



Occupy the SEC

<http://www.occupythesec.org>

January 16, 2024

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

**Re: Notice Seeking Public Input on the Regulatory Capital Rule
(Docket No. OCC-2023-0008 / Docket No. R-1813, RIN 7100-AG64)**

Dear Sir or Madam:

Occupy the SEC¹ ("OSEC") submits this comment letter in response to the Office of the Comptroller of the Currency's and the Federal Reserve Board's ("Agencies") joint notice seeking public input on the Basel III "end-game" regulatory capital rule.

The U.S. is the only major banking power that has yet to implement "Basel III end-game" standards. We applaud the Agencies for finally implementing these global standards to improve the resilience of large banks as well as smaller banks with significant trading activities. We note that bank CEOs and conservative legislators have been pulling out all the stops to browbeat the Agencies into adopting laxer standards in their implementation of the proposed capital rules. These opponents of the end-game proposal have deployed a number of arguments that must be debunked.

¹ Occupy the SEC (<http://occupythesec.org>) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.

While the end-game proposal has many provisions, its most salient feature is that it requires banks to adopt a standardized framework to determine capital levels, in lieu of the proprietary risk models that have run the show thus far. Proponents of the status quo argue that internal models are fine-tuned to each bank's unique risk profile. However, such fine tuning did little to avert the recent failures of Silicon Valley Bank and other banks in 2023 (even despite the regulatory interventions of the Dodd-Frank Act). Similarly, the internal risk models devised by the legions of math and physics PhDs employed by banks did famously little to avert the 2008 financial crisis. Indeed, such failures are reminiscent of Long Term Capital Management (LTCM), the hedge fund whose options bets almost caused a financial meltdown in 1998, despite the fund being led by Nobel Prize winners who literally wrote the book on options theory.²

The Basel end-game eschews opaque and abstruse internal models in favor of a standardized approach that brings transparency and reliability to risk modeling. Aside from making it harder for banks to hide risk within proprietary spreadsheets, a standardized approach will also allow regulators (and banks themselves) to benefit from collective cross-industry data that can help avert crises before they happen.

Even though increased capital requirements could help avert or mitigate the next banking crisis, the end-game's opponents lament that it inefficiently requires banks to hoard idle cash derived from stock sales. However, this idea loses sight of the fact that even under the end-game proposal, banks can put their capitalized cash to work and earn revenue, while simultaneously improving their capital ratios. To achieve this, banks can sell off risky assets and instead purchase U.S. treasuries, which carry a zero percent risk weight.³ Unlike illiquid investments, which are often zero-sum bargains with little benefit to anyone other than the concerned counterparties, treasury purchases often fund massive government infrastructure projects that can boost the broader economy, if not save it (as we saw in 2020 with the government's COVID-related spending).

Bank lobbyists often argue that poor mortgage decisions, not exploding derivatives, caused the 2008 financial crisis. If that were true, then the end-game proposal would help avoid a similar crash in the future. Studies show that banks meeting higher capital requirements are more likely to make prudent lending decisions,⁴ since defaulting loans increase risk weighting. The end-game proposal's heightened capital standards would force banks to reconsider their balance sheets and offload under-performing assets. This also means that banks would avoid underwriting the sort of over-leveraged mortgages that contributed to the 2008 crash.

Some opponents of the Basel III end-game have argued before the Agencies that the proposal would not have averted the failure of Silicon Valley Bank. Experts actually disagree on whether

² See Roger Lowenstein, *When Genius Failed: The Rise and Fall of Long-Term Capital Management* (2001).

³ See 12 C.F.R. § 628.32(a) (2023).

⁴ Douglas J. Elliott, Quantifying the effects on lending of increased capital requirements, Brookings Institution (Sep. 21, 2009), *available at* https://www.brookings.edu/wp-content/uploads/2016/06/0924_capital_elliott.pdf.

