LATHAM & WATKINS LLP

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Barr Speech on the Basel Endgame – A Snapshot: Many Comments Unaddressed and Significant Concerns Remain

Barr Speech: Addressed and Unaddressed Material Issues*

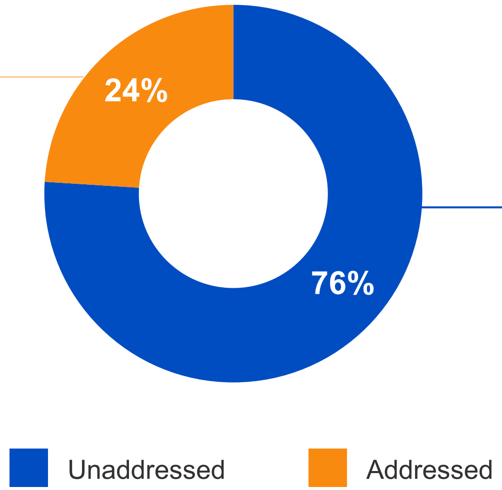
- On September 10, Federal Reserve Vice Chair for Supervision Barr gave a speech (the Barr Speech) in which he outlined the principal changes to the federal banking agencies' 2023 proposal to implement the Basel Endgame (the Proposal) that he would recommend in a re-proposal (the Re-Proposal).
- Based on public comments issued after the speech, Vice Chair Barr has the support of Federal Reserve Chair Powell, FDIC Chair Gruenberg, and Acting OCC Comptroller Hsu, who each issued separate statements agreeing that the Barr Speech reflects their joint work revising the Proposal.
- Of the 75 material substantive issues raised by the public comments, 24% were addressed in the Barr Speech.[1] By contrast, 76% of material substantive issues were not addressed in the Barr Speech.
- In light of significant comments received on the Proposal, Chair Powell and Vice Chair Barr both publicly and repeatedly stated that a Re-Proposal will include "broad and material changes." **However, the changes described appear to be relatively narrow and cannot be said to be both broad *and* material.**

* ***This presentation provides a summary of the commenter issues still outstanding after the Barr Speech. For a more detailed analysis, please refer to this report.***

Particular Material Issues: Addressed vs. Unaddressed

Vice Chair Barr addressed certain issues raised by:

- Housing industry and government-sponsored entities (Fannie Mae / Freddie Mac)
- Certain consumer advocates
- Renewable energy interests
- Banks and their trade associations



Unaddressed issues include comments from banks and their trade associations, members of Congress, and other non-bank commenters, including:

- Manufacturers
- Utilities
- Commercial end-users of derivatives and other financial products
- Agricultural interests
- Energy companies
- Small- and medium-sized businesses

[1] We considered an issue to be a material substantive issue if it focused on any of the credit or equity risk weights in the Proposal, a significant aspect of the operational, market, and CVA risk weighting, tailoring concerns, overlap with the Federal Reserve stress tests, or a significant aspect of the separate G-SIB surcharge proposal, as described more fully in the report.

Overview of Principal Areas of Addressed Concerns

Explicit Revisions Noted in Vice Chair Barr's September 10 Speech

Macro Concerns	• Exempted banks with between $100 billion and $700 billion in assets that do not have large trading operations, and are not internationally active or G-SIBs, from the Re-Proposal's requirements (addressed except for AOCI issues)
Credit Risk	• Added preferential risk weights for more investment-grade borrowers (but only if regulated) • Reduced risk weights for most mortgages and certain retail exposures • Removed minimum haircuts for securities financing transactions (SFTs)
Equity Risk	• Restored preferential risk weights for tax credit equity exposures, such as renewable energy tax credits
Operational Risk	• Revised operational risk charge not based on operational risk history • Revised operational risk charge for investment management activities • Revised calculation of netting of fee income
Market & CVA Risk	• Lowered magnitude of capital charges on cleared derivatives • Revised treatment of agency-backed mortgage-backed securities • Adjusted incentives to use internal models
G-SIB Surcharge Re-Proposal	• Changes associated with client clearing • Updated global bank indicator levels • Would account for economic growth and inflation going forward

"[T]he proposal's potential grouping of renewable energy tax equity into the 400% equity-exposure risk weight category would be extremely unwarranted due to these investments' loan-like characteristics, low-risk profile, and over-whelmingly positive historical returns. This proposed risk weight would make clean energy projects uneconomic and is already stifling crucial financing for our sector at a time when it is needed most."

