LATHAM & WATKINS LLP

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Barr Speech on the Basel Endgame: Many Comments Unaddressed

Significant concerns of many groups remain

LATHAM & WATKINS LLP

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I. Executive Summary

In February 2024, we issued a report on the public comments received on the proposal of the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC, and together with the OCC and the Federal Reserve, the Banking Agencies) to implement the Basel Endgame (Proposal). We found that the Proposal had drawn an unprecedented amount of criticism — more than 97% of the 356 commenters whose letters we deemed material,[1] including 300 from non-banks, opposed the Proposal in full or raised substantial concerns with it in part.

In light of the significant comments received, Federal Reserve Chair Jerome Powell and Vice Chair for Supervision Michael Barr stated that they intended to make "broad and material changes" to the Proposal. On September 10, Vice Chair Barr gave a speech (the Barr Speech) in which he outlined the principal changes that he would recommend to the full Board of Governors in a re-proposed rule (the Re-Proposal). Chair Powell subsequently stated that he supported the proposed changes that Vice Chair Barr previewed and that those changes had been negotiated between the Banking Agencies with his support and involvement. Acting Comptroller of the Currency Michael Hsu and FDIC Chair Martin Gruenberg echoed this view in public statements.[2]

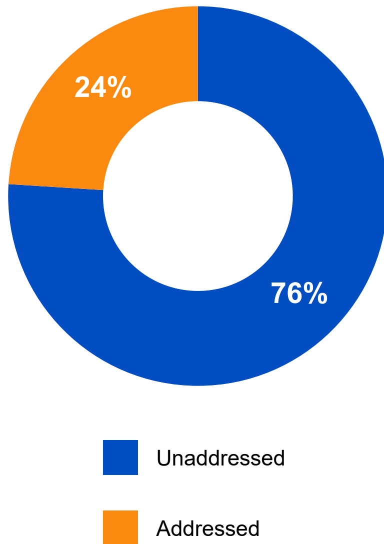
The Barr Speech outlined a package of proposed and specific reforms to the credit risk, market risk, operational risk, CVA risk, and tax equity provisions of the Proposal and recommended that the Proposal's most stringent provisions should only apply to a subset of banks — the US global systemically important banks (G-SIBs) and other large banks that were internationally active or had significant trading operations. Nonetheless, a diverse set of commenters — including banks, pension firms, manufacturers, utilities, commercial end-users of derivatives and other financial products, agricultural interests, energy companies, and small- and medium-sized businesses — had significant concerns with a wide range of issues beyond what the Vice Chair included in his speech, concerns that we described in our February report.

Because we do not know what will ultimately be included in any Re-Proposal and Vice Chair Barr did not claim to be providing a comprehensive summary of a Re-Proposal, this report is based solely on the Barr Speech and our review of the comment record.[3] That said, the Barr Speech was wide-ranging and detailed, and so we believe it is a reasonable description of what would be included in a Re-Proposal. Based on our review, we conclude that the Barr Speech omitted many important areas where a broad range of commenters had expressed criticism. This was true when we considered both the number of material substantive issues raised by commenters and the issues that many commenters frequently addressed.

By our analysis, of the 75 material substantive issues raised by the public comments,[4] 18, or 24% would be addressed in a Re-Proposal as outlined by Vice Chair Barr. By contrast, 76% of those issues were not addressed in the Barr Speech, which included material comments on credit and equity risk, operational risk, market risk, CVA risk, and the G-SIB surcharge.

In addition, many of the core constituencies that expressed concerns about the Proposal may have their concerns only partially addressed or not addressed at all in a Re-Proposal, as we show in more detail on the next page.

Particular Material Issues: Addressed vs. Unaddressed



Commenters Whose Concerns Appear to Be Generally Addressed

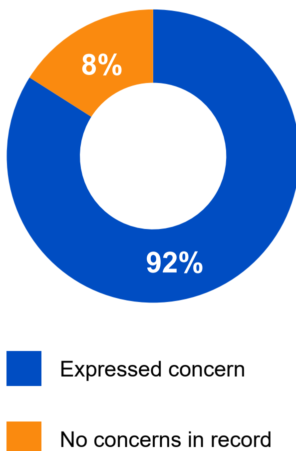
- Regional banks
- Commenters from the housing industry and government-sponsored entities (Fannie Mae/Freddie Mac)
- Certain consumer advocates
- Renewable energy firms

Commenters Whose Concerns Were Partially Addressed or Not Addressed at All

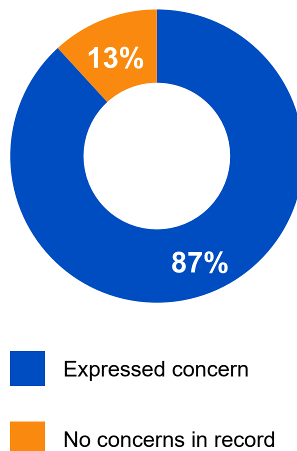
- Banks / bank trade associations
- Main Street business entities such as manufacturers, utilities, commercial end-users of derivatives and other financial products, agricultural interests, energy companies, and small- and medium-sized businesses
- Members of Congress

