Statement of Kevin Fromer, President and CEO of the Financial Services Forum

before the Subcommittee on Financial Institutions and Monetary Policy

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Introduction

Chairman Barr, Ranking Member Foster and members of the Subcommittee, I appreciate the opportunity to submit this statement regarding the Basel III Endgame proposal, on behalf of the members of the Financial Services Forum (Forum).

The Forum represents the eight global systemically important banks (GSIBs) headquartered in the United States. Forum members play an essential role in the U.S. economy, lending to consumers and companies, providing underwriting and other services within the capital markets, and managing and safeguarding the assets of individuals and institutions. Forum institutions hold over 40 percent of U.S. banking assets, underwrite over 75 percent of corporate and municipal debt and equity offerings, provide millions of individuals and families with basic banking services, are innovators in advancing new banking technologies, and employ over 700,000 people across the country.

U.S. GSIBs also play a vital role in advancing the economic competitiveness of American business and the U.S. economy. Globally active companies, from the largest to mid-size to small businesses, rely on the largest banks to finance their operations, grow through trade, and offset the risk of losses that could occur due to fluctuations in currencies, interest rates, commodity prices and other factors.

As the largest banks, Forum members meet the most stringent set of bank regulatory requirements and undergo the most rigorous supervision from the federal banking agencies. Collectively, the U.S. GSIBs maintain over $900 billion in Common Equity Tier 1 Capital, triple the level in 2009. The firms maintain more than $3 trillion in highly liquid assets, nearly triple the level immediately after the financial crisis. GSIBs meet a long list of other significant requirements put in place after the crisis, designed to result in strong and resilient institutions. The firms are annually measured for their ability to weather very severe economic conditions through stress tests administered by the Federal Reserve. Because of their strength, they have passed these tests – which assume no emergency government support – without difficulty. Over the past decade, stress tests have produced average hypothetical total GSIB losses of $132 billion compared to an average aggregate Tier 1 capital level of $915 billion, a clear example of the capital strength of the firms.

In recent years, the firms have not only satisfied hypothetical stress tests, but they have also been a strong source of support during real economic stress events. During the COVID-19 pandemic, Forum institutions acted quickly to conserve capital – by voluntarily suspending capital distributions – in anticipation of the needs of individual and business customers as major parts of the U.S. economy came to a halt. The GSIBs activated lines of credit, conducted record-setting levels of underwriting to support companies that fund themselves in the capital markets, and made accommodations for individuals and families who lost income suddenly and indefinitely. The GSIBs were leaders in delivering billions in federal income support payments, and billions in special small business loans as part of the Paycheck Protection Program.

In the spring of 2023, as a few regional banks failed, the GSIBs remained demonstrably strong, by consistently supporting their existing customers, accepting deposits from new customers, and providing billions in deposits to First Republic Bank.

The strength and resilience of the largest banks has been repeatedly cited by former and current government officials responsible for financial policy and bank regulation, including the current Treasury Secretary, members of the Federal Reserve Board of Governors, the acting Comptroller of the Currency, and the chairman of the FDIC. As stated by the Federal Reserve when it announced the results of the 2023 stress tests, **"Large banks are well positioned to weather a severe recession and continue to lend to households and businesses even during a severe recession."**

Basel III Endgame

Despite the clear strength of the largest banks, and without any indication that the institutions are undercapitalized, the federal banking agencies released a proposal on July 27 to raise capital requirements for the GSIBs by approximately 20 percent, through the implementation of the final component of the post-crisis capital reforms known as Basel III. If finalized, these increases in capital would adversely impact families and businesses and the economy of the U.S. broadly.

Basel III is the third iteration of capital reforms since the late 1980s, approved by the Basel Committee on Banking Supervision, a body of central bank officials from around the world named for the city in Switzerland where the committee meets. The standards approved by the Basel Committee are not enforceable by any treaty or comparable agreement. They represent standards that are met, or not met, at the discretion of individual countries, or groups of countries in the case of the European Union (EU).

The core Basel III reforms were approved in 2013 and serve as the primary international capital standard implemented in the U.S. and other nations. The U.S., however, has chosen to implement capital requirements for its largest banks in a way that significantly exceeds the international standard. The largest U.S. banks therefore meet stricter capital requirements and maintain more equity capital on their balance sheets than their international peers, particularly those in the European Union. This is primarily due to three parts of the U.S. capital framework: risk-based capital requirements, the stress capital buffer (SCB), and the GSIB surcharge. While a GSIB surcharge applies to all GSIBs, the Federal Reserve has applied a separate and more stringent method of calculation for the eight U.S.-based firms.

For purposes of comparison, U.S. GSIBs had a total risk-based capital ratio of 11.3 percent, as of the last quarter of 2022. The twelve European GSIBs had a risk-based capital ratio of 9.9 percent. In terms of actual equity capital maintained, the U.S. GSIBs had an equity capital-to-assets ratio of 8.1 percent, as of the end of 2022, versus 5.7 percent for the European GSIBs. So, while the Basel standards are supposed to produce "standard" or relatively equivalent requirements, the requirements for the largest U.S. banks are significantly higher.

Basel III finalization was intended to further standardize the measurement of riskiness of bank assets, also known as "risk weighting." It was not, as stated by several central bank officials at the time, intended to further raise overall capital requirements. Up until the fall of 2022, leaders of the Federal Reserve Board also indicated the feasibility and intention to implement the Basel Endgame in a "capital neutral" fashion.

