CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
SENIOR VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

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Mr. Robert de V. Frierson
Secretary
Board of Governors of the Federal Reserve
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer, RIN 7100 AE-43, Docket No. R-1529

Dear Mr. de V. Frierson and To Whom It May Concern:

The U.S. Chamber of Commerce ("Chamber")[1] created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC has commented extensively on capital, leverage, and liquidity rules issued by the Board of Governors of the Federal Reserve (the "Federal Reserve") and other banking regulators in the past, with a particular focus on the impact of capital, liquidity and leverage standards upon the ability of non-financial businesses to raise the resources needed to grow and operate.[2]

We believe that appropriate capital requirements are necessary to safeguard against over-leveraging, but they must be properly calibrated. Capital standards that

[1] The Chamber is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are users, preparers, and auditors of financial information.

[2] *See* June 14, 2011 letter from the Chamber to Federal Reserve Chairman Ben Bernanke on G-SIFI surcharges, October 22, 2012 comment letter to U.S. banking regulators on proposed Basel III regulations, September 19, 2013 letter to the BCBS on the Revised Basel III leverage ratio framework, September 23, 2013 letter to U.S. banking regulators on enhanced supplementary leverage ratio standards, January 31, 2014 letter to U.S. banking regulators on liquidity coverage ratio rules, January 31, 2014 coalition letter to U.S. banking regulators on liquidity coverage ratio rules, May 28, 2014 letter to NCUA on risk based capital, September 11, 2014 letter to Federal Reserve on Capital Plan and Stress test rules, September 19, 2014 letter to Bank of International Settlements on The Net Stable Funding Ratio, and letter of February 11, 2016 on Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations.

are too onerous can have serious, unintended negative consequences. Allowing suitable levels of risk-taking is necessary to fuel growth and innovation within the overall economy.

We support the intent of the countercyclical capital buffer (the "CCyB") proposal to increase the resilience of global systemically important banks. However, we are concerned the CCyB proposal, as currently written, will unnecessarily harm credit growth and far exceeds its intended purpose of acting as a supplemental macroprudential tool to augment minimum capital requirements and other capital buffers that are currently applicable to large, internationally active banking organizations ("advanced approaches institutions").

In particular, the CCMC wishes to raise the following issues:

- The CCMC is particularly concerned that the Federal Reserve will set a CCyB amount on the basis of its evaluation of the overall financial environment and without notice and comment. We believe that, during times of procyclicality, such an opaque process could result in the amount of capital required being too high and cutting off credit to the economy.

- A public notice and comment process for setting the CCyB could inform the Federal Reserve on critical issues like whether smaller lenders or nonbank actors would be able to step in and fill this credit gap. We strongly urge the Federal Reserve to ensure a notice and comment process that will inform whether regulatory, supervisory, or other governmental actions aside from a higher CCyB amount would be more effective in mitigating the potential risks of excessive credit growth.

We also believe that the CCyB proposal cannot be viewed in isolation and must be considered in conjunction with other Basel III-related initiatives, as well as Global Systemically Important Bank ("GSIB") surcharges, to assess the cumulative impact of multiple, similar regulatory mandates. For example, at the international level, the Financial Stability Board ("FSB") has pursued this issue by conducting a Quantitative

Impact Study ("QIS"), micro- and macro-economic impact assessments, market survey and historical loss survey (collectively the "TLAC Studies"). The TLAC Studies are an important step and we welcome this as an evidence-based process to determine if holistic approaches to capital and liquidity are the right ones or if a different path is needed. A similarly rigorous cost-benefit analysis of the CCyB proposal that takes into account recent and future Basel III and other capital and leverage regulations, would be appropriate in this circumstance.

Our concerns are discussed in greater detail below.

Discussion

Capital, liquidity, and leverage requirements are important tools to achieve and maintain stability within financial institutions. However, if those standards are too arduous they can have serious, unintended negative consequences for financial institutions and the broader business community.

Allowing suitable levels of risk-taking and ensuring access to liquid, market-based capital are critical banking activities needed to fuel business growth, job creation, and innovation throughout the domestic and global economy. We recognize that providing access to liquid capital markets must be balanced with the need to establish appropriate safeguards to maintain the overall safety and soundness of the financial system.