In addition to comparing the comment letters with the Barr Speech, we analyzed the number of public meetings between the Banking Agencies and interested parties. Based on the public record, it appears that 194 meetings were held on the Proposal.[5] The public record shows that in the overwhelming majority of those meetings, interested parties expressed concerns about the Proposal:

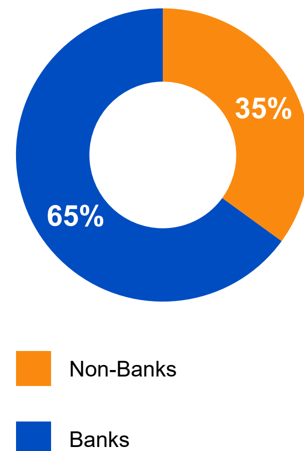
Percentage of All Banking Agency Meetings With Expressed Concerns



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



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



Changes to the Proposal that Vice Chair Barr foreshadowed, while substantial, therefore appear to be relatively narrow and cannot be said to be both broad **and** material, particularly for those banking organizations that have the most significant connections to the overall economy and would see their capital requirements rise the most, 9% by the Vice Chair's estimate.[6]

Moreover, given that, as a quantitative matter, most of the reductions in required capital under the Vice Chair's approach will be in the area of credit and operational risk, and much less so with respect to market risk and CVA risk, Main Street entities that are capital markets and derivatives clients of banks stand to be the non-bank firms most affected by a Re-Proposal. Indeed, during a Q&A after his speech, Vice Chair Barr stated that the bulk of the increase in capital requirements will be focused on trading-related activities.

In the remainder of this report, we describe the principal comments that were addressed in the Barr Speech, as well as the areas of significant public concern that the Vice Chair did not address or addressed only in part.

II. Principal Comments That Were Addressed

The Barr Speech addressed the following nine areas:

- **Scope: Carveout for regional banks.** Responding to the concerns of regional banks, Vice Chair Barr stated that banking organizations with total assets between $100 billion and $250 billion that did not have large trading operations would not be subject to the new Basel rules other than the new requirement to recognize unrealized gains and losses on securities held for sale when calculating regulatory capital (part of AOCI).

  Banking organizations with between $250 billion and $700 billion in total assets that are not G-SIBs or internationally active would generally be exempt from the new frameworks for market risk and CVA risk, which would apply only if such firms engaged in significant trading activity. In addition, such firms would not be subject to the Proposal's more restrictive definition of regulatory capital with the exception of changes regarding AOCI.

- **Credit Risk: Reduced risk weights for most mortgages and certain retail exposures.** Responding to concerns that the Proposal's mortgage risk weights would negatively affect the mortgage markets, including mortgages for many low-income borrowers, Vice Chair Barr stated that he would propose aligning residential real estate exposures with the international Basel standard. For loans to retail customers, Vice Chair Barr stated that he would also align their treatment with the international Basel standard, with two exceptions: he would lower capital requirements for credit card exposures where the borrower uses only a small portion of the commitment line and for charge cards with no pre-set credit limits.

- **Credit Risk: Preferential risk weights for more investment-grade borrowers, but only if regulated.** Partially responding to concerns over a requirement that investment-grade borrowers have publicly traded securities outstanding in order to receive a preferential risk weight, Vice Chair Barr stated that he would recommend extending the preferential risk weight to investment-grade firms that were regulated entities, including pension funds, certain mutual funds, and foreign equivalents — even if they were not publicly traded.

- **Credit Risk: No adoption of minimum haircuts for securities financing transactions (SFTs).** Responding to concerns that the Proposal would impose severe capital charges that no other nation had adopted on securities financing transactions such as repo-style transactions and margin loans, Vice Chair Barr stated that he would recommend dropping such minimum haircuts to allow time to seek greater international consensus on an approach.