American Council on Renewable Energy

"[T]he current Endgame proposal from the Agencies will add another massive hurdle for consumers look[ing] for mortgage loan products. The specific changes to the risk-weighting for mortgages and servicing rights and the overall increase in capital across the board for the large banking institutions will inevitably mean that the cost of mortgages will increase, especially for lower-income consumers, those already struggling the most to obtain housing."

National Association of Realtors

Overview of Principal Areas of Unaddressed Concerns

"In the current economic and geopolitical environment, the Coalition has serious concerns that increased transaction costs associated with prudent risk-management hedging practices by derivatives end-users will result in two materially adverse impacts: (i) even further increased costs will flow through to consumers for goods, services and everyday necessities; and (ii) reduced capacity for derivatives end-users to hedge their commercial risks because the costs to hedge those risks could become prohibitively expensive, which would lead to greater price volatility. These results would be bad for consumers and bad for economic stability and neither result decreases risk to the broader U.S. economy—a flawed and detrimental result of the Proposals."

Coalition for Derivatives End-Users (on behalf of 103 companies that use derivatives)

"U.S. implementation of the Basel III capital standards is already more stringent than those of the European Union, including higher capital standards and mandatory stress testing on capital payouts. As a result, U.S. banks already hold more capital currently than the European banks will likely hold after they have completed Basel III Endgame implementation. This unaligned capital treatment would only increase after the full implementation of the U.S. proposal, with U.S. banks required to hold significantly more capital than their European counterparts."

Senators Kirsten Gillibrand (D-NY) and Cynthia Lummis (R-WY)

Examples of Points Not Addressed in Barr Speech

Macro Concerns	• Adverse effects on the economy • US banks already better capitalized than global peers • Interaction between the Proposal and stress tests • Adverse effects on minorities and underrepresented communities • Overall effects on capital markets activities • Legal and process issues raised with rulemaking • Align mismatch in the effective dates of SBC and Basel transition
Credit Risk	• Criteria for investment-grade companies that are not financially regulated • Treatment of securitizations • Requirement for "eligible guarantor" for credit risk mitigation • Treating certain broker-dealer and bank holding companies as banks per international standard • Aligning bank short-term risk weighting with international standard • Revising definition of defaulted exposure
Equity Risk	• Retention of the 100% equity bucket • Allow for greater hedge recognition for equity exposures
Market & CVA Risk	• Improved CVA treatment for regulated financials • Diversification and netting recognition • Use of models for default risk charge • Treatment of sovereign issuances • Treatment of daily margined trades • Revision of fall-back approach for equity investments and funds • Improve recognition of single-name and index hedges • Add exemption for derivative exposure with corporate end-users
G-SIB Surcharge Concerns	• Frequency of averaging • Recalibration of short-term wholesale funding weight • Classification of equity ETFs

"The impact of this proposal is understated and will impede the ability of America's banks to provide a range of critical financial services to Business Roundtable member companies, reducing both innovation and economic growth. ... The proposed increase in capital requirements will negatively impact the U.S. capital markets."

Business Roundtable

"[M]arket liquidity and market-making are fundamental to the efficient operation of financial markets. We are very concerned that this Proposal, in its rush to impose Basel III on US banks, has failed to explore in-depth — let alone pay more than even lip-service to — the potentially detrimental consequences to market liquidity and market-making of imposing higher or ill-conceived capital standards on banks, which in turn could harm funds and their millions of shareholders."

