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April 2, 2015

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

Via Email: regs.comments@federalreserve.gov.

Re: Docket No. R-1505/ RIN 7100 AE-16,

Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies

Dear Board of Governors.

On behalf of more than 350,000 members and supporters of Public Citizen, we are pleased to submit these comments in response to the Federal Reserve Board's (Board) request for comment on Risk-based Capital Guidelines and the Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies.

We welcome the Board's efforts to strengthen safeguards against the failure of a major banking institution. Specifically, we endorse the use of additional capital requirements for firms especially reliant on short-term funding.

Overview

The financial crisis of 2008 revealed that regulators permitted certain major U.S. financial firms to become so large and reliant on so much debt that their failure threatened global instability. The bankruptcy of Lehman Brothers was the breaking point when bank creditors accurately valued the assets that government-chartered banks were using as collateral for their funding. With the Board's capital proposal, regulators can take an important step in reducing the need for taxpayer bailouts.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act requires in Section 165 that regulators adopt rules to reduce the need for public assistance for large financial institutions that suffer stress. Generally, this involves requirements for greater capital.

In simplest terms, a firm's capital is the difference between the value of what it owns and what it owes. When that difference falls to zero, the firm is insolvent. The greater this difference, the further the firm is from accounting insolvency. In order to ensure no taxpayer bailouts are necessary this capital should be substantial.

By any measure, including the estimation of the mega-banks themselves, the capital levels leading into the financial crisis were low. Bank capital was about 3 percent of assets. That meant that a 3 percent decline in a bank's assets would render it insolvent. This is too low. The distance between health and insolvency should be 20 percent at a minimum. Public Citizen welcomes the Board's proposal for what is a substantial step toward this level. Several of the largest banks will be required to operate with important new levels of capital.

Industry argues that higher capital would stymie loan-making, and therein, economic growth. We view these arguments as specious.

First, the financial crisis of 2008 stemmed from too little capital. Higher capital requirements would have forced stricter requirements on risk exposures. When those exposures proved to be problematic, regulators would have required banks to stand down from further problem investments. Instead, with too little capital, regulators were faced with widespread problems that had grown well beyond their ability to repair through intervention in the banks' operations. The resulting crisis drained more than \$12 trillion from the economy. Any measure of reduced loan-making from higher capital requirements must be measured against this \$12 trillion loss.

Second, the Modigliani-Miller concept theorem, or the capital structure irrelevance principle, challenges this view. The firm's value is not affected by the means by which it is funded.

Discussion of the Board's Proposal

On December 9, 2014, the Board requested public comment on a proposed rule that would impose a risk-based capital surcharge that would apply to eight U.S. globally systemically important banks--G-SIBs. This specific proposal draws from an international standard adopted by the Basel Committee on Banking Supervision that was adopted in November 2011.

In essence, the proposal amends the Board's risk-based capital rules. It relies on Section 165 of Dodd-Frank, which generally requires large bank holding companies to meet enhanced prudential standards. The proposal consists of two parts. First, the proposal includes ways for the Board to identify a GSIB. Second, the proposal lays forth a metric by which to calculate a capital surcharge.

To become a GSIB, a bank holding company must first have more than \$50 billion in assets. It must then meet a test covering five broad categories the Board correlates with systemic risk: size, interconnectedness, cross-jurisdictional activity, substitutability and complexity. Within these categories are 12 systemic risk indicators. This includes, for example, volume of cross-jurisdictional claims and assets under custody. Using a weighting formula, a firm then qualifies as a GSIB.

Under the formula, eight firms would qualify: Bank of America, Citigroup, JPMorgan Chase, Goldman Sachs, Morgan Stanley, Wells Fargo, Bank of New York Mellon and State Street Corporation. The Board notes that there is a gap between the least systemic of these eight, and the ninth, which does not qualify.

At these eight banks, the Board would then measure the dependence on short-term wholesale funding. This source of credit encompasses various forms of funding-- wholesale brokered deposits, securities financing transactions and repurchase agreements. The Board appropriately recognizes that reliance on such funding renders a G-SIB vulnerable to liquidity runs. Firms need not become insolvent to face such runs; consequently, the Board correctly identifies this reliance as a justification for capital levels well beyond the norm. The Board uses calculations of a firm's short-term wholesale funding from recently finalized rules. This includes the quantitative liquidity coverage ratio. Basically, the average of a BHC's short-term wholesale funding amount is divided by its average risk-weighted assets. Of some concern, different forms of short-term wholesale funding are weighted differently. This invites a firm to rely on some forms rather than others and the Board has not justified these different weights.

At the end of this exercise, the Board would then require additional capital at the eight GSIBs of 1.0% to 4.5%. This is larger than the original Basel methodology, which plateaus at 2.5%. We note that other countries are setting higher capital requirements, such as Switzerland, Netherlands, and Sweden

We support this higher capital requirement for the reasons outlined above.

Generally, Public Citizen prefers simplicity over complexity. We are skeptical of risk weighting assets. While we recognize that some assets may be safer than others, implementation of such a rubric contains more problems than that theory promises. For example, US Treasuries may be safe, but the debt of sovereign countries such as Greece may not be. Yet risk weighing favors both of these. A simpler solution would be to strengthen the leverage requirement.

The Board's current proposal effectively risk weights a bank's liabilities. As such, we are concerned that the Board proceeds down a path of layering a new level of complexity on top of risk weighting assets.

But we agree that short-term funding should be viewed more skeptically than long-term funding. We cannot find a reason why such short-term funding should be treated other than as the Board proposes.

In the end, we support the Board's proposal because it results in higher capital requirements for several major financial institutions. This represents progress.

For further information, contact Bartlett Naylor at bnaylor@citizen.org, or 202.580.5626.

Sincerely

Public Citizen