- **Equity Risk: Restoration of preferential risk weights for tax credit equity exposures, benefiting renewables.** Responding to concerns primarily from the renewable energy industry, Vice Chair Barr stated that he would recommend restoring the most common current risk weight for tax credit equity funding structures.
- **Operational Risk: Substantial revisions to operational risk capital charge.** Responding to concerns that the Proposal's operational risk charge was significantly higher than international standards and did not reflect actual risk, Vice Chair Barr stated that he would suggest three changes: (i) a firm's operational risk charge would not be based on its operational loss history; (ii) the charge's input for fee income would be calculated on a net basis; and (iii) operational risk capital requirements for investment management activities would reflect the smaller historical operational losses for these activities relative to income produced.
- **Market Risk: Better treatment for agency-backed mortgage-backed securities.** Vice Chair Barr indicated that uniform mortgage-backed securities positions would be treated as having a single obligor, regardless of whether they were issued by Freddie Mac or Fannie Mae. With respect to the broader market risk rules, Vice Chair Barr noted that he would recommend "adjustments to improve incentives" for banking organizations to use internal models for market risk exposures.
- **CVA Risk: Lessening of capital charges on cleared derivatives.** Partially responding to concerns that the new CVA risk requirements would unduly burden the derivatives markets, Vice Chair Barr stated that he would recommend adjusting the capital treatment for client-cleared derivatives activities by reducing the capital required for the client-facing leg of a client-cleared derivative.
- **G-SIB Surcharge Re-Proposal.** Vice Chair Barr addressed issuing a re-proposal of a separate rule governing the capital surcharge for US global systemically important banks (G-SIBs) whose features would partially respond to the concerns of large banks. Under it, (i) proposed changes associated with client clearing would not be adopted; (ii) the surcharge would reflect changes in the global banking system since 2015; and (iii) going forward, effects from inflation and economic growth would be reflected in the measurement of a G-SIB's systemic risk profile.

III. Principal Comments That Were Not Addressed

1. Adverse Effects on the Economy

215 of the 373 comment letters raised concerns about the overall effects of the Proposal on the economy, including that the Banking Agencies did not sufficiently consider any evidence on this score. The Vice Chair appeared to respond to these concerns, stating that a Re-Proposal would appropriately strike a "balance between resiliency and efficiency." He did not, however, provide further details.

These concerns came from a wide range of constituencies, including:

Agricultural concerns	Insurance companies
Asset managers	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Pension funds
Energy companies	Small- and medium-sized businesses

> "First, all other things equal, increasing capital requirements for banks will increase their cost of lending and undertaking various bank activities. This has consequences through two channels. One channel is that banks would in part or in full pass on the increase in the costs to borrowers, end-users, or other customers. … Second, banks may choose to reduce their activities or even withdraw from providing some products or services. … Not only may the impact fall disproportionately on certain groups, it also could reduce investment. Reduced investment can lead to lower productivity growth, reducing both wage growth for workers and overall economic growth. … If banks have disincentives to make markets, market liquidity may suffer and market dysfunction requiring central bank action to stabilize markets may become more frequent."
>
> Professor Randall S. Kroszner, Ph.D. at 1-2

> "An aggregate increase of this magnitude suggests that we are likely to observe profoundly negative consequences in many parts of the U.S. economy. For example, implications for the mortgage market will be driven not only by elevated credit risk weights, but also by operational risk and securitization components of the B3 Proposal. … Similarly, the capital markets activities that serve a foundational role for the U.S. economy will incur higher costs from multiple aspects of the B3 Proposal. … A substantial rise in banks' capital costs for these and virtually all other activities will result in banks either (i) reducing the volume of certain products and services provided, or (ii) passing those higher costs on to end users where possible given market considerations. Both of these outcomes are likely to exacerbate the ongoing shift of banking activities to non-bank providers, which is concerning from a financial stability perspective ..."
>
> JPMorgan Chase & Co. at 4

2. US Banks Have More Capital Relative to Global Peers

88 of the 373 comment letters criticized the Banking Agencies for issuing the Proposal at a time when the US banking industry was already well capitalized, both as an objective matter and in comparison to global banks of the same size and complexity. Many of these letters cited repeated statements by Federal Reserve Chair Powell and Treasury Secretary Janet Yellen that the US banking system was strongly capitalized when arguing against the Proposal's increased capital requirements. The Vice Chair did not address these concerns, even though by his estimates, a Re-Proposal would increase required capital by 9% for banking organizations with the most significant connections to the global economy.

These concerns came principally from the following constituencies:

Agricultural concerns	Manufacturers
Asset managers	Members of Congress
Banks / bank trade associations	Small- and medium-sized businesses

> "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) at 2

> "Layering on additional standards begs the question of analytical justification for such a large increase. Banks have consistently been deemed to be well capitalized and well positioned to deal with stress. … Given these noted improvements … we urge you to maintain the agreed upon Basel III international standards rather than adopting additional stricter policies ..."
>
> National Housing Conference at 2

> "As a U.S.-based banking organization that has a global network of financial services that stretches across nearly 160 countries, we are concerned by the [Banking] Agencies' failure to advance the international harmonization and comparability of the regulatory capital framework, which was the stated objective of the Basel Committee on Banking Supervision … in finalizing the 2017 standards … that serve as the foundation for the Proposal. The Proposal would exacerbate the unlevel regulatory playing field that exists between large U.S. banking organizations and those in other jurisdictions, without justifying why material divergence from the BCBS standards is necessary."
>
> Citigroup, Inc. at 2

3. Interaction Between the Proposal and the Federal Reserve Stress Tests

33 of the 373 comment letters criticized the Proposal for not taking account of the Federal Reserve's annual CCAR stress tests, principally because under the Proposal's expanded risk-based approach, risk-weighted assets would include operational risk, CVA risk and market risk, all of which the stress tests are designed to capture. Vice Chair Barr stated that the Banking Agencies "were looking carefully at how our stress test complements the risk-based capital rules to help ensure our overall framework supports a resilient and effective banking sector." At this time, however, no stress testing changes have been proposed by the Federal Reserve.

