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November 30, 2023

Chief Counsel's Office,
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity;

Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15); and

Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions

Introduction

The Center for American Progress (CAP) welcomes the opportunity to submit comments to the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) on their proposals to amend risk-based capital[1] and long-term debt[2] requirements for the largest U.S. banks. CAP is an independent, nonpartisan policy

[1] The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity," Federal Register ,September 18, 2023, available at https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant; Board of Governors of the Federal Reserve System, " Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)," Federal Register, September 1, 2023, available at https://www.federalregister.gov/documents/2023/09/01/2023-16896/regulatory-capital-rule-risk-based-capital-surcharges-for-global-systemically-important-bank-holding.
[2] Office of the Comptroller of the Currency, Department of the Treasury, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, "Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large

institute dedicated to improving the lives of all Americans, through bold, progressive ideas, strong leadership, and concerted action.

For over a year, the agencies have been carefully examining and considering adjustments to the current capital framework.[3] This work became even more critical following the March 2023 failures of Silicon Valley Bank and other midsize firms, which highlighted the vulnerabilities of the existing requirements. The emergency measures taken by financial agencies—such as the Board's lending facility, retroactive FDIC guarantees for uninsured depositors, and public statements of support from the U.S. Treasury— were critical in averting the worst-possible consequences of the crisis.[4] However, it is infeasible and irresponsible to rely solely on emergency measures in the absence of strong prudential regulation.

Capital requirements are among regulators' most powerful tools in ensuring banks can weather periods of stress while continuing to provide the credit and payment services upon which businesses and households rely. CAP supports the agencies' efforts to improve the risk-based capital framework and offers the following considerations to ensure these proposals effectively reduce fragility within the banking system and foster a more resilient financial system.

Agencies' Risk-Based Capital Proposals

The agencies' proposal to amend risk-based capital requirements for banks with more than $100 billion in total assets (risk-based capital proposal) makes several important changes, including: eliminating or reducing firms' reliance on internal models for measuring credit, market, and operational risk in their risk-weighted assets (RWA) calculations; establishing enhanced capital requirements for securities and derivatives trading; and extending the requirement to include accumulated other comprehensive income (AOCI) in regulatory capital calculations for all banks above the $100 billion threshold.[5] The Board also issued a proposal that would improve the sensitivity of the global systemically important bank

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Insured Depository Institutions," Federal Register, September 19, 2023, available at https://www.federalregister.gov/documents/2023/09/19/2023-19265/long-term-debt-requirements-for-large-bank-holding-companies-certain-intermediate-holding-companies.

[3] Board of Governors of the Federal Reserve System, "Making the Financial System Safer and Fairer," Speech, September 7, 2022, available at https://www.federalreserve.gov/newsevents/speech/barr20220907a.htm.

[4] See, for example, Board of Governors of the Federal Reserve System, "Federal Reserve Board announces it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors," Press release, March 12, 2023, available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312a.htm; Federal Deposit Insurance Corporation, "FDIC Acts to Protect All Depositors of the former Silicon Valley Bank, Santa Clara, California," Press release, March 13, 2023, available at https://www.fdic.gov/news/press-releases/2023/pr23019.html; U.S. Department of the Treasury, "Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC," Press release, March 12, 2023, available at https://home.treasury.gov/news/press-releases/jy1337.

[5] "Proposals that would amend capital requirements for large banking organizations in line with the Basel III accord and modify risk-based capital surcharges applicable to U.S. GSIBs.," Board of Governors of the Federal Reserve System, July 18, 2023, available at https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-memo-20230727.pdf.

surcharge to systemic risk indicators (GSIB surcharge proposal).[6] Collectively, these actions take important steps to strengthen the banking system. However, our analysis (described below) shows that there are perhaps improvements that can still be made to ensure these large firms are adequately capitalized.

The agencies have estimated that, under the proposed rules, there will be an increase in common equity tier 1 (CET1) capital requirements amounting to 16 percent for all banks – six percent for banks with assets between $100 billion and $700 billion (Category III & IV) and 19 percent for the U.S. GSIBs (Category I) and firms with assets above $700 billion that are not U.S. GSIBs (Category II). These estimates include changes in the way RWAs are calculated, changes in risk measures, and enhanced equity requirements for securities and derivatives trading.[7] Using the agencies' estimates of the aggregate increases to CET1 capital, it is possible to gauge the effects on CET1 capital ratios and the supplementary leverage ratio (SLR), which are measures used by the agencies to assess whether banks have sufficient equity to survive financial shocks and remain solvent.

