Congress of the United States
Washington, DC 20515

January 16, 2024

The Honorable Martin J. Gruenberg
Chairman of the Board of Directors
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

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

Acting Comptroller Michael J. Hsu
Office of the Comptroller of the Currency
400 7th Street, S.W.
Washington, D.C. 20219

RE: Comment on Regulatory Capital Rule (88 FR 64028, Docket ID OCC–2023–0008) – Considering the Effect on Capital Markets

Dear Vice Chair Barr, Chairman Gruenberg, and Acting Comptroller Hsu:

We write today regarding your agencies' proposed U.S. implementation of the Basel III Endgame, and its potential impact on U.S. capital markets. Because the U.S. Basel III Endgame proposed capital rule will overhaul the current risk-based capital framework and increase risk weighted assets associated with banks' trading and capital markets activities by $880 billion and required capital ratios by 67 basis points,[1] we are concerned that there may be a significant impact to the ability or willingness of banks to play various critical roles in our capital markets. These concerns need to be carefully considered, as does the importance of making sure that banks have adequate capital.

Debt and equity financing from capital markets (rather than loans) play a greater role in funding businesses in the U.S. than they do in the Euro Area.[2] Considering this unique aspect of the U.S. financial system, a substantial capital increase targeting the specific products and services banks offer capital markets could have unintended downstream consequences for the ability of end-users to access capital and hedge risk.

In particular, we write to urge your agencies to consider the cumulative consequences of the proposed capital rule on capital market activities such as **securities underwriting**, **derivative hedging**, **securitization**, and **equity investments in funds**, and the potential subsequent effects that will be felt by investors, consumers, and U.S. businesses. We also urge you to evaluate the effect the **new operational risk charge** could have on capital markets.

[1] Federal Register Vol. 88, No. 179, Page 64170.
[2] Securities Industry and Financial Markets Association, "SIFMA 2023 Capital Markets Outlook." Page 10. https://www.sifma.org/wp-content/uploads/2022/12/2023-Capital-Markets-Outlook-SIFMA.pdf

Securities Underwriting

Securities underwriting is a critical service that banks provide to companies and local governments looking to raise funds in debt and equity markets to finance business growth or fund new projects. Bank underwriters act as intermediaries between end-users that want to issue new securities and investors, with the U.S. Global Systemically Important Banks (GSIBs) alone representing roughly half of equity, corporate debt, and municipal debt securities underwriting.[3]

As proposed, the new capital rule could make securities underwriting activity significantly less economically attractive, both due to the treatment of such activity under the Fundamental Review of the Trading Book (FRTB) and the introduction of capital requirements for fee-based services under the revised operational risk framework.[4] This means it could become more expensive for companies to launch initial public offerings (IPOs) or issue corporate debt. It could also become more expensive for states and localities to issue municipal debt used for public projects such as roads and bridges.

Equity markets are the public face of finance and are often seen as a barometer of the overall health of the economy. In that sense, a thriving IPO market is perhaps the most direct and tangible evidence of an economy where new businesses have confidence in their future prospects. Making U.S. capital markets less appealing for businesses looking to issue an IPO, as the proposal could do, may reduce the United States' ability to foster innovation and entrepreneurship, and attract global capital.

Of course, increases in capital requirements can make banks better able to survive difficulties. This must be balanced by the considerations described in the above paragraphs.

Derivative Hedging

The use of derivatives to hedge commercial risk benefits global markets by allowing businesses across a wide variety of economic sectors to improve their planning and forecasting and offer more stable prices to consumers – with commodity derivatives for price fluctuations in raw materials, cross-currency swaps for international currency variations, and interest rate swaps for interest rate changes on long-term liabilities. Large banking organizations serve as counterparties to commercial end-users, pension funds, insurance companies, and municipalities for their derivatives transactions. The *combined* impact of the introduction of new Credit Valuation Adjustment (CVA) requirements on derivative transactions, FRTB, and operational risk charge may decrease the banks' ability or willingness to facilitate end user hedging, which could reduce market liquidity and increase hedging costs. On the other hand, bank capital must be sufficient given the risks taken by the bank under the derivative contract.

[3] *Ibid.* Sections I and II.

[4] Two significant drivers of the anticipated increased capital requirements associated with securities underwriting in the Notice of Proposed Rulemaking come from (1) higher credit conversion factors (CCFs) of 40% on **off-balance sheet commitments to purchase securities** vs. the likely 20% under current rules, and (2) potentially higher counterparty risk-weighted asset charges for **derivative services** under the Standardized Approach for Counterparty Credit Risk (SA-CCR), although this would be portfolio-dependent. In addition, any **fees earned from underwriting** activity will increase the Services component of the operational risk risk-weighted assets calculation.

