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August 25, 2025

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Ladies/Gentlemen:

On behalf of the Secured Finance Network (SFNet), I extend our congratulations to each of you on your selection to serve the vital function of overseeing our country's financial system, and, in particular, in crafting common-sense regulations that strike the proper balance between mitigating systemic risks while still ensuring that U.S. businesses have access to essential capital sources.

SFNet is the principal U.S. trade association for financial institutions that provide asset-based lending, factoring, and supply chain financing to commercial borrowers. With nearly 300 members, including major money-center, regional and community banks as well as non-bank commercial lenders, we represent the core of the \$5 trillion secured finance ecosystem that directly underpins 20 percent of US GDP. These specialty lenders are the lifeblood of over 100,000 middle-market businesses, who rely on these forms of financing for crucial working capital during periods of economic growth and stress alike. As a leading voice of this community, I would like to share our thoughts regarding the Basel III regulations as you prepare to reassess your position on this important framework.

The Asset-Based Lending Industry

By way of background, asset-based lending plays a critical role for a great number of U.S. businesses. Much of the financing provided by our members goes to U.S. small and medium-sized businesses that form the backbone of the U.S. economy. These businesses manage increasingly complex sales networks and supply chains, and asset-based lending provides the enhanced liquidity

and risk mitigation tools that allow them to participate competitively in the U.S. and international marketplaces. Asset-based lending is also particularly important in times of economic stress, as it offers a solution to companies that otherwise would not be able to obtain financing, while also providing lenders with an effective way to manage credit risk.

An essential characteristic of asset-based lending is that it predicates advances to borrowers on the value of their eligible receivables and inventory, and in some cases specific valuable equipment or real estate. This enables lenders to extend credit in a way that is much less risky than other forms of commercial lending in terms of losses on a defaulted loan. The value of this loan structure has been recognized by the Office of the Comptroller of the Currency (the "OCC"), which has noted that, with the right controls, asset-based lending "can result in lower losses in event of default when compared to other types of lending."ⁱ In addition to the OCC's guidance, other regulatory agencies have recognized that the value of the collateral and lending structure in an asset-based loan mitigates risk so effectively that such loans are excluded from leveraged lending regulation.ⁱⁱ In addition to the agency guidance, the financial industry recognizes, and has reported on, the safety and soundness of asset-based lending as compared to other types of financing. Rating agencies have noted that the recovery rate on asset-based loans is consistently better than other types of lending arrangements, particularly when the economy is in a downturn.ⁱⁱⁱ Historically, while first-lien debt facilities generally have high recoveries after default of 70-80%, asset-based facilities have performed even better due to stronger covenant and collateral protection, realizing recoveries after default at or near 100%.^{iv} SFNet's own data also reflects the better credit quality of asset-based loans, showing that gross charge-off rates for asset-based loans are significantly lower relative to general commercial loans, a point that is consistently reflected in data going back to 2011.^v

Concerns with Previously Proposed Basel III Framework

When the Basel III regulatory framework was initially proposed in 2023 (the "Proposed Rule"), SFNet was involved in analyzing and gathering data relevant to its impact on our members, particularly as it pertains to the methodology for calculating capital cushions related to credit risk. In a comment letter sent to the agencies on January 10, 2024 (a copy of which is attached to this letter), we identified certain key issues with the Proposed Rule.

First, while the Proposed Rule recognized the value of the limited category of "financial collateral," it failed to take into account the value of highly liquid nonfinancial collateral, such as receivables and inventory, in determining capital requirements. It is precisely the reliance on the value of such collateral that allows the asset-based lending industry to have reliable, strong recoveries even in times of financial stress. A failure to recognize the value of non-financial collateral in credit risk mitigation will have unintended consequences in the market, discouraging banks from extending asset-based loans to U.S. small and medium-sized businesses. This will increase the cost and decrease the availability of asset-based loans. One of the key goals in the Basel III regulations is to provide a better gauge of the risks of banks' exposures, and recognizing the value of highly liquid collateral that allows asset-based lending to be safer and have far higher recoveries after default aligns with this purpose.

