

**Implementing Basel III: What's the Fed's Endgame?**  
**Subcommittee on Financial Institutions and Monetary Policy**  
**House Financial Services Committee**  
**September 14, 2023**

**Opening Statements**

**Chair Barr (R-KY)** said that federal banking regulators recently proposed new rules to rewrite rules in the financial system largely on a partisan basis and the rule with the greatest impact is the Basel III proposal. He pointed to how this is part of VC Barr's holistic review and how the regulation is supposed to be based on Basel III standards, but it goes far beyond this. Barr said that this proposal would impose arbitrary and extreme increases in capital requirements that are not justified since the banking system is strong. He said that the Basel capital proposal lacks a convincing ground and appears to simply be arbitrary and capricious. Barr noted the lack of quantitative analysis on what the impacts will be or any cost benefit analysis. He said that the proposal also presents threats to the Treasury securities market, and we do not know how this rule will interact with rules from other regulators. Barr said that now is not the time to raise capital levels given the incoming credit crunch and the situation in CRE. He said that this proposal is just the start of proposals from Biden regulators and noted that the FDIC and others put out proposals on living wills recently. Barr said that the Basel III proposal should be withdrawn and replaced with one that addresses real problems and has input from Congress.

**Ranking Member Foster (D-IL)** said that these proposals modify capital requirements for the largest banks, so they properly manage their risk. He said that the 2008 crisis and the taxpayer bailout of banks demonstrated the needs for reforms. Foster pointed to Dodd Frank and how global regulators convened on the Basel III Framework. He said that many predicted that the increased capital requirements from Dodd Frank and Basel would hurt the competitiveness of US banks, but this has not proven true. Foster said that threats to the financial system are dynamic and constantly evolving. He said regulators and Congress must learn from crises of the past and look at future risk. Foster said that the Basel III proposal is very complex, and the public should be able to look into the quantitative analysis behind this proposal. He noted that he joined Barr in a letter to the regulators requesting the data that led to these proposals. Foster said that this is not a purely quantitative operation and urged the regulators to be more forthcoming.

**Chair McHenry (R-NC)** said that the regulators had the chance to learn from the March banking crisis, but instead they are using this to implement partisan reforms. He said that we must know how this proposal impacts inflation, the cost of credit, credit availability and more. McHenry pointed to the letters that Committee Republicans sent the regulators requesting that they rescind this proposal.

**Ranking Member Waters (D-CA)** pointed to the recent banking crisis and said that we need to improve safety and soundness measures for large banks, including increased capital requirements. She emphasized that we need stronger rules, not deregulation, to avoid future crises.

**Witness Testimony**

**Mr. Greg Baer, *President, and CEO of the Bank Policy Institute***, said that this proposal is a de facto repeal of S. 2155 and wanted to talk about the misunderstandings around it. He said that some think that this proposal has to do with the recent banking failures, but it does not deal with liquidity risk or interest rate risk. Baer said that some point to the global financial crisis as the justification, but this occurred on the watch of a Basel standardized approach. He added that nonbanks will pick up the slack when lending moves out of the banking system. Baer said that banks are the only reliable source of lending in economic downturns. He pointed to the second half of the proposal and how it includes no justifications for its proposed risk weight formulas. Baer said that the proposal ignores reality as the banking system has proven highly resilient. He went on that this proposal would make it difficult to offer products that it disfavors. Baer said that the agencies often refer to this as an implementation of the Basel agreement, but it is inconsistent with the understanding that Basel was not supposed to increase capital charges.

**Mr. Robert Broeksmit, *President and CEO, Mortgage Bankers Association***, said MBA believes that the NPR contradicts many of the Biden Administration's policy goals, including those pertaining to affordable housing (both ownership and rental), fostering bank competition over consolidation, and the closing of significant racial homeownership and wealth gaps. He added that it is unclear how this proposal interacts with other proposed regulations and their cumulative impact on housing. Broeksmit said that the problem that the federal agencies are trying to solve is also unclear since they have consistently said that the banking system is strong. He then dove into the implications for the mortgage market, noting that this proposal would likely decrease the participation of banks in single family and multifamily financing. Broeksmit said that this would result in less first time homebuyers and down payment activity would be driven to the GSEs. He added that the proposal also does not provide credit for private mortgage insurance. Broeksmit concluded by saying that MBA strongly opposes key elements of the proposal, which undermine the mortgage market.

