Proposal: 1813 (AG64) Reg H, Q, LL & YY-Regulatory Capital Rule: Amendments to LBOs and Banking Organizations

Description:

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From: Bruce E. Langenkamp

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Subject: R-1813 Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking

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Comments:

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Proposal: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity [R-1813]
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Your comment: Comment on Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity [R-1813]: In his meeting with the U.S. Senate last Fall, Michael Barr defended the proposed regulatory rule for increased capital requirements on large banks, saying: "The proposed rules are anticipated to increase capital requirements for large banks, ... and the bulk of the estimated rise is attributable to trading and other non-lending activities." But capital allocation standards are based on 4 categories: - Credit Risk (loan loss risk) - Operational Risk (inadequate processes) - Trading Risk (market risk) - Credit valuation risk (losses on derivatives) For JP Morgan for example, Trading Assets of $625 billion are only 16% of total assets. Also, trading assets are mostly short term in nature, whereas most loans are long term, so the proposed capital requirements would impact longer-dated assets most. So, for Barr to say that most of the increased capital requirements apply to trading activities is very misleading to the U.S. Senate and to the public. JPM Chase estimates that the proposed capital rule, requiring $80 billion in additional capital, would be comprised as follows:

1. A $50 billion capital increase resulting from regulators required $500 billion increase in JPM's RWA (Risk Weighted Assets) - but given trading assets total just $625 billion (16% of assets), clearly the $500 billion RWA increase (being 80% of total trading assets) must apply far less to trading assets. The required $50 billion capital increase associated with RWA would mostly be associated with non-trading assets - principally longer term credit/loans, and the fact that JPM is a GSIB bank (globally systemically important). JPM estimates that $22.5 billion of the capital increase is due solely to its GSIB status. But JPM's GSIB status is primarily due to its size and global economic importance, not to its trading book

assets (ie, eliminate JPM's $625 billion in trading assets and it is still a GSIB bank).

2. A $30 billion increase in Operational Risk Capital - virtually none of this $30 billion is associated with trading activities risk since Operational Risk relates to failed processes and fraud. So, of the $80 billion JPM-estimated required capital increase from regulators' proposed rule, clearly Barr's statement that the required capital increase applies principally to trading assets is hugely misleading, and likely patently false. As U.S. senators said, Barr and the regulators didn't provide any quantitative evidence justifying the capital increase rules proposed. Even some of the Fed and OCC leaders voted against the proposed rule changes as the Fed vote was 4-2 in favor and FDIC was 3-2 in favor. Michelle Bowman's defense of her dissent was much more compelling. In her view, ".regulatory reform can pose significant financial stability risks, particularly if it fails to take sufficient account of the incentive effects and consequences. Regulatory actions also could depress economic activity through reduced availability of credit or by limiting the availability of financial products or services." "Inhibiting innovation in the banking sector could push growth of certain key products and services further into the nonbank sector, leading to much less transparency and potentially greater financial stability risk." To this point, Jamie Dimon hinted last Fall that JPM would likely have to substantially reduce its consumer mortgage loan levels, ie, all but exiting this long-term lending business due to the large amount of capital required on longer term loans. JPM would still originate mortgages but sell them off to institutions outside the Fed's regulatory scope, a process that is exactly what Bowman rightfully worries about. JPM has made no secret of its dissatisfaction of being a home lender, given the existing capital requirements and its innate mediocre returns - JPM's home lending loans have declined nearly 30% from $240 billion in 2017 to $172 billion in Q1, 2023, just prior to its 2023 acquisition of Silicon Valley Bank. Bank of America's home lending levels have declined approximately $5 billion over the same time period, while its total loans have grown significantly. Looking back at why large banks have failed over the past 50 years (1980-82, 1990-92, 2008-09), the reasons for failure have largely been bad loans, not trading book losses, which Barr has said is the primary target of increased capital requirements. In conclusion, the increased capital proposal merits substantial revision, preceded by transparent quantitative analysis provided by the regulators, granularly applied to the above 4 categories of risk.