These concerns came principally from the following constituencies:

Agricultural concerns	Energy companies
Asset managers	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Pension funds

> "Although Vice Chair for Supervision Barr has attempted to distinguish between minimum capital requirements and capital buffers derived from the stress tests, this argument fails for three reasons. First, it does not reflect that capital requirements are set through two aspects of the capital framework: (i) the calculation of RWAs and (ii) the determination of numerical ratio requirements, including buffer requirements; i.e., RWAs determine the dollar amount of capital necessary to satisfy both minimum requirements and buffer requirements. Second, it does not reflect that, for all practical purposes, a buffer requirement is as binding as a minimum requirement in light of the severe market, reputational, supervisory and regulatory requirements of breaching a buffer. Third, there are design similarities between the underlying methodologies for calculating stress capital requirements and RWAs under the Expanded Risk-Based Approach."
>
> Bank Policy Institute and American Bankers Association at 27-28

> "The new market risk component … known as FRTB, has been calibrated to require large banking organizations to capitalize for market risk assuming a period of market stress. The global market shock component of CCAR also requires large banking organizations to calibrate for market risk assuming a period of market stress. FRTB was calibrated and finalized by the Basel Committee without regard for the US CCAR stress tests. … Therefore, FRTB is completely additive with the [global market shock] component of CCAR."
>
> Coalition for Derivatives End-Users at 10 (on behalf of 103 companies that use derivatives to manage commercial risk)

> "[T]he introduction of significantly more conservative RWA standards raises questions about the interplay of revised RWA standards with CCAR shocks. In the wake of the financial crisis, the [Federal Reserve] Board instituted market shocks in supervisory stress testing that assumed, for many trading portfolios, tail-event losses, limited diversification offsets, and long liquidation timelines. The Basel Committee developed FRTB with these same principles to correct for observed flaws in legacy Market Risk RWA standards. While the B3EG Proposal does not analyze this interplay, the [Federal Reserve] Board should harmonize FRTB implementation with CCAR market shocks …"
>
> Morgan Stanley at 7

4. Adverse Effects on Minority Groups and Underrepresented Communities

119 of the 373 comment letters contended that the Proposal's increased capital requirements would have adverse effects on particular minority groups and underrepresented communities, either by increasing the cost of banking services or by incentivizing banks not to offer certain services at all. Vice Chair Barr did address a portion of these comments in his remarks on reducing risk weighting for mortgages, including many low down payment mortgages. Nonetheless, 86 of these letters, mostly from individuals and advocacy groups, advanced significant concerns with the overall effects of the Proposal on minority and disadvantaged communities, which, like concerns on the overall effects of the Proposal on the economy, Vice Chair Barr did not address.

> "Black-owned small businesses in Michigan, like many across the United States, have long grappled with economic disparities and financial challenges. These enterprises play a vital role in our communities, not only by creating jobs but also by fostering economic empowerment and equity. … Leaders should be looking to improve access to loans and credits and this proposal would only further restrict access to much-needed financing, hindering their growth and potential for job creation."
>
> Jamiel Robinson, Grand Rapids Area Black Businesses at 1

> "I know that an increase in capital requirements could exacerbate the existing economic disparities faced by African-Americans. Historically, Black individuals and communities have faced discrimination in banking and lending practices. … Additionally, Black-owned businesses often rely on loans and lines of credit to keep their doors open and plan for expansion. Increased capital requirements could restrict the availability of these critical resources, hindering the growth and success of Black entrepreneurs."
>
> Tonza Thomas, State Secretary, Columbus Branch, Georgia NAACP at 1

> "The combination of higher risk weights, the operational risk methodology, and capital requirement volatility results in a material increase in capital requirements for banks engaged in mortgage origination. … These impacts will be passed through to borrowers or limit bank activity, including for first time home buyers and underserved borrowers that have lower down payments."
>
> Wells Fargo at 6-7

5. Overall Effects on Capital Markets Activities

88 of the 373 comment letters expressed concerns about the Proposal's cumulative effects on capital markets activities, and these concerns remain outstanding. Given that, as a quantitative matter, most of the reductions in required capital under the Vice Chair's approach will be in the area of credit and operational risk, and much less so with respect to market risk and CVA risk, Main Street entities that are capital markets and derivatives clients of banks will still have concerns that they will be the types of entities most affected by a Re-Proposal. Further, during his oral remarks, Vice Chair Barr acknowledged that the "bulk of the increase in capital requirements" will be "focused on trading related activities."[7]