The CCMC believes that the Federal Reserve's CCyB proposal may hamper and raise the costs of capital formation for non-financial businesses, particularly given the fact that the Federal Reserve believes that advanced approaches institutions would respond to a higher CCyB level by "tightening lending standards, otherwise reducing their risk exposure, augmenting their capital, or some combination of those actions."[3] These concerns alone caution against using the CCyB as a routine supplement to existing capital requirements.

We further note that the utility of the CCyB is currently unknown in practice, meaning that the Federal Reserve should not move too quickly to implement the

[3] 81 Fed. Reg. 5661, 5665 (Feb. 3, 2016).

buffer in times of perceived rapid credit creation. Governor Fischer recently noted that, with respect to procyclical measures that can be taken by the Federal Reserve, the "efficacy of new tools in the United States, such as the countercyclical capital buffer, remain untested."[4] Moreover, given the uneven implementation of a CCyB requirement by members of the Basel Committee on Banking Supervision, triggering the requirement may disproportionately impact advanced approaches institutions in the United States and banks elsewhere already subject to the requirement.[5]

Indeed, we take particular issue with the lack of clarity in the approach taken by the Federal Reserve to even determine whether and by how much to raise the CCyB amount. The Federal Reserve states that it will consider

> a number of financial-system vulnerabilities, including but not limited to, asset valuation pressures and risk appetite, leverage in the nonfinancial sector, leverage in the financial sector, and maturity and liquidity transformation in the financial sector.[6]

Raising capital requirements on the basis of assets held by an advanced approaches institutions should be subject to clearly defined and enumerated factors similar to the approach used when determining the capital ratio requirements of such institutions. By vaguely defining what factors may or may not be considered by the Federal Reserve in setting the CCyB, the CCyB proposal only creates uncertainty and incentivizes advanced approaches institutions to preemptively sideline more capital.

Furthermore, while we agree that no single indicator or fixed set of indicators can adequately capture all the key vulnerabilities that contribute to the build-up of excessive credit growth, the Federal Reserve particularly noted the credit to GDP ratio is a useful indicator that may be relied upon. However, we caution that industry and academic consensus remains fractured on whether the credit to GDP ratio gaps

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[4] Federal Reserve Vice Chairman Stanley Fischer, at the "Macroprudential Monetary Policy," 59th Economic Conference Of The Federal Reserve Bank Of Boston, Boston, Massachusetts, October 2, 2015, Macroprudential Policy In The U.S. Economy, *available at* http://www.federalreserve.gov/newsevents/speech/fischer20151002a.htm

[5] *See* Countercyclical Capital Buffer, Basel Committee member jurisdictions (Mar. 1, 2016), *available at* http://www.bis.org/bcbs/ccyb/.

[6] 81 Fed. Reg. 5661, 5665 (Feb. 3, 2016).

should be used as a reference point for countercyclical capital buffers and a foundation for policymaking more broadly.[7]

Finally, we also note that, because of the fungible nature of capital, the CCyB may have the unintended consequence of limiting growth in lending and investment activities that do not pose an excessive credit risk but contribute to the capital markets. When faced with the need to retain more capital to meet a CCyB requirement an advanced approaches institution may decide to eliminate its services in the capital markets, which are currently subject to some of the highest capital charges of all banking activities as a result of recent capital reforms. This will, of course, have an immediate and detrimental impact to the growth of our economy by limiting the ability of the nonfinancial sector to access financing through the capital markets. Given this reality, the CCyB may hurt economic growth while not reaching its intended goal of curtailing excessive credit growth.

More broadly, while retained earnings and securities issuances are a means of meeting the CCyB requirements, there is a limit as to how much retained earnings and securities issuances can be used to meet these goals, as well as meeting the requirements of other regulatory requirements, such as TLAC. The CCyB, in combination with TLAC, may siphon off capital by sidelining resources until they are needed for a GSIB recapitalization or wind down. This is the equivalent of removing billions dollars of productive capital, normally used by the business community, from the global economic circulatory system. A reduction of productive capital on this scale will have negative consequences and undermine the ability of the global economy to achieve the economic growth envisioned by the G20 Brisbane Summit communique.

