

From: American Action Forum, Douglas Holtz-Eakin and Meghan Milloy
Proposal: 1603 (RIN 7100-AF 02) Reg Q, Y, YY - Amendments to the Regulatory Capital, Capital Plan, Stress Test
Subject: Reg Q, Y, YY - Amendments to the Regulatory Capital, Capital Plan, Stress Test

Comments:

Date: Jun 18, 2018

Proposal:Regulations Q, Y, & YY: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules [R-1603]
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Your comment:June 18, 2018
Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Re: Docket No. R-1603 and RIN 7100-AF 02

Dear Ms. Misback:

The American Action Forum scholars ("AAF") appreciate the opportunity to submit comments on the Board of Governors of the Federal Reserve System's ("Board") notice of proposed rulemaking ("proposed rule") to integrate the Board's regulatory capital rule and the Board's Comprehensive Capital Analysis and Review ("CCAR") and stress test rules in order to simplify the regime applicable to firms subject to the capital plan rule.

AAF is an independent, nonprofit 501(c)(3) organization that is not affiliated with or controlled by any political group. Its focus is to educate the public about the complex policy choices now facing the country and explain as cogently and forcefully as possible why solutions grounded in the center-right values that have guided the country thus far still represent the best way forward for America's future. The proposed rule would: (1) create a stress capital buffer to replace the capital conservation buffer; (2) introduce a new stress leverage buffer; and (3) modify the Stress Testing Policy Statement, which provides certain assumptions to be used in the Board's supervisory and firms' own stress tests. We hope these comments will be helpful to illustrate the proposed rule's strengths and weaknesses. Certain proposed amendments would ensure financial stability and support Americans' continued access to credit, while other aspects of the proposed rule appear to be based on insufficient data. The proposed rule aligns with the principle of regulatory simplicity which AAF has championed since 2010.

We address the remainder of the rule below.

1. The effective date of the proposed rule permits adequate time for firms to become compliant. In previous comments on past proposed rules, AAF scholars have argued against the rule because,

among other reasons, the new regulatory costs and requirements imposed by the rule would necessitate a larger compliance window than was mandated by the proposed rule. Though regulated firms must often allocate an unreasonable amount of resources to comply with regulatory changes, the effective date of the proposed rule, December 1, 2018, and the enforceable date, October 1, 2019, provide firms adequate time to comply. Therefore, firms' interests are not unacceptably burdened, in this case.

2. We support the proposed rule's consolidation, from 24 to 14, of the total number of regulatory capital requirements to which firms with assets over \$50 billion must comply. Currently any bank that qualifies as a systemically important financial institution with assets over \$50 billion is subject to 24 different capital requirements. As illustrated in the Board's own staff memo on the proposed rule, the current non-stressed capital requirements are: CET1 Standardized, CET1 Advanced, Tier 1 Standardized, Tier 1 Advanced, Total Standardized, Total Advanced, Tier 1 Leverage, and Supplementary Leverage. The current stressed capital requirements are: CET1 Standardized Severely Adverse, CET1 Standardized Adverse, Tier 1 Standardized Severely Adverse, Tier 1 Standardized Adverse, Total Standardized Severely Adverse, Total Standardized Adverse, Tier 1 Leverage Severely Adverse, Tier 1 Leverage Adverse, Supplementary Leverage Severely Adverse, and Supplementary Leverage Adverse. Just having to read all of those is enough to make one want for streamlining.

Under the proposed rule, the new stress buffer requirements are: CET1 Standardized, Tier 1 Standardized, Total Standardized, and Tier 1 Leverage, while the non-stressed buffer requirements are: CET1 Advanced, Tier 1 Advanced, Total Advanced, and Supplementary Leverage. AAF believes that tailoring the capital requirements from 24 to 14 will not only lift a regulatory burden off of these financial institutions, thereby allowing them to continue with their market making, lending, and commercial banking activities that spur economic growth, but also, they remain sufficiently high to protect against a worst-case scenario. It is this balance of safety and efficiency that is most attractive about the proposed rule.

Pursuant to both Governor Quarles' and our view that bank regulations are best when they are simplified, transparent, and efficient, this move toward fewer redundant regulatory burdens is a step in the right direction.

3. We support the proposed rule's movement from a static capital requirement to more dynamic capital buffer that is more tailored to the individual firm

Not unlike the above point regarding a reduction in capital requirements from 24 to 14, we further support the proposed rule's more dynamic capital buffer. Instead of the static 2.5 percent of additional common equity Tier 1 capital that banks are required to have at any given time; also known as the capital conservation buffer, the proposed rule would tailor a firm-specific capital requirement that takes into account a bank's size and activities and would be based on the worst case scenario from the CCAR process.

This prevents the Fed supervisors from being able to step in and dictate whether or not a bank can make dividend payments or stock repurchases if it is hovering around the arbitrary 2.5 percent mark. It also allows for banks and regulators to work together to achieve an equilibrium of appropriate risk and regulation.

Further, the buffers would be allowed to change annually, taking into account Federal Reserve models of losses during times of stress and any changes in the bank's own financials or mix of activities. Despite some arguments against the proposed rule, allowing for regulations to be reactive both to changes within firms and changes in the financial stability of the system as a whole creates the ultimate safety and soundness tools as regulatory changes don't have to be wholly reactionary. Instead, a dynamic regulatory regime like the one proposed will be able to spot an issue before it becomes a crisis.

AAF scholars have long argued for a more tailored approach to financial regulation in an effort to balance safety and soundness with appropriate, economically beneficial risk. This change to the capital buffer would do just that.

4. We support the proposed rule's replacement of the 4.5 percent leverage ratio with a stress leverage buffer while leaving unchanged the Supplemental Leverage Ratio

As a companion to the proposed rule's more tailored stress capital buffer above, the proposed rule also introduces a more tailored stress leverage buffer that would replace the static 4.5 percent leverage

ratio. Currently, covered banks are required to maintain at least a 4.5 percent capital buffer against their assets, regardless of what those assets actually are. Under the proposed rule, the stress leverage buffer would be calculated similarly to the stress capital buffer. Specifically, instead of the current leverage, the stress leverage buffer would be equal to the difference between a bank's non-stressed leverage and post-stress minimum leverage ratio.

Further, under the proposed rule, while the leverage ratio would be replaced with the stress leverage buffer, the supplemental leverage ratio would remain the same. And, although the stress capital buffer and stress leverage buffer would be calculated differently than before, the actual capital requirements would change little if at all, as the biggest banks have always been required to hold appropriate amount of capital to survive the most adverse situations.

Again, as the stress leverage buffer moves from a static, arbitrary capital requirement, to a more tailored, institution-specific capital requirement, a proper balance between safety and soundness and appropriate risk is struck. We support a tailored regulatory approach across the board, and, as such, support the movement to a stress leverage buffer.

Beyond the above specific points, the proposed rule would make bank stress testing and capital requirements more efficient for all parties involved – both the regulators and the regulated. That is an admirable regulatory agenda which would be prudent for other regulators to take up in future proposed rules.

It is for the aforementioned reasons that we support the proposed rule as it is currently written and encourage the Board to take into consideration the comments received throughout the duration of this comment period. AAF stands ready to provide research and additional assistance to the Board and other interested parties as needed.

Sincerely,

Douglas Holtz-Eakin
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Meghan Milloy
Director of Financial Services Policy, American Action Forum