These concerns came principally from the following constituencies:

Agricultural concerns	Energy companies
Asset managers	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Pension funds

> "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 at 2

> "[T]he revised approaches to Credit Valuation Adjustment, Operational Risk and Market Risk capital requirements with respect to derivatives transactions should be either eliminated from the proposal or reconsidered and recalibrated in light of the broader regulatory context and with an eye toward preserving end users' ability to hedge their business risks."
>
> American Council of Life Insurers at 2

> "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 US capital markets."
>
> Business Roundtable at 2-3

6. Adverse Effects of the Market Risk Capital Rule (FRTB)

54 of the 373 comment letters raised concerns with the Proposal's market risk capital requirements. Of these 54 letters, 39 letters expressed concern that went beyond the two areas described above where Vice Chair Barr stated that he would recommend changes, such as:

- The new standardized approach to market risk does not recognize the benefits of diversification, and the new models-based approach incorporated overly conservative stress testing.
- The Banking Agencies have provided no empirical support for the Proposal's conditions for using the models-based approach for calculating the market risk capital requirements as opposed to its standardized approach.
- The Banking Agencies diverged from the Basel agreement by disallowing the use of models for the "default risk charge," placing US banks at a disadvantage.
- Banks could be forced to switch between applying the two approaches for calculating market risk capital, given the arbitrary nature of the eligibility requirements for using the models-based approach, and this would lead to irrational results.
- There is no evidence that large banking organizations currently undercapitalize their trading and other market-risk activities, but the Banking Agencies estimated that the Proposal would increase market risk risk-weighted assets 77% for the largest bank holding companies, with substantial new costs imposed on trading and related activities.

These concerns came principally from the following constituencies:

Agricultural concerns	Energy companies
Asset managers	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Pension funds / insurers

> "The Proposed Rule's substantial increase in capital requirements for banks' trading books through the Fundamental Review of the Trading Book will significantly increase the costs of critical risk management tools for U.S. manufacturers. When a bank provides a derivative to a customer, it is often required to record the transaction in the bank's trading book as a dealing/ market-making exposure. Banks will then mitigate the market risk from customer-driven derivatives through offsetting or hedging activities in order to ensure the bank is risk neutral. The Proposed Rule does not recognize the most efficient hedging activities, thereby forcing banks to utilize less efficient and more costly hedges."
>
> National Association of Manufacturers at 3

> "The implementation of the FRTB under the Basel III Proposal would significantly increase capital requirements for market risk. Based on the Federal Reserve's own estimates, the impact of the Basel III Proposal would increase risk-weighted assets for market risk relative to the current U.S. capital rules by approximately 75% for Category I and II banking organizations. As a first order effect, investment funds and their clients could face higher costs arising from such increased capital requirements, significantly increasing bid-ask spreads in trading markets. As a second order effect, client investment goals for college, a home, and a comfortable retirement could be seriously compromised, and risk-hedging tools limited."
>
> Securities Industry and Financial Markets Association (SIFMA) Asset Management Group at 21

> "The Fundamental Review of the Trading Book will significantly raise capital standards for all market making activity. Derivative transactions are among the most penalized, including interest rate derivatives and equity derivatives. Many retirement plans use equity derivatives as an efficient means to gain market exposure."
>
> American Benefits Council at 4

7. CVA Capital Charge Adverse Effects

58 of the 373 comment letters took issue with the Proposal's approach to CVA risk for derivatives transactions. Of these 58 letters, 37 letters expressed concern that went beyond the CVA risk issue to which Vice Chair Barr responded, reducing the capital required for the client-facing leg of a client-cleared derivative, and made arguments including that:

- The Proposal departs from current capital treatment under which CVA hedges that do not qualify as eligible CVA hedges are not automatically included in market risk capital requirements.
- The European Union's implementation of Basel III diverged from the Basel agreement on CVA risk by specifically exempting derivative transactions with commercial end users and pension funds from the CVA requirements, thus providing better capital treatment than the Proposal.
- The Proposal is over-calibrated to the actual CVA risk posed and therefore would impose significant burdens on banks in offering derivatives products to their financial and commercial end user clients for hedging purposes.
- The Proposal's CVA requirements conflict with pre-existing legislative requirements on mandatory clearing and mandatory daily margining by requiring US banks to assume derivative transactions can be un-margined for greater than one day.

