



FedFin Client Report

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GOP Blasts Basel End-Game Regs, Dems Seek a Few Changes

Client Report: CAPITAL235

Executive Summary

With HFSC Chairman McHenry (R-NC) leading the way, GOP Members of the panel's Financial Institutions Subcommittee today blasted the banking agencies' end-game proposal ([see Client Report CAPITAL234](#)). Republicans were unanimous in joining leadership's attack on the proposal's process and substance, pointing to what they called incomplete impact analyses, an inexplicably short comment period, and adverse macroeconomic and regional-bank implications. Democrats led by Ranking Member Waters (D-CA) were more restrained and in some cases supported the proposal, but concerns were also noted with specific provisions (e.g., re the treatment of certain mortgage and securitization assets) and the interface with the pending CRA final rule. We continue to expect the banking agencies to hold firm to the proposal in broad terms and make minimal, if any, changes to the comment deadline. However, pressure from Republicans and the industry could well force renewed and what many would consider improved impact analyses designed not only to allay political opposition, but also the courts if litigation challenges the final rule.

Analysis

Opening Statements

Echoing today's GOP [letter](#) to the banking agencies, full Committee Chairman McHenry called the proposal politically motivated and accused Vice Chair Barr of ignoring congressional requests for quantitative analysis. Subcommittee Chairman Barr (R-KY) called the capital proposal underdeveloped, partisan, and highly influenced by international regulators. He also argued that the banking agencies failed to deliver sufficient quantitative and cost-benefit analysis and evaluate how the proposal would interact with other regulations, also emphasizing that it would constrain credit availability, threaten financial stability, and jeopardize the CRE sector.

Subcommittee Ranking Member Foster (D-IL) and full committee Ranking Member Waters defended the proposal on grounds that higher capital requirements will not undermine U.S. bank competitiveness and improve financial stability. Rep. Foster nonetheless called for

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maximum transparency regarding the data and analysis used to support the proposal, urging the Fed to be more “forthcoming.”

Testimony

Greg Baer of the BPI argued that the Basel proposal fails to address the causes of recent bank failures by omitting interest-rate and liquidity risk, warning that higher capital charges will result in nonbank deposit migration as well as competitive disadvantages. Robert Broeksmit of the MBA argued that the proposal would undermine other Biden administration affordable housing goals, adversely affecting the ability of regional banks to hold MSAs. Andrew Olmem of Mayer Brown argued that the proposal contradicts congressional intent as well as APA procedural requirements for transparency and accountability, highlighting what he called its unduly short comment period, inadequate impact analysis, and disregard for tailoring standards. Alexa Philo of AFR argued that the proposal would buttress financial stability goals by strengthening banks, highlighting the importance of AOCI capital recognition and disputing that the proposal would constrain credit availability to underserved communities.

Q&A

- **Regional Banks:** Chairman Barr and Rep. Rose (R-TN) raised concerns about the proposal’s impact on regional banks, arguing that it would undo tailoring standards, encourage consolidation, and result in a barbell banking system. Mr. Baer agreed, noting that regional banks’ primary challenge is earnings, not capital and that the proposal’s requirements for market risk and the SLR are not fit for purpose. Rep. Luetkemeyer (R-MO) raised concerns that a “one-size-fits-all” approach would undermine smaller banks; Mr. Olmem agreed.
- **Credit Availability:** Reps. Luetkemeyer, Rose, Fitzgerald (R-WI), Loudermilk (R-GA) and Kim (R-CA) asked how the proposal would affect mortgage lending; Mr. Broeksmit reiterated that it would constrain it, calling additional LTV requirements “nonsensical.” Rep. Sherman (D-CA) raised concerns about the proposal’s failure to credit private mortgage insurance; Mr. Broeksmit called it “nonsense.” Rep. Hicks (D-NY) asked if the proposal would affect special purpose credit programs; Mr. Broeksmit argued that increased capital requirements would reduce SPCP availability as well as increase mortgage rates. Ranking Member Waters countered that the proposal does not apply to community banks and thus would not constrain lending to vulnerable communities; Ms. Philo agreed. Rep. Pressley (D-MA) argued that stronger capital requirements improve bank lending through financial stress at great benefit to LMI communities.
- **Stress Testing:** Rep. Luetkemeyer argued that increased capital ratios demonstrate that current stress testing is inadequate; Mr. Olmem argued that bank failures should not trigger wholesale revisions to capital requirements.

- **Supervision:** Reps. Posey (R-FL), Luetkemeyer, and Kim argued the agencies should prioritize addressing supervisory issues they said were responsible for this year's banks failures before instituting new rules.
- **Securitization:** Rep. Rose raised concerns that the proposal would negatively impact securitization; Mr. Olmem agreed, noting that the proposal lacks economic analysis for liquidity impacts.
- **CRA:** Rep. Kim argued that the agencies should hold off on finalizing their CRA proposal until the capital rules are finalized; Mr. Baer emphasized that the "holistic review" must entail a better analysis of regulatory interactions.
- **Commercial Real Estate:** Chairman Barr pointed to CRE market risk, arguing that the proposal would undermine lending to this sector; Mr. Broeksmit emphasized that the agencies have failed to assess the proposal's interaction with other rules.
- **Internal Models:** Rep. Foster argued that the proposal rightly moves away from internal modeling and asked for witness views on the issue; Mr. Baer defended internal models on grounds that there is little evidence that they are gamed by banks, while Ms. Philo argued that the assumptions underlying internal models are often weak and vary widely.
- **Public Engagement:** Chairman Barr raised concerns that the proposal's comment period is insufficient and said the agencies should have put out an ANPR; Mr. Olmem reiterated that the proposal defies the APA.
- **Impact Analysis:** Reps. Barr and Posey asked witnesses if they believed the agencies had performed a sufficient impact analysis; Mr. Baer argued that the proposal lacks rigor and would impair economic growth, calling it a "benefit-benefit" analysis.
- **AOCI:** Ranking Member Waters also argued that SVB's failure had a direct relationship to inadequate capital requirements; Ms. Philo agreed, highlighting lack of AOCI recognition.
- **International Competitiveness:** Reps. Luetkemeyer, Hicks and Williams (R-TX) raised concerns that the proposal would reduce U.S. bank competitiveness; Mr. Baer said the proposal would increase consumer costs and migration to nonbanks.
- **Tax Equity Investments:** Reps. Casten (D-IL) and Sherman raised concerns that increases to the risk-weights for tax equity investments could compete with IRA clean energy investment objectives; Ms. Philo and Mr. Baer agreed that this is an area where more detail is needed.