**Mr. Andrew Olmem, *Partner, Mayer Brown***, said that the proposal represents a major shift in bank regulatory policy, and will materially change the scope and nature of capital requirements for banking organizations. He also emphasized the importance of getting capital requirements right since it influences the allocation of credit. Olmem then noted serious process, policy and legal problems with the proposal. He particularly pointed to how the proposal fails to provide the data and analysis supporting its policy choices as required by the APA. Olmem added that the proposal also eliminates the prudential tailoring scheme that was adopted by the Fed four years ago. He said that one size fits all regulation may be easier for the regulators, but Congress enacted tailoring in two mandates in the last 13 years. Olmem concluded by recommending that Congress call for the banking agencies to withdraw the Proposal (which was issued as a Notice of Proposed Rulemaking (NPRM)) and replace it with a statutorily-compliant proposal issued as an Advanced Notice of Proposed Rulemaking (ANPR).

**Ms. Alexa Philo, *Senior Policy Analyst for Banking, Systemic Risk, Economic Justice & Racial Equity, Americans for Financial Reform***, said that these capital proposals are essential to strengthening the banking industry's ability to withstand stresses and shocks that can imperil banks' financial viability, create uncertainty for depositors and customers, and negatively affect the economy. Philo pointed to the recent bank failures and said that all of them were in the asset size band where regulators loosened regulation in 2018. She said that these proposals further the

lessons learned from the financial crisis. Philo added that they disagree that increased capital requirements will reduce lending. She noted that increased capital requirements also reduce the risk of financial crises. Phil said that the agencies should move forward on these proposals as better capitalized banks are better able to help customers and make the economy work for everyone.

### **Member Questions**

**Chair Barr (R-KY)** submitted a statement from the Financial Services Forum and turned to Baer on how he is concerned about the proposal's impact on mid-size and regional banks. He said that this proposal will result in a barbell system of banks and eradicate the diversity of the banking system. He asked Baer to comment on the proposals' impacts on the regional banking sector. Baer said that regional banks are well capitalized, and their challenge right now is earnings. He said that this proposal would add massive costs to them. Baer added that they are also subject to detailed reporting on market risk and SLR, which should not really apply to them. Barr applauded Olmem's testimony on APA and noted how the public does not have the data to provide meaningful input. He asked Olmem to touch on these administrative fouls. Olmem said that these are statutory violations since Congress mandated APA. Barr then turned to CRE and said that he is very concerned about this market. He said that we have trillions of CRE loans coming due and these loans were financed when rates were around zero. He asked if now is the time to undermine the ability of banks to lend in CRE markets. Broeksmit said that they are also concerned about this issue and said that there is no economic underpinning to this rule or how it interacts with other rules like CRA. He said that these types of rules could really slow down the economy.

**Ranking Member Foster (D-IL)** said that the 'rubber hits the road' with the risk weighting of assets and asked how they view the tradeoffs of in house modeling of these risks versus complex regulations. Baer said that this is not a simple matter, but on credit risk, the purpose of Basel was to maintain the use of bank models but there would be a floor to the risk weights. He said that these models are back tested constantly by regulators and there is no evidence that there are significant deviations on banks' risk weights. Foster said that this was an issue during the crisis though. Philo responded that oversight is important here and internal models have been a substantial problem coming out of the crisis and this proposal helps remedy this. Foster then asked about the complexity issue and asked for comments on this and asked if they have problems with the coefficient or the whole complex thing that reacts differently to different businesses. Broeksmit went back to his first question and said that Basel III recommendations around LTV were good, but the regulators gold plated this by 20 percentage points. Olmem said that this is why data is needed and said that Basel is a complex process which requires time.

**Rep. Posey (R-FL)** asked if the regulators have conducted an impact study. Baer said that it is lacking in economic analysis and interaction with other rules. He said that there are costs to raising capital and the tough question is weighing the tradeoffs, but the proposal does not do this. Posey asked if they did a cost benefit analysis. Baer said there are a couple paragraphs but there are no numbers or rigor attached to this. Posey asked if it would be better to have better bank supervision than implement new rules in the wake of the recent bank failures. Baer said that there are a series of smart things they could do to make things better, but the answer to a liquidity crisis at one bank is not increasing capital requirements at other banks.