As with market risk, broad sectors of the US economy expressed these concerns:

Agricultural concerns	Energy companies
Asset managers	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Pension funds / insurers

> "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 at 3 (on behalf of 103 companies that use derivatives to manage commercial risk)

> "The [Proposal] requires that CVA capital be calculated for all parties involved in CVA-covered positions-with no exceptions. This adds to the current capital requirements and undermines existing regulatory relief and policy objectives."
>
> Kaiser Aluminum Corporation at 3

> "Costs will increase to manufacturers and companies for hedging commercial risks due to the inclusion of CVA charges for uncollateralized transactions. The cost of hedging risk associated with foreign revenues and expenses of international operations through long-dated foreign exchange derivatives will become so costly that companies may forgo hedging. … Similarly, additive CVA charges will increase the cost of transportation, and ultimately U.S. commerce, by increasing the cost of hedging energy and other critical inputs for U.S. logistics companies and other corporations that rely on the movement of physical goods. These increased costs will likely be passed on to U.S. consumers."
>
> Goldman Sachs at 11

> "Specifically, SWIB utilizes a wide variety of derivatives to manage the risk and exposures of the assets we manage. … [S]everal banks have indicated that their capital charges will increase by up to five times, and if even a small portion of that increase is shifted to public pension funds, there will be a material impact on our derivative transaction costs, leading to lower returns for our members."
>
> State of Wisconsin Investment Board and the Ohio Public Employees Retirement System at 7

8. Criteria for Investment-Grade Risk Weighting

67 of the 373 letters criticized the Banking Agencies for including a requirement that an entity be publicly traded in order to benefit from a lower risk weighting for being investment-grade. These letters did so principally on the ground that the publicly traded requirement was highly arbitrary and would exclude many investment-grade businesses that posed low risk. This concern was partially addressed by the Vice Chair, when he indicated that a firm's being financially regulated could serve as a proxy for being publicly traded. The Vice Chair's proposed adjustment, however, did not respond to the 41 comment letters that urged a broader approach to allow all investment-grade companies to benefit from a lower risk weighting on the ground that this would better align with the true risks posed. Firms that had raised this concern included:

Agricultural concerns	Manufacturers
Banks / bank trade associations	Members of Congress
Derivatives end-users	Small- and medium-sized businesses
Energy companies	Utilities

> "Unnecessarily high capital requirements that do not match the associated risk also will create a barrier to entry for certain market participants, such as farmer-owned cooperatives. As noted above, farmer cooperatives are businesses owned, governed, and controlled by farmers and ranchers. Thus, we are particularly troubled by the determination of "Investment Grade" for Unlisted Corporate Exposures (the 'Public Listing Requirement'). … NCFC believes [agricultural] co-operatives, as not being publicly traded, will be put to a disadvantage to other entities … in accessing the derivatives markets."
>
> National Council of Farmer Co-operatives at 3-4

> "While the Basel III Endgame Proposal provides for a preferential 65% risk weight for investment grade corporate exposures based on a large banking organization's internal assessment of creditworthiness, it only allows the preferential risk weight to be applied if the counterparty or its parent has outstanding shares that are publicly traded on a national securities exchange or foreign equivalent. The Gas Authority and other municipally owned utilities, although highly rated and a significant presence in the market delivering essential, reliable utility services at the lowest possible costs to communities across the country, including otherwise under-served markets, cannot qualify for this narrowly drawn exception ..."
>
> Municipal Gas Authority of Georgia at 3

9. Concerns With Treatment of Securitizations

38 of the 373 letters raised concerns over the Proposal's treatment of securitization transactions. These letters noted that in the US, a large portion of consumer and small business loans are funded by securitizations, and US banks are an "integral part" of the securitization markets. Many large banking organizations stated that because they have significant securitization exposures on their balance sheet, and by materially increasing the amount of capital that would be required to be held against those exposures, the Proposal would make participation in the securitization markets much more costly and result in less credit availability for consumers and small businesses. In addition, manufacturer commenters stated that they rely on securitization to manage their liquidity risks and provide efficient financing for their operations. Vice Chair Barr did not address these concerns.

> "Under the Proposed Rule, loans made by banks to [bankruptcy-remote special purpose entities] will become more expensive and less available; banks will require higher interest rates on [asset-backed securities (ABS)] before investing in them; liquidity in ABS will be reduced as market-making becomes more expensive and less available; and banks will be hindered in their ability to manage the credit risks arising from their loan portfolios. As a result, credit will become more expensive and less available for consumers and businesses, thus threatening their economic well-being."
>
> Structured Finance Association at 3

10. Adverse Effects of Calculation of G-SIB Surcharge

27 of the 356 letters urged that an existing proposal to revise the G-SIB surcharge be modified. Of these 27 letters, 10 letters were limited to a single issue, criticizing increasing the extent to which client-cleared derivatives contribute to a bank's G-SIB surcharge, which Vice Chair Barr stated would be addressed. The remaining 17 that raised other concerns that were not addressed in his speech came from the following constituencies:

Agricultural concerns	Members of Congress
Banks / bank trade associations	Non-bank financial market participants, exchanges, and clearing organizations

Certain of these 17 letters are notable for expressing concerns that the G-SIB proposal's classification of equity ETFs as "financial institutions," which diverged from the Basel international standard in considering transacting in these products as systemically risky, would place US banks at a disadvantage. The types of firms that could be affected if the G-SIB proposal is not modified on this issue, in addition to banks, include pension funds, asset managers, and non-bank financial market participants.

