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# CONGRESSMAN BRAD SHERMAN

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**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:

Please see below for a transcript of my comments at House Financial Services Committee hearings that took place this year relating to the Regulatory Capital Rule Notice of Proposed Rulemaking. I respectfully request consideration of these issues – which include the impact of the proposed rule on mortgage lending, clean energy tax equity investments, and small business lending – as your agencies work to finalize the Regulatory Capital Rule.

Sincerely,

[redacted]

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

**<u>House Financial Service Committee – Financial Institutions Subcommittee Hearing</u>**
**"Implementing Basel III: What's the Fed's Endgame?"**
**September 14, 2023**

**SHERMAN:** Mr. Barr is right to point out that increasing capital is not free. It does reduce economic activity. But having capital standards that are too low is very expensive. Just this year, we saw three banks go under. This was not a matter of just a liquidity problem. These banks were bankrupt, and the proof is the FDIC sold them for a negative $30 billion. So the market looked at their assets and liabilities and said they were vastly underwater. The cost to our system is not just the $30 billion that will be recovered in effect from depositors over coming years, but the lack of confidence, particularly in regional and community banks, that are still impacting our economy and will for years to come.

Banks face two types of risks, credit risk and interest rate risk. The risk that the borrower won't pay, or the risk that the borrower will pay but at a lower interest rate than the bank -- at an interest rate that's too low given then current economic conditions and the bank's cost of capital. We have a tendency to fight the last war. France relied on fixed fortifications, and we saw Blitzkrieg. 2008 was about a credit risk. So now we have Basel III.

But 2008, but 2023 was about interest rate risk. And while Mr. Barr says Basel III does nothing, he's only mostly right. It does way too little with regard to interest rate risk. And there's this myth, and I fear Jay Powell buys into it, that if interest rates go up, the banks will be fine because although the loans they've made and their portfolios have declined in value, their depositors will be lazy and stupid and leave the money in low interest bank accounts. And I don't think that a financial system based on the idea that depositors will be lazy and stupid over the long term is a sound basis for regulating banks.

One thing that needs to be pointed out is that when you focus on credit risk, you take money away from local business loans and the construction loans that we need to build more apartment buildings because the rents are too damn high. When you fail to focus on interest rate risk, you incentivize the banks putting their money in 10-year treasuries, 30-year treasuries, highly rated -- you know, Apple can borrow all the money it needs.

So a system that underrates the risk of investing in lending money to Apple on a fixed rate 20, 30-year basis and overstates the risk of making loans to people building apartment buildings and building small businesses in my district is a perverse system. Now, we do something under Basel III in the available for sale securities. If they go down in value, that portion of the interest rate risk is captured. But what about those that are supposed to be held for maturity? What about just the basic loan portfolio that is in securities?

Basel III is helpful in saying we're not going to rely on the bank's own internal modeling, but that's only as good as the new modeling that the regulators come up with, and let's see what they do. I'm particularly interested, Ms. Philo, in that the risk weight capitals on tax equity investments where the bank buys the tax credit from the project developer will increase from a hundred percent to 400 percent for many banks.

Tax equity investments can help low-income housing. That won't be affected. But under this rule, clean energy tax equity investments would face a four-fold increase under the proposal. Ms. Philo, what effect could that have on our ability to meet the standards of the Inflation Reduction Act and meet our requirements under climate change treaties?

**PHILO:** I do appreciate where you're coming from. Different risks, you know, have different weights, and we're relying on the regulators in this process to make sure that they align. I think this is one area where we may wish to see more of that.

**SHERMAN:** On behalf of polar bears everywhere, yes. I want to go on to one other question. Mr. Broeksmit, I'm told that we're going to have no credit for mortgage insurance. Does that make any sense?

**BROEKSMIT:** Nonsense. It makes no sense at all. We should encourage banks to use other sources of loss-absorbing capital in our marketplace, and this gives no credit for private mortgage insurance.

**SHERMAN:** Thank you.

**<u>House Financial Service Committee – Financial Institutions Subcommittee Hearing</u>**
**"A Holistic Review of Regulators: Regulatory Overreach and Economic Consequences"**
**September 19, 2023**

**SHERMAN:** We're looking at cost benefit analysis by those who think that we should have lower standards, lower capital standards. And one of the reasons for that is when you do the cost benefit analysis, you leave out the social costs, political costs, the cost of the fabric of our society, going back to what caused Basel III, namely the 2008 meltdown.

If you just look at the economics, you can say, hey, we actually made money bailing out the banks, no cost, cost benefit analysis. That may be true. We lost some money bailing out the auto companies. Maybe we should have held the stock a little longer, but that's a side issue. The reason for that was that they came to us with the toxic asset recovery program, TARP. And a lot of us put some pressure on, and they ended up buying preferred stock, rather than the toxic assets, they bought the toxic assets, we would have lost hundreds of billions. And that's the effect. But even with us not losing any money on the bank bailout, the damage to the social contract, how many of us had been told by every group that wants anything? Well, you gave it to the banks, give it to us.