**Ranking Member Waters (D-CA)** noted that big banks and Republicans are complaining that this proposal will reduce lending and crash the economy. She asked Philo if it is true that this only applies to large banks with more than \$100 billion or extensive trading operations. Philo agreed and said that it does not impact community banks. Waters said that some say capital was not an issue with the regional bank failures this year, but there was a Republican witness who said that capital was an issue at SVB as it relates to AFS securities. She asked Philo if lack of capital played a role in SVB's failure. Philo said yes, adding that there was also a lack of transparency to depositors. Waters pointed to how the Fed found a shortcoming in capital with SVB, saying that this would be addressed by this proposal since they would have to include unrealized losses when calculating regulatory capital. She then asked Philo if she agreed that capital was clearly an issue and that we need to strengthen capital requirements at the largest banks given the risks they pose. Philo agreed and said that SVB was a vulnerable firm and Fed supervisors failed to act.

**Rep. Luetkemeyer (R-MO)** said that they've held hearings on the March banking crisis and the regulators seem as much to blame as the banks. He turned to Baer and asked why it is a good idea to implement Basel III European standards on US banks. Baer said that there is a notion that there should be comity when it comes to banking regulation. He said that the worst of this is that regulator staff went over to negotiate this and then added on further. Baer added that in terms of holistic reviews, Basel is a good place to start, but agencies should prove where they got the risk weights. Luetkemeyer turned to Olmem and said that this sends the message that stress tests are inadequate to predict problems. He asked for comment on this. Olmem said that the proposal does not reflect the work done over the past decade and questioned when enough is enough. He questioned why we need to have a wholesale revision of capital requirements each time a bank fails. Luetkemeyer asked if small banks would be the losers in this with, essentially, the repeal of S. 2155. Olmem agreed and said that it would result in consolidation and a loss of diversity in the banking system. Luetkemeyer then pointed to the impact of capital requirements on banks' lending ability and the impact on the GDP. He asked what the cost would be to the home mortgage market. Broeksmit said that there would be fewer sources of mortgage financing and fewer mortgage servicers, which will increase costs and hurt consumers.

**Rep. Sherman (D-CA)** said that increasing capital is not free, but capital standards that are too low are very expensive. He said that banks face credit risk and interest rate risk. Sherman said 2008 was about credit risk and 2023 was about interest rate risk. He said that Basel III does not do enough to deal with interest rate risk. Sherman pointed out that when you focus on credit risk, you take money away from local business loans and loans to build apartment buildings. He said that a system that underrates risk in lending to Apple but overstates the risk of those building apartments is a perverse system. Sherman pointed to what Basel does to AFS securities and how it is good that banks are no longer reliant on their own modeling, but the modeling from the regulators better be good. He then turned to tax equity credit and how clean energy investments would face an increased risk weight under the proposal. Sherman asked how this would impact the implementation of IRA and our agreements under climate change treaties. Philo appreciated where he was coming from and said that different risks have different weights. She thought this was one area where they may wish to see more. Sherman agreed and then turned to how the

proposal does not provide credit for mortgage insurance and asked if this made sense. Broeksmit said no, it makes no sense at all.

**Rep. Williams (R-TX)** said that this proposal is using the bank failures as a weak justification for a rewrite of banking regulations that will dramatically impact the banking community. He asked Baer how Basel will impact lending and the cost of credit for consumers and small businesses. Baer said that a credit crunch is already beginning, and this proposal applies higher risk weights to commercial loans, and they are only lower if the company is a publicly listed company, which does not have any real justification. He said that this lacks justification and will negatively impact American businesses. Williams turned to how Basel III will worsen mortgage markets and put homeownership out of reach. He asked what effects Basel III will have on the market. Broeksmit said that banks will make fewer mortgage loans or raise the price at which they offer those loans. He added that the servicing aspect will also raise prices for consumers. Williams noted that US regulators are proposing heightened standards compared to European banks and asked Olmem to expand on if European banks will have a competitive advantage and how this impacts American competitiveness more broadly. Olmem said that this is not discussed in the proposal, but US banks play an important role internationally and this proposal makes it harder for them to participate in these markets.