Basel III would⁵ or would not⁶ have saved SVB. But what is clear is that the end-game rules would push more banks to incorporate unrealized investment gains and losses (like the interest rate exposures that upended SVB) into their regulatory capital calculations. The incorporation of such real-time valuations would only improve resilience across the banking industry. Once SVB failed, its shareholder's equity was insufficient to make depositors whole. The FDIC was essentially forced to compensate depositors even beyond the standard \$250,000 level to quell anxious markets. It is incontrovertible that if SVB were better capitalized, more depositors would have been made whole through shareholder losses rather than the FDIC backstop. This would have been a much preferred alternative, as the need for government intervention to safeguard SVB depositors is precisely what precipitated fears of a broader banking crisis in early 2023.

Another red herring bandied about is that the Basel III end-game will cause marginalized communities to have less access to credit. The theory is that higher capital requirements will lead large banks to cease lending for being too expensive. First, the numbers belie this claim: the end-game rules will increase banks' cost of funding the average lending portfolio by a measly 3 basis points (.03%).⁷ Secondly, these fears overstate the proportion of services that large banks currently provide to marginalized communities. Credit unions and community banks are not subject to Basel III, so even if large banks were pushed out of retail lending, these smaller entities would be available to pick up the slack. Large banks engage in a disproportionately small portion of mortgage, commercial real estate and small business lending as compared to credit unions and community banks. For example, the FDIC has found that the proportion of commercial real estate loans held by community banks has remained stable over the last 30 years even though the total share of banking industry assets held by these small banks has diminished significantly during the same period.⁸ Credit unions, in particular, do a better job than banks of catering to underserved communities. Large banks have a long history of withdrawing credit from these communities during tough times, whereas credit unions actually increase their lending during such periods.⁹ In light of these facts, bank CEOs' invocations of minority access to credit ring hollow.

Of course, not all lending business leaving big banks would flow to community banks or credit unions. Some of it would also flow towards the much-feared "shadow banking" industry. While unregulated banking is undoubtedly a concern, it should be noted that the Agencies and other regulators already have shadow banking in their sights. Indeed, Dodd-Frank included numerous provisions to regulate that industry. Moreover, there is no conclusive evidence that shadow banks pose more of a systemic risk than large banks. Indeed, some of the major shadow banking

⁵ Greg Feldberg, *Could Better Rules Have Saved Silicon Valley Bank?*, Yale Insights (May 16, 2023), at <https://insights.som.yale.edu/insights/could-better-rules-have-saved-silicon-valley-bank>.

⁶ Tobias Burns, *New 'endgame' bank rules promise greater financial stability, lower returns*, The Hill (Dec. 29, 2023), at <https://thehill.com/business/4371501-basel-iii-endgame-banks/>.

⁷ See Michael S. Barr, Federal Reserve Vice Chair for Supervision, Speech at the American Bankers Association Annual Convention (Oct. 9, 2023).

⁸ FDIC, *Community Banking Study 4-1* (Dec. 2020), available at <https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-4.pdf>.

⁹ Wenling Lu and Judith Swisher, *A comparison of bank and credit union growth around the financial crisis*, 35 Am. J. of Bus. 1 (2020).

alternatives are actually well-capitalized fintech companies like Quicken Loans, which have not faced any more complaints or fines than the large banks impacted by the Basel III end-game.

It is vital to note that the end-game proposal should serve as only an intermediate step towards greater bank safety. We wish to emphasize that true safety and soundness will require the implementation of much higher capital requirements than those proffered by the Basel Committee. As Anat Admati and Martin Hellwig have credibly argued, true safety and soundness requires raising required bank capital to up to 30 percent.¹⁰ However, for purposes of the end-game proposal, we exhort the Agencies not to be sidetracked by the sort of red herring arguments referenced above, which, if given credence, could undermine the safety and soundness of the banking system.

Thank you for your attention to this matter of great public interest.

Sincerely,

/s/

Occupy the SEC

Akshat Tewary
et al.

¹⁰ Anat Admati & Martin Hellwig, *The Bankers' New Clothes: What's Wrong With Banking And What To Do About It* (2014).