

Basel III Endgame – Unintended and Unjustified Consequences

Issue Update

It is critically important that banks' capital levels be correctly calibrated to provide an adequate cushion against risk and losses, while also allowing banks to remain competitive sources of credit for their communities. Regulatory capital serves as a cushion to help banks absorb unanticipated losses of all kinds, protecting bank customers and allowing banks to provide ongoing services. However, excessive capital levels impose a cost. Increasing required capital will act as a constraint on credit growth and bank innovation and could hinder adjustment to changing business conditions, so proper calibration is essential.

In July 2023, the banking agencies proposed Basel III Endgame, a proposal that if enacted, would usher in the most radical transformation of bank regulation in the last decade. ABA believes the proposal is unworkable in its current form and needs to be withdrawn. It is notable that so many voices beyond the banking sector – users of credit and other banking services – have also concluded that this proposal is a mistake.

Why it Matters

Banks are highly capitalized, resilient, and additional capital is unwarranted. Over the last year regulators have continually recognized that the banking industry is safe, resilient, and highly capitalized.

The proposal would negatively impact borrowers, businesses, and the capital markets. The proposal would raise capital (in excess of 25% for some institutions) limiting the availability, and increasing the costs, of bank products and services including:

- **Negatively impacting housing finance and homeownership**, particularly for first-time or first-generation home buyers who have high loan-to-value ratios.
- **Negatively impacting farmers, ranchers, and other agricultural end-users** who hedge commodity price risks with banks.
- **Negatively impacting small businesses** because the proposal favors larger companies that have access to capital markets.

The proposal was developed without adequate economic analysis. The proposed rule makes no attempt to justify significant increases in capital, nor does it meaningfully assess the significant costs associated with the proposal.

The proposal would reverse regulatory tailoring by applying a one-size-fits-all standard to all banks above \$100 Billion.

Increasing capital requirements will drive demand to the less regulated nonbank sector. These nonbanks are not subject to any robust capital requirements and as economic conditions worsen over the course of a business cycle, they will not be able to absorb the shocks and continue providing credit to these businesses and households. This will impact the economic resiliency of the US economy.

Recommended Action Items

Ask the banking agencies to withdraw the proposal, fully assess the impact and offer a new proposal that won't harm the economy. Regulatory capital is important to promoting a safe and resilient banking system, but requiring banks to hold too much capital comes at a cost to consumers, businesses, and the economy.

Ask your congressional delegation to exercise vital oversight regarding the costs and benefits of this sweeping regulatory proposal and encourage the banking agencies to withdraw the rule pending deeper analysis of potential unintended consequences.

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Proposed Changes Impacting Customers and Communities

Issue	Proposed Change	Customers Negatively Impacted
Mortgage Treatment	Increases capital requirements based on a borrower's Loan-to-Value ratio	Mortgage borrowers, particularly lower income and first-time home buyers
Equity Treatment	Raises capital requirements for certain legislatively mandated programs	Renewable energy infrastructure companies, and future users
Mortgage Servicing	Increases regional bank capital requirements for mortgage servicing	Mortgage borrowers, as regional banks will likely reduce or exit the servicing business
Determination of Investment Grade	Lowers capital requirements for loans to investment grade entities – but only if publicly listed	Non publicly listed companies like small- and medium-sized businesses that are not public companies, mutual funds, and pension funds
Operational Risk	Introduces an operational risk framework	All banking activity is impacted but fee-based activities like custody, wealth management services and securities underwriting, will be disproportionately impacted, areas where U.S. banks dominate
Credit Value Adjustment	Captures credit deterioration of derivative counterparties, but does not include end-user exemption	Any business using banks to hedge their risks: <ul style="list-style-type: none"> - Corporations, e.g. airlines, hedging business and operating risks - Pension plans hedging interest rate risk - Farmers hedging commodity risk
Securitization Treatment	Raises capital requirements on most securitizations, including credit linked notes	Companies, like smaller banks, that use credit linked notes or other securitizations to allocate risk Borrowers whose financing depends on securitization markets
Fundamental Review of the Trading Book	Rewrite of how market risks are calculated, resulting in higher capital requirements	Corporations, pension funds, municipalities and insurance companies hedging risks and managing investment activities
Trade Finance	Significant implications for the bank-related provisions of trade financing for goods and services	US Exporters, Agriculture, Commodities, US based Global Contractors, Small and Medium-Sized Enterprises engaged in international trade, Supply Chain efficiency, global competitiveness