**Rep. Meeks (D-NY)** said that he is very concerned about homeownership and asked Broeksmit to provide background information on special purpose credit programs (SPCP) and if they will be impacted by Basel III. Broeksmit said that SPCP allows lenders to craft programs for those who have been disadvantaged in the homebuying process. He said that lenders have used this to reduce the racial wealth gap, but this proposal increases the capital requirements on these types of loans and the availability of these programs will go down. Meeks said that he understood the harmonization intent of Basel III, but some say our implementation seems to go in a different direction from Europe. He asked if Baer agreed. Baer agreed and pointed to how other nations do not have a stress capital charge to cover some of the same risks which are already covered. Meeks asked if this affects our global competitiveness. Baer said yes, but this is more around capital markets than mortgages. He said that US businesses and homeowners will pay more for credit than they need to, and more business will move into the nonbank sector. Meeks said that he is also concerned about Basel III's impact on money going to MDIs and CDFIs.

**Rep. Rose (R-TN)** pointed to how securitization could be adversely impacted under this proposal, and asked Olmem if this was a concern. Olmem said this was a concern and noted that the proposal talks about how the impact on liquidity requires further analysis. Rose said that Fed Governor Bowman has expressed concern about the rollback of tailoring and asked if he is worried that the lack of tailoring will drive consolidation. Olmem said that this is a serious issue which is not addressed by the proposal. Rose then asked if Olmem feels that the lack of capital rule differentiation among this range of banks is appropriate. Olmem said that Congress has passed two separate bills on the importance of tailoring and the regulators are ignoring clear directives from Congress. Rose said that this proposal seems to make it more difficult to buy a home and asked Broeksmit if this proposal will make home affordability worse. Broeksmit thanked Rose for this work on trigger leads and said that this proposal would make mortgages even less affordable. He added that there is no evidence that the additional capital requirements have anything to do with the underlying risk of the loans. Rose asked how regulators could fix

these downstream impacts. Broeksmit said that Basel III standards, which vary by LTV, are sensible, but the additional 20 percentage points the regulators are adding is nonsensical. He said that simply going with the Basel III rules would yield a better result. Rose then asked Baer what their members shrinking their residential lending portfolio will do to the housing market. (QFR)

**Rep. Scott (D-GA)** said that during the 2008 crisis, banks were over reliant on their own models to look at credit risk and this is why HFSC put strong capital requirements into Dodd Frank. He said that he is very concerned with the unintended consequences of this proposed rule and its impact on banking institutions as they engage in critical market activities. Scott said that there was significant dissent to releasing this proposal, including from Fed Chair Powell. He said that Powell was concerned about the scope of the proposal and how it exceeds what is required by Basel. Scott pointed to how this proposal eliminates the tailoring of rules as required by Dodd Frank and asked Baer why it is important to consider things like risk, size, business models, and complexity of individual institutions and what Baer has to say to Powell's comments on the rule. Baer said that the proposal raises capital requirements by 16% and pointed to the increases for market risk and operational risk capital, which doesn't make sense.

**Rep. Timmons (R-SC)** said everyone wants a good economy and these proposals will do more harm than good despite their intent. He pointed to the subprime mortgage crisis and how federal policy contributed to this. Timmons asked Olmem if he agreed. Olmem agreed. Timmons then discussed how government spending contributed to increased interest rates and how SVB and Signature banks failed. He asked Olmem if these banks would have failed without this dramatic increase in rates. Olmem said that this is a counterfactual, but interest rates were a major factor. Timmons said that these new policies will further impede people's ability to get mortgages. He asked if Basel will make it harder or easier to get a loan. Olmem said that we do not really know, and the agencies are moving forward in an uninformed manner, but there is a high probability that the answer is yes.

**Rep. Casten (D-IL)** brought up tax equity credits and said that under the current rules, bank capital spent on tax equity only has a 100% risk weighting, unless it's less than 10% of bank capital and then it takes on a 400% risk weighting. He went on that under the proposed Basel rules, the 10% cap on this would be removed except for low income housing. Casten then submitted a letter to the record from the American Council on Renewable Energy and asked if Baer agreed that these capital requirements would reduce investments in this sector. Baer said absolutely and said that they do not know why they decided to go from 100 to 400%. Casten asked if the risk profile for low income housing is substantially different from renewables. Baer said that loss experience with these sectors does not justify a 400% risk weight. Casten said that Basel refers to low income housing as community development investments and asked if Baer was opposed to saying that renewable energy investments were also community development. Baer said that you can do whatever you want based on the risk and cost in this proposal. Casten hoped they could fix this because we are seeing huge investments in this sector due to the IRA and we should not handicap this. He closed by saying that it is still important for banks to be well capitalized.