And then this was added to by the Silicon Valley in New Republic problem, which just added to this idea that banks are bailed out. Nothing really is fair in our society and give me mine. We're told that it's -- that we can't possibly know the effect of these new regulations and we can't. But we also possibly can't possibly know the effect of not adopting these regulations. That's the thing about the future.

Now, I'm concerned that Ms. Valladares about the effect this is going to have on IPOs. How will these standards discourage banks from participating in IPOs and otherwise in the capital market?

**RODRIGUEZ VALLADARES:** The question is for whom?

**SHERMAN:** For you?

**RODRIGUEZ VALLADARES:** Oh, right. There -- there is no reason it would discourage IPOs.

**SHERMAN:** Do the other -- do the other witnesses agree?

**TAHYAR:** No.

**SHERMAN:** OK. I'll hear from both sides very quickly.

**RODRIGUEZ VALLADARES:** Right, so there's ...

**TAHYAR:** Sorry, go ahead.

**RODRIGUEZ VALLADARES:** Right there -- there is an initial public offering right now. In fact, for many companies, many of them might prefer it because of the elevated interest rate environment, right? So we -- there is there's no proof that having banks that are safer, is going to impact IPOs, banks that are safer ...

**SHERMAN:** Right. If you've -- but if you particularly raise the capital requirements on that segment is going to cause the banks to do less than that segment.

**RODRIGUEZ VALLADARES:** It wouldn't.

**SHERMAN:** I'll ask the witness next to you whether she has a quick comment, because I got to go on to another subject.

**TAHYAR:** Sure. Thank you, sir. We're in a secular decline for IPOs over the last 10 years. We have to understand we have fewer and fewer public companies, the pressure on from many parts. There will be greater operational risk and fee capital. And I think unbalanced, that's going to be more than the lack of preferential weights on unlisted companies.

**SHERMAN:** OK.

**TAHYAR:** So I think -- I think it's a risk.

**SHERMAN:** Thank you. I want to go on to another thing, and that is raising capital standards is the bluntest way to ensure banks don't go under. The better way to do it, is to look at the individual assets and do good bank examination. And that is where I think our regulators have failed us, because they've ignored interest rate risk.

Now, when you pay attention to -- to credit risk, that's a reason not to make a loan to a local government. When you pay attention to interest rate risk, that's a reason to not buy a 30-year treasury. Well, how did Silicon Valley Bank was famous for loaning money to startups, and -- and yet they lost their money by buying the 30-year treasuries. And we still see a situation where -- and I have legislation on this that stress tests don't look at the number one stress is what happens if interest rates go up. As a matter of fact, they once did a stress test about what happens if interest rates go down, which isn't a bad stress test, but isn't so bad.

The one other thing, illustration of how poorly crafted regulations can necessitate higher capital rates, is they're going to give no credit to private mortgage insurance. In what world is private mortgage insurance irrelevant to the creditor? As a matter of fact, the creditor is the one that makes sure that the homebuyer gets the private mortgage insurance. So I'd have a lot more faith in these rules, if they looked at a little bit better, didn't use the blunt instrument of just raising the rates and instead looked at better bank examination.

**House Financial Service Committee – Financial Institutions Subcommittee Hearing**
**"The Tangled Web of Global Governance: How Biden Administration Is Ceding Authority Over American Financial Regulation"**
**November 7, 2023**

**SHERMAN:** If our standards are too low, we're going to see bankrupts -- bankrupt banks and bailouts. If our standards are too high, we're going to constrain economic growth, and especially, constrain small business lending. Our standards are higher than those of Europe, and that ties to a different insurance system.

In Europe, deposits, I believe, are insured to 100,000 euros. Here it's to $250,000, more than twice as much governmental involvement in securing depositors. While you can argue for lower standards, you can argue for higher standards, you can't argue for stupid standards. And I think when we get involved in some of these details, I want to illustrate that some of these standards don't meet an intelligence test.

But we should not call these European standards. This is not -- this -- the responsibility, positive or negative, belongs to the three major U.S. regulators. They're just waving the Basel flag when they want to do something and saying, "Oh, the Europeans are suggesting it." And then when the Europeans suggest something they don't like, they ignore it.

As Bill Foster's questioning demonstrated, all the power is with the U.S. regulators. And if these regulations are good or bad, that's entirely the result of Americans. Yes, we listen to foreign regulators. We also listen to economics professors, neither of which are mentioned in the U.S. Constitution. The allocation -- how we allocate capital is important, particularly big versus small loans.