Investment Company Institute

"As currently written, the Proposal would interfere with our ability to access critical services, manage our assets in ways that create value for our members, and allow us to prudently manage our risk. The cumulative effect of these impacts is that U.S. public pension funds will experience increased costs, as well as additional volatility and risk, despite the fact that our Systems are highly creditworthy, transparent, accountable entities that provide retirement security for millions of Americans."

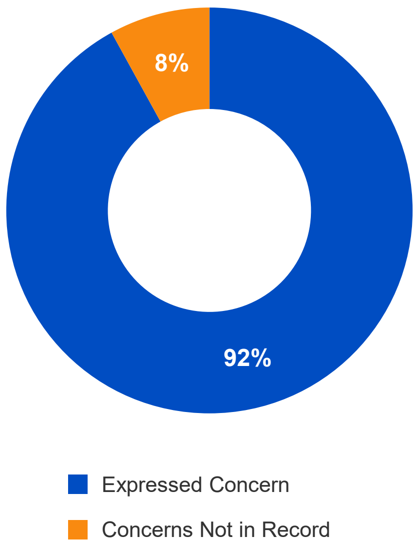
State of Wisconsin Investment Board and Ohio Public Employees Retirement System

Commenters Pressed Concerns in Meetings With Banking Agencies

- In addition to comparing the comment letters to the Barr Speech, we analyzed the significant number of public meetings between the Banking Agencies and interested parties.

- Specifically, we found based on the public record that there were 194 meetings held on the Proposal.[2]
- An overwhelming majority of participants in those meetings expressed concerns about the Proposal.

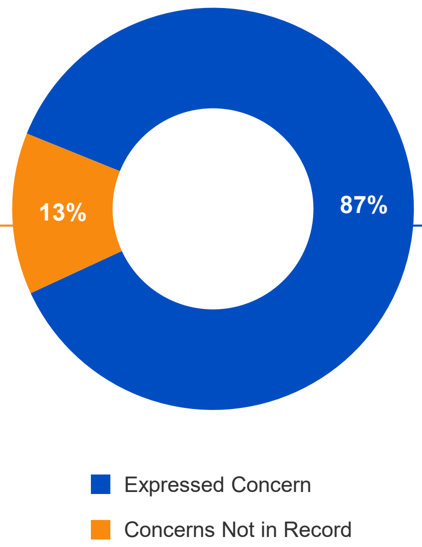
Percentage of All Banking Agency Meetings With Expressed Concerns



Non-bank constituencies whose specific concerns were not in the public record included:

- Academics
- Accounting/consulting
- Housing/real estate
- Think tanks

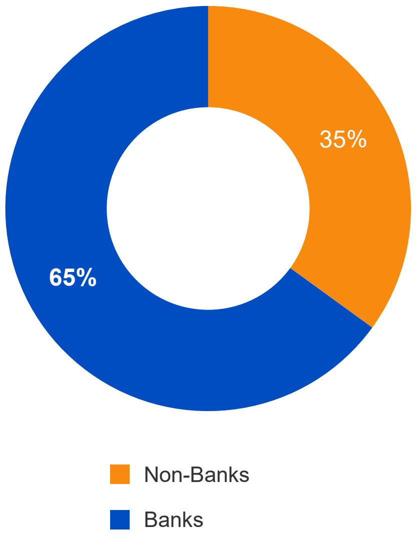
Percentage of Banking Agency Meetings With Non-Bank Participants With Expressed Concerns



Non-bank meeting constituencies that expressed specific concerns included:

- Academics
- Public interest
- Non-bank financial market participants, exchanges, and clearing organizations
- Asset management
- Housing/real estate
- Energy
- Insurance
- General business and manufacturing
- Pension funds/retirement
- Think tanks
- Small businesses

Summary of Banking Agency Meetings: Banks vs. Non-Banks



2 For this analysis, we considered meetings where support, no concerns, or only general comments were summarized in the public record to be meetings where there were not concerns in the record. Due to the last of these considerations in particular, it is possible that an interested party actually did express a concern. We considered "non-banks" to be any entity that did not have, or did not control a company that had, a banking license and that was not a trade association for such entities.