In response, the business community will be faced with a series of unattractive options. Businesses will need to plan for longer time horizons for financing at higher costs, engage in risker financing with higher costs and a greater downside, or simply build cash reserves, which is an inefficient and unproductive use of resources for businesses and the macro-economy as a whole. None of these choices are good ones for business or job creation and economic growth will suffer as a result.

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[7] *See* The Unreliability of Credit-to-GDP Ratio Gaps in Real Time: Implications for Countercyclical Capital Buffers, *available at* http://www.ijcb.org/journal/ijcb11q4a10.pdf].

Comprehensive Study of Capital Requirements Needed

In previous comment letters, we have called for comprehensive studies of various regulatory initiatives as well as the cumulative impacts of those initiatives on the broader global economy and the capital formation system that is the linchpin for growth. We believe that such studies are critical to understanding the impact of capital and leverage requirements on capital formation and urge the Federal Reserve to conduct a similar, comprehensive analysis. A review of the initiatives impacting business capital formation illustrates:

- The Leverage Ratio Framework materially increases the minimum capital requirement by product relative to Basel III. Additionally, the Leverage Ratio Framework and the proposed Net Stable Funding Ratio penalizes many low-risk activities that may harm the ability of non-financial businesses to access markets to prudently mitigate risk or manage cash and liquidity;

- The Liquidity Coverage Ratio creates disincentives for financial institutions to offer certain products and services to businesses even though those activities were not the cause of the financial crisis;

- GSIB Capital Surcharges will force large internationally active banks to withdraw additional capital from productive capital formation streams;

- The complex regulatory regimes envisioned by the final Volcker Rule, and the proposed Vickers and Bank Structural Reform rules are expected to impact the ability of non-financial businesses to enter the debt and equity markets by raising costs and creating barriers of entry to the capital markets;

- Money Market Fund reforms will harm the ability of non-financial businesses to access the short-term commercial paper markets and manage cash; and

- If the Volcker, Vickers and Bank Structural Reform, and Money Market Fund reforms hamper capital formation, the next alternatives are commercial lines of credit; however, Basel III creates disincentives for banks to provide businesses with commercial lines of credit.

- The TLAC proposal will immobilize billions of dollars' worth of capital through its long-term debt requirements while requiring banks to hold many multiples of the capital needed in several of the Federal Reserve's stress testing scenarios.[8]

The combination of all of these initiatives could lead to an underperforming financial sector and the creation of barriers to capital formation. The inability of businesses to engage in normal capital formation activities, efficient cash management and effective risk management will raise costs and create inefficiencies, adversely impacting economic growth, job creation, and financial stability. Therefore, we believe that the Federal Reserve should conduct a comprehensive study to determine: (1) how all of these initiatives will interact and work together; (2) determine the impacts of these initiatives upon the broader macro-economy; and (3) use modeling techniques to "war-game" these new regulatory structures, identify faults and shape comprehensive fixes.

This information will be invaluable to the shaping of a final policy statement for CCyB and would help mitigate potential unintended consequences with the other initiatives discussed above. It will also inform how the final rule should be molded to avoid potential harm to the ability of businesses to raise the resources needed to expand and operate.

Formal Rulemaking and Enhanced Economic Analysis Is Needed

The CCMC strongly believes that, as a regulatory capital rule, the CCyB policy statement and every decision to raise the CCyB amount should be subject to the notice-and-comment and cost-benefit requirements of the Administrative Procedures Act ("APA"). It is deeply troubling that the CCyB proposal contemplates that the

[8] This list is by no means an exhaustive list of regulations and capital initiatives that should be reviewed with such a study. This list is illustrative of the types of initiatives that should be studied.

Federal Reserve would be able to unilaterally raise the CCyB amount through an evaluation of financial-sector and macroeconomic indicators without subjecting that analysis to formal notice-and-comment rulemaking, especially when the Federal Reserve could take steps to address potentially excessive credit growth through other means, such as enhanced supervision.