The Financial Services Forum continues to examine the notice of proposed rulemaking for the Basel Endgame and will provide detailed analysis of the impacts of the proposal in comments due by November 30. The Forum also has joined other banking trade associations in calling on the banking agencies to repropose the rule and to provide data and information used, but not made public, to support the rulemaking, in violation of the Administrative Procedures Act.

We offer, however, the following preliminary observations and examples of impact for the Subcommittee's consideration and are prepared to supplement these generalized comments.

1. The Largest U.S. Banks are Strong, Resilient and Additional Capital is Unwarranted

   As noted in my testimony, GSIB capital is at historic levels, continues to rise each year under existing rules, and more than adequately serves the purposes of supporting our economy and maintaining financial stability. As documented in a report from PwC this year, capital maintained by the largest banks is at the optimal level based on a review of academic literature that examined the costs and benefits of bank capital and the impact of post-crisis reforms on large bank capital adequacy and resilience.

   The proposed rule makes no attempt to justify significant increases in capital, nor does it meaningfully assess the significant costs associated with the proposal.

2. The Basel III Endgame Proposal Would Negatively Impact Borrowers, Businesses, and the Capital Markets

   By raising capital requirements by roughly 20 percent or more, the proposal would inevitably lead to higher borrowing costs or limit access to capital for individuals, families, and small and mid-size businesses that rely on bank borrowing.

   In one key example, the proposal would negatively impact housing finance and homeownership, particularly for first-time or first-generation home buyers. These direct impacts and the indirect impacts on community development have been cited by organizations including the National Housing Conference, the National Urban League, the NAACP, the Mortgage Bankers Association, and others.

   In another example, the proposal assigns a lower capital charge to public companies with access to the capital markets than to smaller businesses that rely primarily on bank borrowing. Specifically, the rule reduces the existing capital treatment for loans to companies that have debt or equity securities outstanding and are listed on a recognized exchange; these companies are deemed to be more "creditworthy." However, there are many companies of various sizes that are creditworthy, but do not have the scale or choose not to fund themselves in the capital markets. The proposal incorrectly deems them as less creditworthy and requires banks to maintain more equity capital to fund their lending.

   In another area, the proposal raises capital for market making by 75 percent. The largest banks are dominant in the capital markets and intermediate the buying and selling of securities – otherwise known as market making – for companies to finance operations, expansions, research and development, and hiring. The largest banks provide similar services to state and local governments, which raise funds in the capital markets to build hospitals, roads and schools.

Previous Basel rules already led to an increase in capital requirements for market-making activities by 40 percent. Given the massive increases in capital already maintained by the largest banks, and their strong performance at critical times for the economy, there is no evidence that these capital markets activities are undercapitalized. Significantly higher capital requirements would raise the costs of these vital services and, to the extent they limit a bank's ability to make markets, would negatively affect market liquidity.

Even if the proposal is modified to address these specific impacts and many others, it also contains an unprecedented and untested standardized approach for operational risk that mechanically produces a significant increase in required capital. The increase in required capital is driven by a simplistic, size-based, "one-size-fits-all" approach to operational risk that fails to consider either the specific features and risk profiles of different business lines or the specific measures and controls that banks have in place to mitigate these risks. Moreover, the proposal does not provide a clear or convincing rationale for why this new requirement is necessary or why existing capital standards are insufficient to capitalize these risks.

3. <u>The U.S. Proposal Continues to Impose Higher Requirements and Costs than Other Jurisdictions</u>

The proposed Basel Endgame would continue a trend of imposing higher capital requirements on large U.S. banks than other jurisdictions require of their large banks, creating a long-term competitive disadvantage for U.S. lenders. For no reason, the U.S. banking agencies are proposing higher requirements for a host of activities, including business loans; mortgages; and hedging products for mid-market businesses, pension funds, airlines, retailers, energy companies and farmers who must manage fluctuations in currency, interest rates and commodity prices.

Regulators in other jurisdictions, primarily in the EU, are implementing the Basel Endgame standard in a manner that would limit or negate additional capital requirements for their institutions, in support of their economy.

4. <u>Migration of Bank-Provided Services to Nonbanks</u>

The Basel III Endgame proposal, by substantially increasing the costs of lending and other large bank services, would further accelerate the growth and fragility of the nonbank sector. A long-term secular trend is the migration of bank activity and associated risk to nonbank financial companies, without the associated safeguards that come with prudential regulation. International and domestic policymakers have identified nonbank financial intermediation as a significant financial stability risk, in stark contrast to the highly regulated and supervised banking sector.

There are multiple examples of this migration, but two of the most significant include mortgage origination and servicing, which is now dominated by nonbanks (though Forum banks remain among the top ten originators); and equity trading, half of which is conducted by high-frequency trading firms that are outside the banking system. A continuation of this trend will lead to a greater risk of financial instability.

Over the next year, we urge the Subcommittee and others in Congress to closely examine the disproportionate impacts of the U.S. Basel III Endgame proposal, considering the existing strength of our largest banks, the significant costs it would impose on borrowers, businesses, and the economy, and the competitiveness of the United States.

We appreciate the opportunity to offer our preliminary views and concerns regarding the Basel III Endgame proposal and stand ready to provide additional information and analysis in support of the Committee's oversight responsibilities.