In June 2023,[8] the average ratio of CET1 capital to risk-weighted assets for the eight U.S. GSIBs was 12.63 percent; and the ratio of total Tier 1 capital to total assets was 7.11 percent; and the ratio of total Tier 1 capital to "leverage exposure", the SLR, was 6.01 percent.[9] If the total amount of CET1 capital were increased by 19 percent, these ratios would rise to 12.87, 8.13, and 6.87 percent, respectively (see Table 1 of the attached spreadsheet).[10]

While these are measurable changes, they do not substantially improve the financial stability of the GSIBs. Specifically, even under the new proposals, the SLR would likely still be insufficient to withstand shocks like those from recent history. We know from experience in the Great Financial Crisis that large shocks can reduce the value of bank assets by a far greater percentage. Quantitative estimates, based on data for the nine largest banks, show that, had interventions by federal regulators not been successful, the potential loss of asset value from bankruptcy-producing runs was 22 percent.[11] In addition, we know that when Washington Mutual failed in September 2008, its losses

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[6] Ibid.
[7] Ibid.
[8] Authors' calculations are based on data from firms' respective Bank Holding Company Performance Reports (BHCPR) and Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101) filings for 6/30/2023, available at https://www.ffiec.gov/npw/Institution/TopHoldings. (last accessed November 2023); see also, Board of Governors of the Federal Reserve System, "Large Banks Capital Requirements," July 2023, available at https://www.federalreserve.gov/publications/files/large-bank-capital-requirements-20230727.pdf.
[9] These ratios are calculated by aggregating Tier 1, CET1, assets, and leverage exposures across all eight U.S. GSIBs, then calculating aggregate Tier 1 leverage, CET1, and SLR ratios using these values.
[10] The changed Tier 1 leverage ratio assumed that all of the required increase in CET1 bank capital is equal to Tier 1 capital. The two measures are not identical, and for any individual bank CET1 capital is usually less than Tier1 capital. Hence the estimate increase in the Tier 1 leverage ratio is likely to be an overestimate.
[11] Veronesi, Pietro & Zingales, Luigi, "Paulson's gift," *Journal of Financial Economics* vol. 97(3) (2010): 339-368, available at https://www.nber.org/papers/w15458.

amounted to 13 percent of its $310 billion in assets.[12] Therefore the increase in equity delivered by the proposals would not materially improve the chances that the GSIBs would remain solvent in the face of shocks in the range of those historically observed.

Increased capital requirements for non-GSIB banks also appear to be inadequate. When Silicon Valley Bank (SVB) failed in 2023, its losses amounted to at least 17 percent of its assets.[13] In the case of Signature, losses were at least 11 percent of assets. The proposed six percent in equity for firms similar in size to SVB and Signature (Category III and IV) would have raised their Tier 1 leverage ratios from 8.1 to 8.5 percent and from 8.8 to 9.3 percent, respectively (see Table 2 of the attached spreadsheet[14]). That is, even with the new equity requirements, both SVB and Signature would have failed.

Although the risk of runs at large regional banks has receded, there is evidence that some of them are still experiencing stress. Banks continue to borrow from multiple Federal Reserve lending facilities, including Federal Home Loan Banks, at an elevated level – reaching nearly $1 trillion in the second quarter of 2023.[15] This suggests that many banks continue to need help to avoid asset fire sales, which could make them insolvent. With greater equity finance, their operations would be better positioned to avoid insolvency without extraordinary support from regulators.

Under the proposal, large banks will need to recognize gains and losses in the market value of securities held on their balance sheet in capital ratio calculations, whether they are designated as "available for sale" or "held to maturity" for accounting purposes.[16] This is a welcome change. While it is likely to have limited effect on the ability of regulators to monitor declines in equity, as fair market value of securities holdings is already required in

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[12] At the end of June 2008, Washington Mutual assets were $309.7 billion, and the accounting value of equity was $26.08 billion. After it was placed in receivership by the FDIC, unpaid claims to debt holders and other creditors were $14.08 billion. Hence losses were 13 percent of assets. See, Washington Mutual, Inc., "FORM 10-Q," June 30, 2008, Securities and Exchange Commission, available at https://www.sec.gov/Archives/edgar/data/933136/000104746908009146/a2187197z10-q.htm; See also, Washington Mutual Bank - Receivership Balance Sheet Summary (Unaudited):For Period Ending September 30, 2023," Federal Deposit Insurance Corporation, available at https://receivership.fdic.gov/drripbal/bank/10015?FIN=10015.