The proposed CCyB policy statement also states that the proposal would not have a significant impact on small entities because the CCyB would only apply to advanced approaches institutions and not bank holding companies and other similar institutions that fall below the threshold for advanced approaches institutions or elect to use the advanced approaches framework.[9] We believe that this economic analysis is fundamentally flawed. It disregards the impact on lending and economic growth on small entities that currently borrow from advanced approaches institutions. Consequently, we urge the Federal Reserve to conduct a more thorough economic analysis when finalizing the CCyB policy statement.

Additionally, the Federal Reserve is subject to the Regulatory Flexibility Act ("RFA") and the Paperwork Reduction Act ("PRA"). The RFA requires assessment of the economic effect of regulations on small business and consideration of less burdensome alternatives. The PRA requires assessment of the paperwork burden on small entities and ways to reduce or mitigate it.

The Federal Reserve must also comply with the Small Business Regulatory Enforcement Fairness Act ("SBREFA"). Among other things, the portion of SBREFA known as the Congressional Review Act states that rulemaking agencies must submit to GAO, and make available to each house of Congress, "a complete copy" of any cost-benefit analysis prepared for a final rule for which such an analysis is performed.[10]

The Federal Reserve is also subject to Riegle Community Development and Regulatory Improvement Act ("Riegle Act," 12 U.S.C. §4802(a)). The Riegle Act mandates that "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or

[9] 81 Fed. Reg. 5661, 5663 (Feb. 3, 2016).
[10] 5 U.S.C. 801(a)(1)(b)(i))

other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest - (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."

Although the Federal Reserve is an independent agency, it has also avowed that it will seek to abide by Executive Order 13563. The Federal Reserve recently stated that it "continues to believe that [its] regulatory efforts should be designed to minimize regulatory burden consistent with the effective implementation of [its] statutory responsibilities."[11] As recently as October 24, 2011, the Federal Reserve wrote a letter to the Government Accountability Office acknowledging the need to engage in a cost-benefit analysis and asserting that the Federal Reserve's use of such an analysis, since 1979,[12] has mirrored the provisions of regulatory reform as articulated in Executive Order 13563.[13]

Executive Order 13563 places upon agencies the requirement, when promulgating rules to:

1) Propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to justify);

2) Tailor regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations;

3) Select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental, public health and safety and other advantages; distributive impacts; and equity);

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[11] November 8, 2011, letter from Chairman Ben Bernanke to OIRA Administrator Cass Sunstein.
[12] Board of Governors of the Federal Reserve System, Statement of Policy Regarding Expanded Rulemaking procedures, 44 Fed. Reg. 3957 (1979)
[13] *See* letter from Scott Alvarez, General Counsel of the Federal Reserve, to Nicole Clowers, Director of Financial Markets and Community Investment of the General Accountability Office.

4) To the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt; and

5) Identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made to the public.[14]

Additionally, Executive Order 13563 states that "[i]n applying these principles, each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible." Conducting the rulemaking and its economic analysis under this unifying set of principles will facilitate a better understanding of the rulemaking and its impact and give stakeholders a better opportunity to provide regulators with informed comments and information.

The CCMC strongly recommends that the Federal Reserve establish a baseline for cost-benefit and economic analysis using the blueprint established by Executive Orders 13563 and 13579, in addition to other requirements they must follow.[15] Doing so would allow meaningful, cumulative analysis that would result in a more coherent final rule with fewer harmful, unintended consequences for the American economy.

Conclusion

We have highlighted several concerns with the proposed CCyB policy statement, underlying the need for a rigorous cost-benefit analysis to determine the impact of heightened capital requirements on advanced approaches institutions, their customers, and their counterparties during times of potentially excessive credit growth. We reiterate that the decision to require a CCyB should only be made after the Federal Reserve has carefully considered and evaluated all other potential options available to it, including heightened supervision or potential re-weighting of risk weights applicable to certain asset classes. We thank you for your consideration of

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[14] Executive Order 13563

[15] Executive Order 13579 requests that independent agencies follow the requirements of Executive Order 13563.

these comments and would be happy to discuss these issues further with you or your staff.

Sincerely,

Tom Quaadman