What seems to be favored in our society is people in thousand-dollar suits making a million dollars a year and making billion-dollar and multibillion-dollar investments in securities. What is downplayed, and those people always have fancy economic -- fancy business degrees. What is disadvantaged is Main Street loans to Jack's Pizzeria.

And needless to say, our regulators favor the first group because they all have fancy degrees, too, and they like to look at big pictures. And who wants to go down to Jackson, sample the pizza? So, when we have credit rate -- when we have credit risk, the small business has credit risk, and we are all focused on that.

The interest rate risk, which is what took down Silicon Valley Bank, we get a short thrift (ph) to because after all, that was the decisions made by the big fancy people with their big billion dollar bets and their big fancy degrees. Having an economy that is weighted toward the giant loans is, I think, really a bad idea.

Now, speaking of stupid regulations, can anyone here please raise your hand if you can even come up with an argument, half an argument, for the idea of ignoring private mortgage insurance in evaluating the risk of holding a mortgage loan? I'm looking here. None of you can even come up with the slightest argument in favor of that incredibly stupid idea.

OK? Ms. Marcellin, you talked about the importance of climate risk, and yet these new Basel Rules increase by a factor of four the risk associated with the tax equity investments for green energy. I don't know -- I don't know if your organization has focused on that. You focused on other aspects affecting climate.

Can you think of a reason why we should adopt regulations that penalize banks for being involved in the -- in the tax credits designed to encourage green energy?

**MARCELLIN:** Yes. Thank you for that question, Congressman Sherman. So, you know, first and foremost, I do want to say that mitigating climate change and cause...

**SHERMAN:** Excuse me, I'm talking here about just one little detail. That's the tax credit. So, are you for clamping down on banks or against clamping down on banks that invest in these tax credit projects and give us clean energy?

**MARCELLIN:** The largest banks that do this are JPMorgan and Wells Fargo, and they are benefiting off of the tax credits and...

**SHERMAN:** Right. We...

**MARCELLIN:** Yes.

**SHERMAN:** ... we -- that was the intention when we passed the law. Should we now penalize them through the bank regulatory system for doing that?

**MARCELLIN:** I don't know if I would characterize it as penalizing them, but I think it's, you know, the...

**SHERMAN:** I do want to try to squeeze in one other thing, and that is that the rules for, quote, "High quality corporate exposures" are once again in Basel, designed to discriminate against making those Main Street loans and push banks into making the billion dollar loans and the securities. And perhaps, we should have a rule against having anybody involved with having too many people with elite degrees making these rules.

**House Financial Service Committee – Full Committee Hearing**
**"Oversight of Prudential Regulators"**
**November 15, 2023**

**SHERMAN:** I'm surprised to hear Republicans criticizing you for visiting Europe because European standards are lower than American standards and more in tune with what they're advocating you to adopt. 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 home buyers, and they discriminate against small business. Now, one of the ways they discriminate against small business is a small business, the bank has very little interest rate risk. Their short-term loans were their adjustable rate. You buy a 30-year bond, might be very credit worthy, might not have any credit risk. It has all that interest rate risk.

I'm flabbergasted that it's taken till now for you to propose regulations to say that banks have to recognize unrealized losses on held 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 security account, and you're not doing anything about it.

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

**M. BARR:** Thank you, Mr. Sherman. You raised 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...

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

**M. BARR:** And with respect to unrealized losses, the proposal is focused on available for sales 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.

**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 decides to- is incentivized to buy that long term debt on a securities market, that's money they can't lend to a local pizzeria.

Speaking of discriminating? Well, against first I mentioned first time home buyers. First time home buyers often need mortgage insurance. Your current roles recognize that mortgage insurance may not be perfect, but it's useful. Can any of you raise your hands if you want to defend the idea of having a zero value for mortgage insurance? I see no hands going up.

**M. BARR:** Mr. Chairman, just to clarify, under the proposal, our treatment of private mortgage insurance doesn't change. So, it's the same approach now under our guidelines, private mortgage insurance can be a factor.

**SHERMAN:** Can be a factor.

**M. BARR:** Of several factors that contribute to a mortgage being considered prudently under...

**SHERMAN:** I would hope that you would write your regulations more clearly because many people have written them and believe that you're going to assign a zero value. And if you intend to do otherwise. Congress spends a lot of money providing these clean energy credits. And you undermine their value, you undermine congressional policy. The tax equity investments, you're going to go from 100% to 400%, making them far less valuable to banks. Is there anyone here who thinks that's in the interest of the environment? Yes?

**GRUENBERG:** If I may just comment, Congressman. This is, in a sense, the reason we have a comment period. We've received a lot of thoughtful comment on this subject, and we're going to give it careful consideration in the final...

**SHERMAN:** I'm glad you're hearing our comments, and I hope that you would have stress tests that look at interest rates going up and down. That's the lesson of 2023.