> "The Proposal and the current U.S. GSIB surcharge are inconsistent with both the Basel framework and its implementation in other jurisdictions. In particular, the U.S. GSIB surcharge already reflects more stringent standards than the framework set forth by the Basel Committee on Banking Supervision ('Basel Committee') because it includes a second calculation methodology (method 2) in addition to the methodology based on the Basel standards (method 1), and the method 2 surcharge is generally higher. The excessive stringency of the U.S. standard in both the Proposal and the current approach worsen, rather than improve, international capital discrepancies, hurting U.S. economic competitiveness and undermining the Basel Committee objective of enhanced comparability.
>
> The preexisting and proposed divergences from the Basel framework are not in service of American interests—rather, they would impose additional requirements on U.S. GSIBs that would harm the American economy and the ability of U.S. GSIBs to compete internationally. Similarly, the potential increases in required capital that would result from the Proposal would exacerbate the movement of financial activity outside the regulated banking system, threatening consumers and financial stability. ...
>
> The weight of the short-term wholesale funding ('STWF') category should be recalibrated to 20 percent, consistent with the intention of the FRB in enacting the 2015 Rule."
>
> Financial Services Forum and Bank Policy Institute at 4-5

> "One other knock-on effect that should be considered is the impact that these measures will have on market-makers and liquidity providers specifically, and in turn exchange-traded markets more broadly. … The rules will also have an effect on aspects of the real economy, such as liquidity in energy markets and hedgers' costs, which could translate into higher energy costs for consumers."
>
> World Federation of Exchanges at 6

> "Absent … changes, we believe that many banking organizations will have a materially diminished ability and risk appetite to serve as liquidity providers in the ETF market (both primary and secondary), which could lead to greater volatility and decreased liquidity in those markets. This would be detrimental to the 16.1 million households who rely on ETFs to meet their financial goals. Further, banking organizations may, as result of the increased costs associated with holding ETF positions, no longer be able to use ETFs as cost-efficient hedging mechanisms, removing an important tool that banking organizations currently use to effectively and efficiently mitigate risk."
>
> BlackRock, Inc. at 14-15

11. Congressional Concerns

237 members of Congress wrote or signed letters commenting on the Proposal, and that of those members, 225 members wrote or signed letters opposing the Proposal or certain of its aspects — 16 Senate Democrats, one Independent who caucuses with the Democrats, 39 Senate Republicans, 129 House Democrats, and 40 House Republicans. Of the 23 letters reviewed, 11 were led (or co-led) by Democrats, and 12 were led by Republicans.

Although Vice Chair Barr did address two areas that generated substantial concern — the heightened risk weighting for tax equity investments (a letter signed by 107 House Democrats, for example, commented on this issue), and changes to risk weightings for mortgages (noted, for example, in a letter signed by 59 House Democrats) — many of the letters also focused on the unaddressed areas described above:

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 Representative Patrick McHenry Representative Andy Barr Representative Bill Huizenga

Issue	Number of Letters	Principal Signatories
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 Proposal on minority 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

> "[O]n December 6, 2023, we heard testimony from the CEOs of the eight largest banks in this nation, which largely discussed how the [Proposal] would hinder economic growth and reduce lending to households and businesses. Those CEOs testified that the [Banking Agencies] have failed to adequately study or contemplate the impacts of the [Proposal], including the detrimental impacts to mortgages and small business loans, retirement and college savings, consumer prices on commodities and everyday household items, costs of borrowing for farmers and rural communities, and government infrastructure and corporate development projects, just to name a few."
>
> Senator Tim Scott (R-SC), joined by 11 other Republican Senators at 2

> "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) at 3

> "Because the [Proposal] 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, 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."
>
> Congressman Brad Sherman (D-CA), joined by 14 other Democratic and Republican House members at 1

12. Legal and Process Issues in the Rulemaking

56 of the 356 comment letters argued that the Banking Agencies' process in issuing the Proposal violated the Administrative Procedure Act (APA) or other legal rules governing agency rulemakings. Vice Chair Barr did not address these concerns in his speech. This said, Vice Chair Barr did state that "the agencies have not made final decisions on any aspect of the re-proposals, including those that are not explicitly addressed in the re-proposal. The public should not view any omission of a potential change in these re-proposals as an indication that the agencies will finalize a provision as proposed. We continue to consider comments already received on the 2023 proposal, and we will consider those comments together with any comments submitted on the re-proposals as part of any final rulemakings. This is an interim step."[8] Addressing all comments received to date may implicitly address some of the commenters' concerns on the legal and process issues in a future Re-Proposal.