Unaddressed Concerns of Members of Congress

225 of 237 Democratic and Republican members of Congress (including one Independent Senator who caucuses with the Democrats) wrote or signed letters expressing opposition to or serious concern with the Proposal

100%

of Republicans in Congress who joined comment letters on the Proposal **expressed concerns**

93%

of Democrats in Congress who joined comment letters — including the Chairs of the Congressional Black Caucus and the Congressional Hispanic Caucus — similarly **criticized aspects of the Proposal**

1

Congressional comment letter, signed by 12 Senators (11 Senate Democrats in total, and one Independent Senator who caucuses with the Democrats), **supported the Proposal**

> "I also believe the agencies must articulate more clearly the ways in which the proposed new requirements overlap with those already in place. For example, some banks are already subject to operational risk charges via the stress-testing process and other existing rules. The proposed changes indicate, however, that your agencies believe these current rules do not properly capture the risk from things like fee- and commission-based services and other activities. The agencies should therefore clearly explain these concerns to stakeholders, including Congress."
>
> Senator Mark Warner (D-VA)

Unaddressed Issue	Number of Letters			Principal Signatories
Impact on the cost of credit and effects on the economy	14	Senate Banking Committee Republicans Sens. Tillis, et al. Sens. Scott, et al. Sen. Warner Reps. McHenry, et al. Rep. Huizenga, et al. Reps. Fitzgerald and Barr, et al.	Reps. De La Cruz, et al. Sens. Gillibrand and Lummis Sens. Sinema and Crapo Reps. Sherman and Wagner, et al. Reps. Meuser, et al. Sens. Peters, et al. Reps. Foster, et al.	Senator Thom Tillis Senator Tim Scott Senator Cynthia Lummis Senator Kirsten Gillibrand Senator Mark Warner Representative Patrick McHenry Representative Andy Barr Representative Huizenga
US banks were already strong and well capitalized	3	Sens. Scott, et al. Reps. McHenry, et al. Sens. Gillibrand and Lummis		Senator Scott Senator Lummis Senator Gillibrand Representative McHenry Representative Barr
Interaction between the Proposal and the Federal Reserve's stress tests	3	Sens. Tillis, et al. Sen. Warner Reps. Sherman and Wagner, et al.		Senator Warner Representative Brad Sherman Representative Ann Wagner
Overall effects of the Proposal on minority groups and underrepresented communities	8	Sens. Scott, et al. Senate Banking Committee Republicans Sens. Gillibrand and Lummis Sens. Brown, et al.	Sens. Peters, et al. Sen. Warner Reps. Foster, et al. Reps. Beaty, et al.	Senator Scott Senator Lummis Senator Gillibrand Senator Gary Peters Senator Warner
Concerns with market risk provisions	3	Rep. Nunn and Sen. Moran, et al. Sens. Sinema and Crapo Reps. Sherman and Wagner, et al.		Senator Mike Crapo Senator Jerry Moran Senator Kyrsten Sinema Representative Zach Nunn Representative Sherman Representative Wagner
Concerns with CVA risk provisions	3	Reps. De La Cruz, et al. Sens. Sinema and Crapo Reps. Sherman and Wagner, et al.		Senator Crapo Senator Sinema Representative Monica de la Cruz Representative Sherman Representative Wagner
Concerns with investment-grade risk weighting	5	Rep. Nunn and Sen. Moran, et al. Sens. Scott, et al. Reps. Fitzgerald and Barr, et al.	Reps. De La Cruz, et al. The Wisconsin Delegation	Senator Tim Scott Senator Moran Representative Andy Barr Representative Fitzgerald Representative Nunn

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