[13] For SVB and Silvergate, we do not yet have data on the total value of unpaid claims after the banks failed. Instead we have an estimate of the resolution costs to the FDIC, which include repaying depositors and administering the wind-up of the banks. Claims by unpaid general creditors are likely to increase loss totals. The loss rates in the text include only the FDIC resolution costs.

[14] Authors' calculations are based off data from the Uniform Bank Performance Report (UBPR) 12/31/2022 filings for the respective banks, available at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx. (last accessed November 2023); for resolution cost estimates, see Martin J. Gruenberg, "The Federal Regulators' Response to Recent Bank Failures," March 29, 2023, available at https://docs.house.gov/meetings/BA/BA00/20230329/115605/HHRG-118-BA00-Wstate-GruenbergM-20230329.pdf.

[15] "FRED Graph," Federal Reserve Bank of St. Louis, available at https://fred.stlouisfed.org/graph/?graph_id=1221346&rn=140 (last accessed October 2023).

[16] 88 FR 64166

SEC filings,[17] it should have a salient effect on banks' investment strategies. Since banks will no longer have the option to classify securities as "held to maturity" in order to avoid recognition of losses in value, their investment strategies will take the increased risk of violating regulatory equity minimums into account.

Considerations for addressing climate-related financial risks

The risk-based capital proposal rightly acknowledges the importance of models. In September 2022, the Board announced that it would conduct its first-ever climate scenario analysis (CSA) for the 6 largest U.S. banks.[18] While the Board has made clear that this exercise will not affect capital requirements at this stage,[19] we offer some considerations as the banking agencies and the firms they supervise continue to develop their climate risk modeling expertise.

The Fed's CSA relies on integrated assessment models (IAMs) developed by the Network for Greening the Financial System (NGFS).[20] In recent years, experts such as Nicholas Stern and Joseph Stiglitz have critically evaluated IAMs. At a fundamental level, they find that IAMs are flawed tools for evaluating the economic impact of climate change and the effectiveness of policy measures to deal with it. They find that basic methodological problems – including the failures to account for deep uncertainty and extreme risk, to incorporate accurate damage functions, and to account for important elements of contemporary economies such as market failure – mean that IAMs have limited value as policy tools. They find that these and other failures account for the differences between the somewhat sanguine view of many economists who use IAMs and the consensus view of climate scientists.[21]

For example, the Fed's CSA employs the NGFS Current Policies scenario, which assumes "that all countries or regional groups preserve currently implemented policies and adopt

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[17] Financial Accounting Standards Board, "Accounting Standards Update 2022-03—Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restriction," June 2022, available at https://www.fasb.org/page/document?pdf=ASU%202022-03.pdf&title=Accounting%20Standards%20Update%202022-03%E2%80%94Fair%20Value%20Measurement%20(Topic%20820):%20Fair%20Value%20Measurement%20of%20Equity%20Securities%20Subject%20to%20Contractual%20Sale%20Restrictions.

[18] Board of Governors of the Federal Reserve System, "Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks," Press release, September 29, 2022, available at https://www.federalreserve.gov/newsevents/pressreleases/other20220929a.htm.

[19] "Pilot Climate Scenario Analysis Exercise," Board of Governors of the Federal Reserve System, January, 2023, available at https://www.federalreserve.gov/publications/files/csa-instructions-20230117.pdf.

[20] Ibid.

[21] Nicholas Stern, Joseph Stiglitz Charlotte Taylor & Charlotte Taylor, "The economics of immense risk, urgent action and radical change: towards new approaches to the economics of climate change," *Journal of Economic* Methodology vol. 29 (3) (2022): 181-216, available at https://www.tandfonline.com/doi/full/10.1080/1350178X.2022.2040740.

no new policies, including those already announced, to abate emissions."[22] This scenario assumes greenhouse gas emissions increase until 2080 and an overall warming of 3°C by 2100. As of October 2023, the Intergovernmental Panel on Climate Change predicts a median warming of 4.8°C above preindustrial levels by the end of the century.[23] This fundamental difference in assumptions about how our climate will change, together with the limitations of IAMs Stern and Stiglitz enumerate, suggest that the results from the pilot CSA could easily understate the magnitude and timing of climate-related financial risks.

We commend the Fed for recognizing the relationship of climate risk and financial stability, as well as its rationale for leveraging the NGFS scenarios as a starting point. However, more can be done to increase the value of CSA efforts. The Fed should regularly engage with established climate scientists and find ways to incorporate insights into CSA-related analysis. It also would be helpful to publicly explain the results of this continuing engagement and periodically discuss the relationship between consensus climate science and CSA results. Doing so would increase understanding of and confidence in the CSA and provide the financial sector and others with regularly updated understanding of the economic impacts of climate change.