Asset Securitization

Asset securitization – packaging a set of assets into a marketable security – is crucial to our economy, helping to ensure businesses and consumers have access to affordable financing. Residential and commercial mortgages, student loans, auto loans and leases, and credit card receivables are just a few examples of the types of assets that rely on securitization. Under the proposed new capital rule, U.S. regulators have sought a broad application of the most cautious of the approaches recommended by the Basel Committee. Further, the proposal doubles the 'securitization capital surcharge' for certain securitization exposures, calibrating it above the level adopted by your agencies after *Dodd-Frank*.[5]

Considering the increased risk weightings assigned to securitization transactions under the FRTB portion of the proposal, together with the effective double counting of those same risks under the U.S. stress testing process, we are concerned that the new capital requirements may lead in some cases to banks having to maintain more capital against the underlying securitization transaction than the underlying exposure itself. If so, banks could be less likely to act as market-makers in the securitization markets, reducing market liquidity and driving up borrowing costs for consumers and businesses.

Investment Funds & Seed Capital

The proposed changes to the treatment of equity investment in funds – which in some cases could require banks to hold more capital than the original exposure itself to be considered well-capitalized[6] – may also inhibit the ability of banks to provide critical seed funding to third-party investment funds. Consequently, these changes to bank capital requirements could limit an important initial source of capital for those funds and ultimately further constrain the ability of businesses and consumers to obtain affordable financing.

Fee-Based Services

Additionally, a new operational risk charge may compound the aforementioned consequences of the Notice of Proposed Rulemaking, given its treatment of fee-based capital markets businesses such as custody, client clearing, wealth management, retail brokerage, and investment advisory

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[5] The securitization standardized approach (SEC-SA) described in the Notice of Proposed Rulemaking increases from 0.5 to 1.0 the multiplicative adjustment of the supervisory parameter (or "p-factor") for exposures that aren't a resecuritization exposure. While the U.S. proposal is consistent with the recommendations of the Basel Committee, the European Union instead uses a lower multiplier, below Basel's most recent recommendations. (See Mayer Brown, "A Road Not Taken: Where the US Capital Proposal Differs From Basel." August 10, 2023. https://www.mayerbrown.com/en/perspectives-events/publications/2023/08/a-road-not-taken-where-the-us-capital-proposal-differs-from-basel. See also Horn, Christopher B. "The Final Stretch: Securitization in the US Under the Proposed Basel III Endgame Rules." Mayer Brown. September 5, 2023. https://www.mayerbrown.com/en/perspectives-events/blogs/2023/09/the-final-stretch-securitization-in-the-us-under-the-proposed-basel-iii-endgame-rules.)

[6] In particular, (1) setting a 20% risk weight floor to equity exposures to an investment fund – a detail not included in Basel's recommendations – while (2) removing the simple modified look-through approach (SMLTA) for equity investments when a high level of transparency in underlying positions is not available and instead requiring the use of the highly punitive 1,250% risk weight could significantly restrict businesses' financing options.

services. The result could be to increase costs and reduce access to these critical services, which are relied upon not only by many market participants and commercial end users, but also by many retail investors. All things considered, we are concerned that the cumulative effects of the proposed new capital rule would disincentivize banks from providing these important and relatively low-risk capital-markets services especially when they diversify and strengthen the banking system. Again, these concerns need to be weighed against the importance of making sure that banks have adequate capital.

International Coordination

It makes sense to periodically revisit bank capital requirements. Your current proposal is being put forward under the rubric "Basel III," thus implying that by adopting the current draft we will be in greater harmony with our major financial partners worldwide, particularly the E.U. However, it is our understanding that your proposal is stricter in the capital markets area than the E.U., particularly in the use of internal modeling.

Conclusion

In each case described above, the prudential regulators must ensure each bank has adequate capital commensurate with the risk that each asset or business line presents. While capital requirements serve to protect financial institutions from failure, the benefits of higher capital requirements must be weighed against their economic effects, especially in those cases where the higher capital requirements may adversely affect our capital markets or our economy overall. Given the likely magnitude of the impact of the Notice of Proposed Rulemaking, we urge you to carefully consider the proposal's consequences on capital markets.

The purpose of this letter is not to prescribe the appropriate capital level but, rather, it is to bring to your attention the effects that certain capital requirements may have on our capital markets. We urge you to continue to do your best to have capital requirements that reflect the actual risk of a bank asset or activity and weigh the societal benefits against any adverse economic impacts.

We appreciate your attention to this important matter and welcome the opportunity to discuss these issues further.

Sincerely,

Brad Sherman
Member of Congress

Ann Wagner
Member of Congress

Bill Foster
Member of Congress

Andy Barr
Member of Congress

Vicente Gonzalez
Member of Congress

Josh Gottheimer
Member of Congress

Wiley Nickel
Member of Congress

Ritchie Torres
Member of Congress

Dan Meuser
Member of Congress

Frank D. Lucas
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