AMERICAN BENEFITS COUNCIL

January 12, 2024

Submitted electronically via Regulations.gov

Office of the Comptroller of the Currency
4007th Street SW, Suite 3E–218
Washington, DC 20219

Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

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

RE: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity, Docket ID OCC–2023–0008

Dear Sir or Madam:

The American Benefits Council ("the Council") is pleased to have the opportunity to provide comments on the U.S. proposal implementing the Basel III Endgame ("the proposal"). As discussed below, we have deep concerns about the effects of the proposal on pension plans and the participants they serve.

The Council is a Washington, D.C.-based employee benefits public policy organization. The Council advocates for employers dedicated to the achievement of best-in-class solutions that protect and encourage the health and financial well-being of their workers, retirees and their families. Council members include over 220 of the world's largest corporations and collectively either directly sponsor or support sponsors of health and retirement benefits for virtually all Americans covered by employer-provided plans.

The Council's mission is to enhance retirement security through the growth of the private retirement plan system. And we do that by advocating on behalf of employers sponsoring retirement plans.

BACKGROUND ON THE IMPORTANCE OF MANAGING DEFINED BENEFIT PLAN VOLATILITY

The key aim of our defined benefit plan advocacy for more than 20 years has been to help employers manage volatility with respect to defined benefit plan funding obligations and accounting treatment. During that time, we have worked with Congress and the regulatory agencies on a bipartisan basis to draft and improve legislation relevant to this objective.[1] But for this bipartisan work, the exodus from the defined benefit plan system and the harm to participants would have been much worse. Although our efforts to minimize funding and accounting volatility have been impactful, more is needed to address volatility issues.

To illustrate and summarize our primary concerns, market downturns generally result in decreases in the value of plan assets, causing funding shortfalls and increased plan obligations. A market downturn can also lead to changes in monetary policy to reduce interest rates to stimulate the economy. Lower interest rates can result in higher valuations of pension liabilities, thus further increasing funding shortfalls and obligations. Together, this means that when companies experience a market downturn, their pension obligations significantly increase at the worst possible time. Because for many companies, pension obligations are very large compared to the size of the business, these adverse effects are exacerbated.

The unpredictability of funding shortfalls and obligations is untenable for businesses that must be able to make multi-year plans. The consequences of volatility and unpredictable funding needs have caused many plans to be frozen or terminated, thus harming participants. Even worse, some plan sponsors have been forced into bankruptcy by volatile and unexpected funding obligations.

MANAGING VOLATILITY AND UNEXPECTED FUNDING OBLIGATIONS

To manage these volatility and funding risks, and to protect their participants' hard-earned retirement savings, plans use critical banking services provided by large U.S. banking organizations. Derivatives are key tools for employers to address volatility

[1] For our most recent set of proposals, please see https://www.americanbenefitscouncil.org/pub/?id=0FF0AC00-D508-2DF7-CD06-11D8D89F5074. Moreover, our concerns with protecting plans' ability to use derivatives to avoid volatility go back many years, dating back to work on Dodd-Frank and the regulations issued thereunder. https://www.americanbenefitscouncil.org/pub/?id=E6112C4B-D536-76DF-2E77-4EAD854467D1; https://www.americanbenefitscouncil.org/pub/?id=E605E5B9-E031-F6F0-FE4E-3A1ABB3A5710

issues. For example, a pension plan can very effectively address the risk of interest rates falling by entering into an interest rate derivative that shifts the risk of an interest rate decline to the counterparty. In this way, many types of derivatives play a critical role in our plan sponsors' efforts to reduce volatility.

In addition, pension plans may use equity derivatives as an efficient means to gain exposure to foreign markets or companies that may not be readily accessible. This not only provides pension plans with alternative sources of improved returns, but also provides portfolio diversification benefits that allows for improved risk adjusted returns. As the proposal acknowledges, capital requirements for derivatives will significantly increase, and therefore substantially challenge pension funds' ability to efficiently manage these volatility and funding risks.[2]

Similarly, plans may use securities lending to manage liquidity risks and improve returns for plan participants. Specifically, plans receive cash and other collateral in exchange for lending securities. Managed appropriately, these transactions help asset managers navigate different liquidity risks and market environments, while receiving a fee for securities that the pension would otherwise be holding passively. Furthermore, these types of transactions can provide short-term liquidity to plans so that plans can continue to make scheduled payments on an ongoing and regular basis to beneficiaries, thus reducing risk related to unexpected funding obligations. Unduly restricting access to securities lending will have a negative impact on pension funds' ability to meet funding obligations and impair the orderly functioning of markets.