**Rep. Kim (R-CA)** said that SVB's failure was largely due to the failure of the bank's leadership to not manage interest rate risk and federal regulators should follow their own reports and

address supervisory mishaps. She asked who is responsible for allowing SVB to breach its limits with regard to long term debt. Baer said that this is the responsibility of the management of the bank and the supervisors of the bank. Kim asked if the SFFRB was the only reserve bank allowing their member banks to purchase long term debt. Baer said that given the increase in deposits, they went and bought long term securities, but the smart banks bought short term securities and managed their interest rate risk. Kim then turned to a letter requesting a delay of CRA until capital rules are finalized and asked how these layers of new regulations could impact access to capital for consumers. Baer said that this is what a holistic review would look like, and they have not even mapped out how each proposal approaches credit allocation. Kim then asked what type of homeowners will be pushed out of the market. Broeksmit said that first time homebuyers will be the most impacted.

**Rep. Pressley (D-MA)** pointed to how the recent bank failures were a result of weakened regulation from the S. 2155. She asked Philo who bears the cost when banks lack capital and there is a financial crisis. Philo said that there is a disproportionate impact on Black and Brown communities and these proposals are essential to prevent the boom and bust of financial cycles. Pressley said that SVB's CEO was paid millions for being incompetent. She asked Philo if better capitalized banks are able to lend more, even during times of stress. Philo said yes, noting that increased capital requirements will not undermine credit availability. Pressley asked if this proposal would slow down the economy given its gradual implementation. Philo said that she believes that these proposals will not slow down the economy, especially given the gradual implementation. Pressley said that the benefits of higher capital requirements are clear, and these proposals will make the banking system more resilient.

**Rep. Fitzgerald (R-WI)** said that this proposal would add up to 20% to internationally agreed risk weight for mortgages. He said that he just met with Wisconsin bankers and realtors and adults aged 25-35 are getting frozen out of the mortgage market. Fitzgerald asked Broeksmit to talk about this issue as it relates to credit scores, as young people may not always have credit scores. Broeksmit said that one of the frustrating things about credit scores is that they do not incorporate things like rental payment history and there are efforts to get landlords to report this. Fitzgerald then noted that with small businesses, there are unused portions of credit and banks can cancel these and reissue them. He asked Broeksmit to comment on this. Broeksmit said that banks would be required to hold capital on the maximum amount that could be drawn rather than the amount outstanding, which is much more expensive. Fitzgerald asked how this would impact the FICO scores for small businesses. Broeksmit said that the cost of credit would go up and credit availability would go down. Fitzgerald asked, with banks tightening up on credit scores, would there be a breaking point. Baer said that this is complex but if your capital requirements increase, you can increase the numerator or decrease the denominator, and that means getting out of loans with higher risk weights like small business loans.

**Rep. Green (D-TX)** noted that the only diversity on the panel is Ms. Philo and complemented Mayer Brown on promoting females at their firm. He then asked each of the witnesses if women of color could do what they do. They all agreed. Green thought there should be more people of color on the panel. He then asked Philo how internal modeling complicates the job of those who have to monitor banks. (QFR)

**Rep. Loudermilk (R-GA)** said that he has heard a lot of concern from his constituents on the US adopting international standards. He said that Basel III does not just affect big banks and it could tangibly increase the costs of capital nationwide. Loudermilk asked if borrowers would notice the treatment of MSR's under Basel III. Broeksmit said yes, it would end up in less servicing of mortgages. He said that there are other players who are in the mortgage sector, but the more players there are, the lower the rate for consumers. Loudermilk then asked if the rule contemplates the consumer confusion this rule will cause. Broeksmit said that is one of things that they have not addressed. Loudermilk asked Olmem if there was broad consensus among regulators on this proposal. Olmem said no. Loudermilk asked what Congress should take away from these dissents. Olmem said that there needs to be more congressional oversight and involvement in this process, and they need to ensure that regulators are following federal law. Loudermilk asked if this issue is partisan. Olmem said that it shouldn't be as past changes on this have been bipartisan.