



United States House of Representatives
One Hundred Eighteenth Congress
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

July 31, 2024

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

Dear Chair Powell:

We write to underscore the importance of withdrawing the current Basel III Endgame proposal and submitting any new change through a new notice of proposed rulemaking. As we have stated for the past year, the July 27, 2023 proposal lacks the necessary evidence and analysis to completely overturn the current methods used for calculating risk-based capital requirements. If finalized in its current form, the proposal would represent the most significant changes to the bank regulatory framework since the Dodd-Frank Act.

To be sure, the vast majority of comment letters on the current proposal, sent by stakeholders from across the ideological spectrum and sectors of the economy, support a withdrawal, re-proposal, or otherwise express significant concerns with the proposal. We are concerned by ongoing reports that the Federal Reserve will seek an as-yet undefined “partial preproposal,” and that “[t]here will be additional changes that will be made that won’t be re-proposed.”¹ Let us be clear, the current proposal contains such widespread structural and fatal flaws that a complete withdrawal and re-proposal *in its entirety* is the only solution.

It is well established that the Administrative Procedure Act requires that interested parties have “an opportunity to participate in the rule making through submission of written data, views or arguments.” To allow for meaningful public engagement, agencies must identify and provide the technical studies and data used to justify proposed rules, including explaining the assumptions and methodology underlying a proposal.

Notwithstanding its length, the current Basel III Endgame proposal is largely devoid of meaningful evidence and analysis to support the proposed overhaul of risk-based capital requirements. This fundamental flaw cannot be resolved through a partial re-proposal. The public must be given the necessary data and methodologies and then be able to submit their views.

¹ *The Federal Reserve’s Semi-Annual Monetary Policy Report: Hearing Before the Comm. on Financial Services*, 118th Cong. (July 10, 2024) (Testimony of J. Powell, Chair, Bd. of Governors of the Fed. Res. Sys.), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409311>.

Second, merely recalibrating aspects of the current proposal cannot fix the fundamental failure to account for the interrelationship between the risk-based capital requirements and stress capital requirements. The stress tests are designed to capture, among other things, operational risk, credit-valuation adjustment risk, and market risk, which are among the same risks captured by the proposal's expanded risk-based approach. Notwithstanding this clear overlap, the current proposal fails to adjust the stress capital buffer or even acknowledge the overlap. This lack of harmony can only be addressed through a re-proposal that acknowledges and harmonizes existing stress capital requirements.

Third, the current proposal effectively ends the use of internal models for credit, operational, and market risks, which is a fundamental structural flaw. For well over a decade, the largest banks used internal models to calculate their risk-based capital. These internal models have been subject to extensive internal and external oversight, including by internal risk functions, independent internal model validation groups, internal auditors, and bank examiners.² Yet, the proposal would severely limit or eliminate the use of internal models, without any evidence demonstrating that internal models misestimate risk.

Moreover, no evidence has been presented demonstrating that agency-promulgated models will result in better risk estimates. Indeed, the proposal fails to address whether the agency promulgated models will be subject to the same backtesting, validation, and model risk management standards as internal models.³ In fact, recalibrating the agency promulgated models to lower the capital impact does not fix this flaw, particularly given that agency-promulgated models are subject to future manipulation aimed at increasing capital rather than improving risk sensitivity.⁴

Courts have repeatedly made clear that an agency's final rules must be a "logical outgrowth" of the rules as proposed.⁵ Fixing each of the current proposal's flaws will require "broad and material changes" that go well beyond a "logical outgrowth" of the proposal, thereby requiring re-proposal. To be sure, there may be minor recalibrations that are logical outgrowths of the proposal. However, given the interconnectedness of risk-based capital requirements, even recalibrations must be part of any re-proposal.

² See, e.g., Supervisory Guidance on Model Risk Management, SR Letter 11-7 (Fed. Res. Sys. Apr. 4, 2011), <https://www.federalreserve.gov/supervisionreg/srletters/sr1107a1.pdf>.