COMMENTS ON THE PROPOSAL

The Banking Agencies' Proposal is a threat to pension plans and should be withdrawn. If that is not done, it should be broadly revised to be inapplicable to transactions with retirement plans.

We are very concerned that the proposal does not include any robust economic analysis evaluating its potential effects on retirement plans. By failing to provide such data and analysis, the banking agencies make it difficult for us, and the public more broadly, to understand and provide responsive comments on the proposal. Further, it is not clear to us how the agencies can design an appropriately calibrated final rule

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[2] See *Federal Register* notice: "Based on the year-end of 2021 data and QIS reports of large banking organizations, the agencies estimate that the increase in RWA associated with trading activity (market risk RWA, CVA risk RWA, and attributable operational risk RWA) would be around $880 billion for large holding companies. Consequently, the increase in RWA associated with trading activity would raise required capital ratios by as much as roughly 67 basis points across large holding companies subject to Category I, II, III, or IV capital standards."
https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant

without sufficient analysis of the proposal's impact on end-users, including retirement plans. The lack of analysis is particularly concerning to us as the proposal is inexplicably different and harsher than the standards being implemented in other jurisdictions, both generally and in particular with respect to retirement plans.[3]

We therefore concur with the sentiments Federal Reserve Chairman Jerome Powell made during the meeting on the proposal when he stated, "the proposal exceeds what is required by the Basel agreement, and exceeds as well what we know of plans for implementation by other large jurisdictions." Similarly, we share his concern that "[the] very large increase in risk-weighted assets for market risk overall requires us to assess the risk that large U.S. banks could reduce their activities in this area, threatening a decline in liquidity in critical markets and a movement of some of these activities into the shadow banking sector."[4]

In this context, we ask that you either withdraw the proposal, pending further study of the effects on retirement plans, or exempt all transactions with respect to retirement plans. In short, it is inappropriate for any agency to put our nation's retirement security at risk without further data, analysis and consideration.

In addition, our members have also identified the following especially problematic elements of the proposal:

- The **Fundamental Review of the Trading Book** will significantly raise capital standards for all market making activity. Derivative transactions are among the most penalized, including interest rate derivatives and equity derivatives. Many retirement plans use equity derivatives as an efficient means to gain market exposure. In the case of equity derivatives, the decision to disallow the use of models, which diverges from the internationally agreed upon approach, significantly impairs netting. If an overall exemption for retirement plans is not afforded, we believe an approach that recognizes the benefits of netting should be considered.

- The new **credit valuation adjustment (CVA)** framework treats retirement plans identically to levered and unregulated entities like hedge funds. To the extent that an exemption for retirement funds is not provided, we believe the CVA framework should at least recognize the reduced risk profile of highly regulated entities, such as retirement funds.

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3 For example, the European Union has exempted pension funds from the proposed CVA capital requirements and the UK proposes lower risk weights for transactions with pension funds.

4 See Federal Reserve Chairman Powell statement: https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20230727.htm

- The **minimum haircut floor for securities financing transactions (SFT)** should not be adopted. No other jurisdiction plans to implement the minimum haircut floor. Moving forward with the minimum haircut floor will therefore hurt U.S. retirement plans' ability to manage liquidity and enhance returns for beneficiaries.

- The unavailability to pension plans and mutual life insurers of the preferential **65% investment grade risk weighting** solely because they do not have publicly listed securities is not an appropriate or even reasonable basis for determining risk and should be removed.

As a whole, the proposal would significantly increase banks' capital requirements for derivatives and SFTs, among other transactions. These costs would be passed on to end users (such as plans), increasing the cost and reducing the availability of these products. The loss of these products at a reasonable price – or the unavailability of these products – will result in some plans managing risks in less effective ways, which will undoubtedly lead to higher costs (again at the expense of participants and beneficiaries) and more harmful volatility. The specter of higher costs and increased volatility will in turn result in more employers terminating their plans, again hurting participants.

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If you have any questions, please contact me at 202-289-6700 or ldudley@abcstaff.org. Thank you for considering the issues outlined in this letter.

Sincerely,

Lynn D. Dudley
Senior Vice President, Global Retirement and Compensation Policy