

October 26, 2023

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Powell:

We write to express continued concern with the Basel III Endgame proposal (proposal) issued by the Federal Reserve's Vice Chairman for Supervision on July 27, 2023, together with officials from the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC).

The proposal is in direct contrast to statements made by both federal banking and administration officials that our banking system is strong; as well as declarations made in each of the Federal Reserve's monetary policy statements since March of this year that: "The U.S. banking system is sound and resilient." The proposal is also in direct contrast to the direct evidence that our banking system is sound, well-capitalized, and resilient. The Federal Reserve's own annual stress tests, bank performance throughout the economic shutdowns from the global pandemic, and the ability to weather tremors instigated by management and supervisory failures of fast-growing coastal banks with risky banking practices – all demonstrate the resiliency and strength of our banking system.

Of particular concern is the lack of analysis underpinning Vice Chair Barr's proposal. In fact, during your recent appearance before the Committee on Financial Services in June, you testified that any proposed additional capital requirements would need to be justified.¹ However, to date, we have yet to see that justification.

The proposal was released with shockingly little analysis and remains incomplete.² Moreover, nothing in the 315 pages of the Federal Register notice of the proposal supports the proposed drastic changes. In fact, the fewer than five pages of the proposal's purported impact and economic analysis section contains mere conjectures. In many regards, the proposal appears arbitrary and capricious.

The substance of the cost-benefit "analysis" appears to be a simple assertion that "The agencies expect that the benefits of strengthening risk-based capital requirements for large banking organizations outweigh the costs."³ (p. 489). The lack of support for the assertion is surprising. Both the Federal Reserve and federal banking agencies have talented research staff, including economists, statisticians, supervisors, and analysts, all of whom are capable of performing a robust economic impact analysis. Those individuals, as well as Members of the Federal Reserve Board have abilities

¹ "The Federal Reserve's Semi-Annual Monetary Policy Report," June 21, 2023, House Committee on Financial Services, at <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408872> .

² For example, regarding changes in capital requirements associated with trading activities, the proposal admits that the authors have no idea whether costs are outweighed by benefits. Instead, the proposal asks for massive capital increases and then concludes that: "The overall effect of higher capital requirements on market making activity and market liquidity remains a research question needing further study."

³ See initial paragraph of "V. Impact and Economic Analysis" of the proposal.

to project and weigh costs and benefits of the proposal, and how it may interact with the onslaught of other regulations in the works.

Specifically, the proposal's impact on home affordability and home ownership opportunities, which the proposal itself oddly recognizes, is unclear. Testimony before the Committee on Financial Services raised additional concerns about implications for, among other things, initial public offerings (IPOs), treatments of exposures to investment that receive favorable tax treatment and/or investment subsidies, effects on liquidity in Treasury markets, and effects on costs and credit availability and availability of financial services and on U.S. global competitiveness.

Even more fundamental, it is unclear how the proposed massive capital increases and other proposed regulatory changes combined will affect credit costs, credit availability, market-making, and consumers, families, homebuyers, car buyers, farmers and ranchers, municipalities, small businesses, and U.S. competitiveness in global markets for financial services.

To better understand the Federal Reserve Board's thinking and justification for the proposal, we respectfully request that you respond to the questions below.

1. The joint press release by the Fed, FDIC, and OCC identifies two rationales for the Basel III Endgame proposal⁴: (i) "The changes would implement the final components of **the Basel III agreement** [emphasis added], also known as the Basel III endgame;" and (ii) "Additionally, following the banking turmoil in March 2023, the proposal seeks to further strengthen the banking system by applying a broader set of capital requirements to more large banks."
 - a. With respect to (i), please provide documentation on why the current standards are lacking, what is needed to improve those standards, what constitutes the "agreement," who made the agreement, and whether Congress was ever informed of the agreement.
 - b. Please provide any quantitative impact study performed by U.S. federal banking regulators to support the "agreement."
 - c. With respect to (ii), please provide the analysis used to connect the events of March 8-11, 2023, to the need for the standards outlined in the agencies' recent Basel III Endgame proposal, including any analysis on proposed changes to regulatory treatments of credit risk, market risk, counterparty credit risk, and risks related to derivative instruments?
2. What specific evidence is there showing that the current capital framework does not provide the strength and resilience that Federal Reserve, federal banking, and administration officials have repeatedly said is a strong and resilient U.S. banking system?
3. The proposal pays significant attention to assignments of risk weights to assets and exposures. What quantitative standards or analyses, either within the proposing U.S. agencies or within the Basel "agreement" were used to arrive at the proposed weights?
4. The proposal abandons the ability of financial institutions to use (supervised) internal models in assessing credit risk and identifying risk capital. Many argue that the move away from internal models is contrary to what the so-called "agreement" calls for and what foreign jurisdictions have


⁴ See, for example, "Federal Reserve Board – Agencies request comment on proposed rules to strengthen capital requirements for large banks," July 27, 2023, available at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm> .

announced they will do. Abandoning internal models appears motivated partly by the agencies' belief that there is "unwarranted volatility" across banks.

- a. Please identify the unwarranted volatility among banks and what evidence exists to show that variation (if that is what is meant by "volatility") is on net undesirable?
 - b. What evidence exists to show that mandating homogenization ("consistency"), as proposed in the "standardization of credit and operational risk capital requirements," is desirable?
5. The proposal in effect repeals statutory tailoring requirements set out in the Economic Growth, Regulatory Relief and Consumer Protection Act enacted in 2018.
- a. Aside from narratives about March banking turbulence,⁵ what empirical evidence justifies putting forward a proposal that attempts to circumvent Congressional intent and legal requirements?
 - b. Has the Fed analyzed the extent to which the proposal for a one-size-fits-all regulatory scheme will have disparate effects on local communities by furthering movement to a barbell banking system with a small number of large banks, a scattering of often-subsidized small ones, and nothing in between?
6. The proposal includes significant increases in capital required for operational and market risks that are already captured in the Federal Reserve's stress tests and existing capital rules.
- a. What is the empirical justification, from history or simulations, suggesting a need for the large and redundant operational risk capital requirements in the proposal?
 - b. Given that some of the biggest operational risk expenses of banks have been those stemming from fines and lawsuits, does the proposal anticipate changes in the risks stemming from more future fines and lawsuits? If so, what are the specific risks?⁶
7. Do you agree that the changes to capital requirements envisioned in the proposal will have significant impacts on credit and resource allocation in the economy, and will channel credit away from some activities and toward others?

Please respond to Megan Gultinan (Megan.Gultinan@mail.house.gov) no later than November 3rd.

Sincerely,



Andy Barr
Chair
Subcommittee on Financial Institutions
and Monetary Policy

⁵ See, for example, the report led and prefaced by the Federal Reserve's Vice Chairman for Supervision titled "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank," April 28, 2023, available at <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>.

⁶ Those making the proposal may anticipate or desire increased legal and other risks to financial institutions stemming from legal claims of climate activists regarding climate change or biodiversity issues, as discussed by the environmental activist funded NGFS in two September 2023 Technical papers— "Climate related litigation: recent trends and developments;" and, "Report on micro-prudential supervision of climate-related litigation risk." Available at <https://www.ngfs.net/en/liste-chronologique/ngfs-publications> .



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