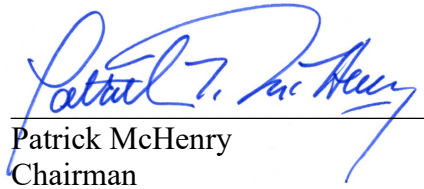
³ Indeed, the Federal Reserve Board's Inspector General has previously criticized the Board's own model risk management processes. See *The Board Can Enhance the Effectiveness of Certain Aspects of Its Model Risk Management Processes for the SR/HC-SABR and BETR Models*, 2022-SR-B-016 (Dec. 7, 2022), <https://oig.federalreserve.gov/reports/board-model-risk-management-SABR-BETR-models-dec2022.pdf>; *The Board Identified Areas of Improvement for Its Supervisory Stress Testing Model Validation Activities, and Opportunities Exist for Further Enhancement*, 2015-SR-B-018 (Oct. 29, 2015), <https://oig.federalreserve.gov/reports/board-supervisory-stress-testing-model-validation-reissue-oct2015.pdf>.

⁴ Additionally, reliance on agency-promulgated models threatens to diminish risk analysis by introducing the "monoculture of models" that federal regulators, including the Federal banking agencies, have identified as potential risks when associated with developing technologies such as Artificial Intelligence.

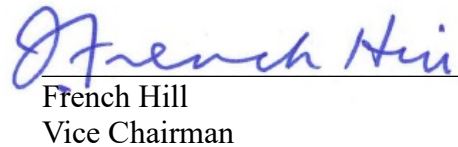
⁵ See, e.g., *Conn. Light & Power Co. v. Nuclear Reg. Com'n*, 673 F.2d 525, 533 (D.C. Cir. 1982).

We appreciate the Federal Reserve Board's efforts to meaningfully engage with the public in its rulemaking process. We strongly encourage the Board to avoid potential litigation and reputational risks by withdrawing and re-proposing in the entirety.

Sincerely,



Patrick McHenry
Chairman



French Hill
Vice Chairman



Frank D. Lucas
Member of Congress



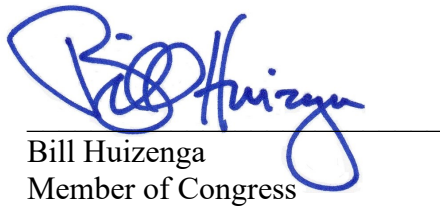
Pete Sessions
Member of Congress



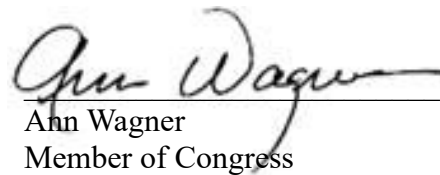
Bill Posey
Member of Congress



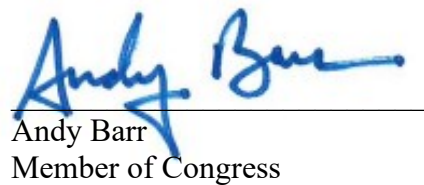
Blaine Luetkemeyer
Member of Congress



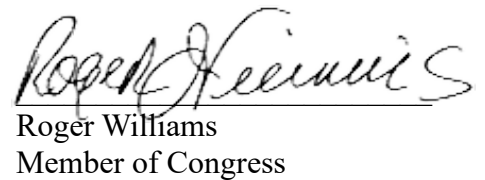
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Member of Congress



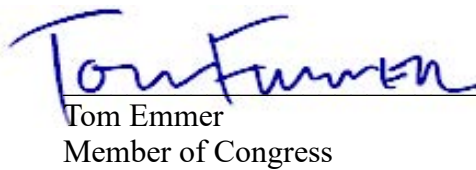
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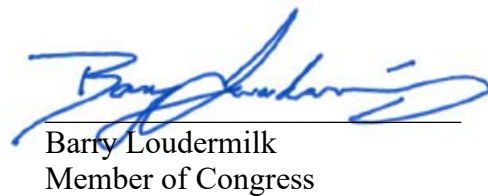
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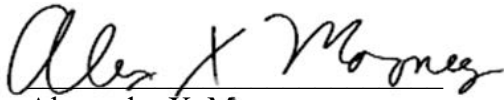
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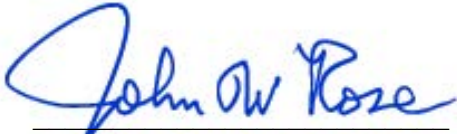
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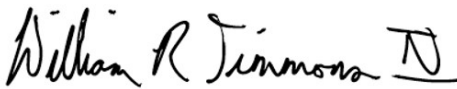
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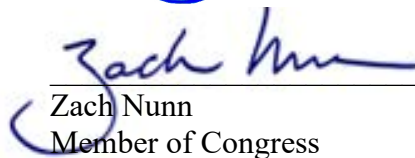
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