> "The Proposal contains hundreds of pages detailing new proposed requirements. ... With such myriad of proposed changes, one would expect that the Agencies would present a detailed and comprehensive economic cost-benefit analysis to demonstrate that the economic benefits of the Proposal exceed the costs of implementing the proposed revisions. This, however, is not the case ..."
>
> Professor Anthony Saunders, New York University Stern School of Business at 4

> "The banking agencies' Basel proposed rule violates the Administrative Procedure Act by relying on data and analysis that the agencies have not made available to the public. As [FDIC board member] Jonathan McKernan noted, while the proposed regulations propose significantly increasing capital requirements for banks, the proposed rule relies on data and analysis that was not released to the public for review."
>
> National Taxpayers Union at 2

IV. Conclusion

The Banking Agencies' initial attempt at implementing the Basel Endgame was highly controversial, both when one considers the comment letters filed and the public record of meetings with Banking Agency staff. We initially found that the Proposal had drawn an unprecedented amount of criticism — more than 97% of the 356 commenters whose letters we deemed material, including 300 from non-banks, opposed the Proposal in full or raised substantial concerns with it in part. In light of that comment record, Chair Powell and Vice Chair Barr repeatedly stated that the Banking Agencies intended to make "broad and material changes" to the Proposal.

Based on the wide-ranging Barr Speech and specific details set forth therein, we found that 76% of the material substantive issues raised by commenters during the public comment period would not be addressed in a Re-Proposal. By contrast, only 24% of those issues would appear to be addressed in a Re-Proposal.

Further, our new analysis found that 92% of parties that met with the Banking Agencies about the Proposal expressed concern, based on 194 published meetings. Of those meetings, 35% were with non-bank interested parties, including non-bank financial market participants, asset managers, energy companies, insurance companies, pension funds, small businesses, and other general business and manufacturing entities.

Therefore, we conclude that the changes described in the Barr Speech appear to be relatively narrow and cannot be said to be both broad and material.

Endnotes

1. For this report, we reviewed another 17 letters that were posted on Banking Agency websites after our initial review.

2. Press Release, Federal Open Market Committee Meeting, Federal Reserve Chair Jerome Powell's Press Conference (Sep. 18, 2024), https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20240918.pdf; *see* Reuters, "Fed's Barr unveils sweeping bank capital plan changes after pushback, delays," (Sep. 10, 2024), https://www.reuters.com/markets/us/feds-barr-unveil-basel-plan-after-industry-pushback-regulatory-delays-2024-09-10/.

3. We also note that Vice Chair Barr stated, "The agencies have not made final decisions on any aspect of the re-proposals, including those that are not explicitly addressed in the re-proposal. The public should not view any omission of a potential change in these re-proposals as an indication that the agencies will finalize a provision as proposed. We continue to consider comments already received on the 2023 proposal, and we will consider those comments together with any comments submitted on the re-proposals as part of any final rulemakings. This is an interim step."

4 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, or CVA risk weighting, tailoring concerns, overlap with the Federal Reserve stress tests, or a significant aspect of the separate G-SIB surcharge proposal. Because many of the comment letters included certain sub-issues and requests for clarification, and the Barr Speech did not specify exactly what changes would be included in a Re-Proposal, some judgment was necessary, particularly with respect to market risk and the G-SIB surcharge. Based on our judgment, we concluded as follows:

Issue	Number Addressed	Number Unaddressed
Credit/Equity Risk	8	17
Operational Risk	3	4
Market Risk	2	19
CVA Risk	1	4
Interaction With Stress Tests	0	7
Tailoring for Category III/IV	1	0
G-SIB Surcharge	3	6

5 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. 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.

6 We note that a frequently expressed criticism of the Proposal was that the Banking Agencies' estimates of the resulting increases in required bank capital were too low — in the eyes of some commenters, materially too low. *See* Financial Services Forum at 24–35.

7 *See* https://www.brookings.edu/events/the-basel-iii-endgame-a-conversation-with-michael-barr/?utm_campaign=Events%3A%20Economic%20Studies&utm_medium=email&utm_content=323881385&utm_source=hs_email.

8 *See id.*

Contacts

Arthur S. Long
arthur.long@lw.com
+1.212.906.1353
New York

Roman Martinez
roman.martinez@lw.com
+1.202.637.3377
Washington, D.C.

Pia Naib
pia.naib@lw.com
+1.212.906.1208
New York

Jordan R. Goldberg
jordan.goldberg@lw.com
+1.202.637.3341
Washington, D.C.

LW.com

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