed, I served a 4-year stint as a Director at SVB.) This was when the bank had less than $10 billion in assets. Although there were attempts by financial institutions to compete with SVB (New Resources, Square 1, etc.), nobody fully succeeded, and the industry concentration grew along with the bank. The Fed was well aware of SVB's long history of hiring effective compliance and risk managers only after getting into trouble then later parting ways with them once issues were resolved.

A contrast to SVB is another former employer of mine, Rabobank. While it describes itself as the world's largest food and agricultural bank with assets close to $1 trillion, and while its knowledge of the industry is unparalleled, its business model is refreshingly simple. It's an important part of the structure of its industry, but not a keystone, and its demise would likely not trigger an apocalyptic financial collapse or inflict a terminal wound to the food and agricultural industry.

Nothing in Basel IV gives any comfort that the agencies will focus the increase of capital requirements on the small subset of financial institutions that truly are load-bearing supports in our financial system's structure that are not sufficiently capitalized.

The second lesson is that our largest financial institutions actually seem quite well poised to weather a number of different real or perceived economic shocks. Cases in point, the performance of our largest banks during COVID and the ability by some of those same banks to invest in and then purchase First Republic Bank in the midst of a banking crisis. It would seem that the bank regulatory agencies would be well served to follow the same advice they give the financial institutions they regulate: "know your customer."

Of equal concern is the timing of this discussion. We are all quite aware that financial institutions are holding a massive portfolio of securities with interest rates below their cost of funds. The recent credit downgrades of large and regional banks will make it costly to raise capital through the bond market. Many institutions hold a large portfolio of commercial real estate loans that are being negatively affected by the fact that so few workers are going back into the office. And making new loans in a rising interest rate environment is challenging, at best. It's virtually impossible to get a consumer financial advocacy organization like Woodstock Institute to feel sorry for banks, but this scenario threatens the industry's ability to work with us on getting capital into disinvested communities.

In reviewing other comments to the rule, carving out particular business lines like bank-originated mortgages or small business loans from increased capital requirements is well intentioned, but impractical and unrealistic. A large financial institution will not differentiate its budget for mortgage lending, small business lending, or its distribution of physical branches if it is being asked to hold more in capital. No business line will be safe from budget cuts. As I witnessed during the 2008 global financial crisis, when money got tight, Community Reinvestment Act activity in the markets I served diminished to a much more dramatic degree than other business lines. I expect the industry would use similar logic and repeat that practice in the wake of increased capital requirements.

We ask the agencies to take a more thoughtful and targeted approach towards balancing the need for increased resilience in the banking system and the need for capital to flow into the communities that are typically the last to enjoy economic prosperity and the first to lose it: low- and moderate-income communities, small businesses, and communities of color. In short, know your institutions well enough to identify which of them needs to hold more capital, and which don't.

Sincerely,

Horacio F Méndez
President & Chief Executive Officer
Woodstock Institute