Agencies' proposed long-term debt requirements

In addition to their risk-based capital related proposals, the agencies are proposing regulations to require insured depository institutions (IDIs) that have assets of at least $100 billion but are not GSIBs to issue a minimum amount of unsecured long-term debt (LTD proposal).[24] At a high-level, this proposal would require insured depository institutions (IDIs) "to have a minimum outstanding amount of eligible LTD that is at least: (1) 6 percent of the covered IDI's total risk-weighted assets; (2) 2.5 percent of the covered IDI's total leverage exposure, if it is required to maintain a minimum supplementary leverage ratio; and (3) 3.5 percent of the covered IDI's average total consolidated assets, whichever is greater (LTD Requirement)."[25]

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[22] "Pilot Climate Scenario Analysis Exercise," Board of Governors of the Federal Reserve System, January, 2023, available at https://www.federalreserve.gov/publications/files/csa-instructions-20230117.pdf.
[23] Intergovernmental Panel on Climate Change, " IPCC WGI Interactive Atlas: Regional information (Advanced)," available at https://interactive-atlas.ipcc.ch/regional-information#eyJ0eXBlIjoiQVRMQVMiLCJjb21tb25zIjp7ImxhdCI6Nzc1Nzc1OSwibG5nIjotMTc4MzUyNywiem9vbSI6MywicHJvaiI6IkVQU0c6NTQwMzAiLCJtb2RlIjoiY29tcGxldGVfYXRsYXMifSwicHJpbWFyeSI6eyJzY2VuYXJpbyI6InNzcDU4NSIsInBlcmlvZCI6Im5lYXIiLCJzZWFzb24iOiJ5ZWFyIiwiZGF0YXNldCI6IkNNSVA2IiwidmFyaWFibGUiOiJ0YXMiLCJ2YWx1ZVR5cGUiOiJBTk9NQUxZIiwiaGF0Y2hpbmciOiJDT01QUkVIRU5TSVZFIiwicmVnaW9uU2V0IjoiYXI2IiwiYmFzZWxpbmUiOiJwcmVJbmR1c3RyaWFsIiwicmVnaW9uc1NlbGVjdGVkIjpbMCwxLDIsMyw0LDUsNiw3LDgsOSwxMCwxMSwxMiwxMywxNCwxNSwxNiwxNywxOCwxOSwyMCwyMSwyMiwyMywyNCwyNSwyNiwyNywyOCwyOSwzMCwzMSwzMiwzMywzNCwzNSwzNiwzNywzOCwzOSw0MCw0MSw0Miw0Myw0NCw0NSw0Niw0Nyw0OCw0OSw1MCw1MSw1Miw1Myw1NCw1NSw1Niw1N119LCJwbG90Ijp7ImFjdGl2ZVRhYiI6InRhYmxlIiwic2hvd2luZyI6dHJ1ZSwibWFzayI6Im5vbmUiLCJzY2F0dGVyWU1hZyI6IkFOT01BTFkiLCJzY2F0dGVyWVZhciI6InRhcyJ9fQ== (last accessed October 2023).
[24] This debt would be unsecured and subordinate to claims of depositors, general unsecured creditors, and FDIC expenses for administering a receivership.
[25] James L. McGraw, "Publication of Federal Register Notice Regarding Long-Term Debt for Certain Insured Depository," August 29, 2023, available at https://www.fdic.gov/news/board-matters/2023/2023-08-29-notice-dis-a-mem.pdf.

The effect of this requirement would be to ease the resolution of insolvent banks. When banks fail because they lack the equity to cover losses, those losses will affect creditors. Depositors are creditors, and uninsured depositors will be exposed to those losses if the losses are large enough. By requiring that banks' liabilities include a tranche of unsecured long-term debt subordinated to depositors, uninsured depositors are less likely to be harmed. This kind of debt will also make it less likely that FDIC will need to liquidate the bank, which can increase bank losses through forced asset sales. While resolution would be improved, and contagion caused by losses to uninsured deposits would be reduced, the agencies should consider an increased equity requirement of equal amount. If a bank has greater equity, the need for resolution is reduced.

Conclusion

CAP appreciates the opportunity to comment on these important proposals. If you have questions related to the considerations outlined above, please contact Marc Jarsulic, Chief Economist and Senior Fellow, at mjarsulic@americanprogress.org and Lilith Fellowes-Granda, Senior Policy Analyst for Financial Regulation and Corporate Governance, at lfellowesgranda@americanprogress.org.

Sincerely,
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