In addition to the consideration of non-financial collateral, the Proposed Rule discouraged banks from serving as administrative agent on syndicated asset-based facilities. Because advances on these facilities are often made on a daily or other frequent basis to match the borrower's cash flows and the collateral value, the facilities often rely on a swingline loan structure to ease the administrative burden of all lenders funding on a daily basis. The Proposed Rule would increase materially the amount of capital that swingline lenders (most often the administrative agent bank) would be required to hold, even as it relates to exposure to the most highly secure, investment grade counterparties. This impact is exacerbated even more for counterparties that are not investment grade, which is especially applicable for any facilities that also involve private credit lenders, a structure that is more and more common in the market.

Key Considerations Going Forward

As your respective agencies are reevaluating the Proposed Rule, SFNet urges that you take into account the powerful role played by nonfinancial collateral in reducing the risk profile of the vast amount of asset-based loans that fuel and sustain the U.S. middle market, and minimize capital requirements accordingly. Regulatory agencies, particularly the OCC, already have a deep understanding of the value and the risks of asset-based lending. The OCC has issued detailed guidance intended to assist lenders in making safe and sound asset-based loans. This guidance includes factors that should be considered in assigning a credit risk rating to an asset-based facility.^{vi} In that regard, we encourage you to take the necessary time to examine existing guidance and the large body of data that supports the powerful role that nonfinancial collateral plays, day in and day out, in supporting the vital economic funding that enables U.S. companies to thrive and grow in times of economic prosperity, and to survive in times of economic stress. In addition, we urge you to reconsider changing the level of capital that is required for banks that serve as the fronting agent on swingline facilities, taking into the account the value of the collateral that supports these facilities and that losses on such facilities have been minimal under the current regulatory framework and required capital levels. We believe much of the data required for an analysis of these considerations is already in your possession as a result of your activities in overseeing banks, but SFNet is pleased to help provide any additional information you may require.

SFNet leadership would be happy to meet with you or your staff at your convenience to discuss our concerns and suggestions, and the asset-based lending industry overall, in more detail. Asset-based lending is both secure and fills a gap in the market that is key to U.S. economic stability and growth. SFNet and its members stand ready to work with your agencies to craft policies that strengthen our financial system while ensuring businesses of all sizes have access to the financing they need to thrive. We look forward to working with you.

Sincerely,

Richard D. Gumbrecht
Chief Executive Officer
Secured Finance Network

ⁱ Comptroller's Handbook, Safety and Soundness, Asset-Based Lending, p.1 (Jan. 2017), available at <https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/asset-based-lending/index-asset-based-lending.html>, page 5

ⁱⁱ See, e.g., Question 3 of *Frequently Asked Questions (FAQ) for Implementing March 2013 Interagency Guidance on Leveraged Lending*, which notes, in part, that "...it is appropriate to exclude certain loans secured by tangible collateral (for example, accounts receivable, inventory, property, plant and equipment and real estate) that do not rely on enterprise valuations for repayment... because the lender has additional sources of repayment beyond the cash flow from the operations of the borrower." See, also, Question 4 of that Guidance, which states, in part:

Generally, an enterprise valuation analysis is not necessary if the ABL tranche is the only tranche that an institution holds and the ABL is subject to the full monitoring typically associated with ABLs. In these instances, the agencies expect repayment analyses based primarily on conversion of the related working capital assets to cash and an understanding of the overall cash flow of the borrower. See, also, *Assessments, Large Bank Pricing: Final Rule*, 12 CFR Part 327, which provides that banks may exclude asset-based loans from higher risk commercial and industrial loans owing by higher risk commercial and industry borrowers if they

meet certain criteria.

ⁱⁱⁱ Moody's Investor Services Report, *Borrowing Base Credit Facilities do not Disappoint in a Downturn* (July 2018)

^{iv} For the 12.5 year period through October 2020, the recovery rate on first lien facilities was 79%, and on ABL facilities was 98% - the less than 100% recovery caused by anomalies within the oil and gas industry. By contrast, junior lien and unsecured debt averaged recoveries of 28-30%. S&P Global Ratings, *From Crisis to Crisis: A Lookback at Actual Recoveries and Recovery Ratings from the Great Recession to the Pandemic*, p.6 (Oct. 8, 2020).

^v https://www.sfnet.com/docs/default-source/data-files-and-research-documents/sfnet_market_sizing_impact_study_extract_f.pdf?sfvrsn=72eb7333_2

^{vi} Comptroller's Handbook, Safety and Soundness, Asset-Based Lending, p. 32-34, available at <https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/asset-based-lending/index-asset-based-lending.html>