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

Description:

Comment ID: 157252

From: Diligence Capital Management, James Abbott

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

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

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Comments:

Date: Jan 20, 2024

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: Dear Members of the Board of Governors of the Federal Reserve, My name is James Abbott, and I have been a long-time investor in the banking system. I have professionally covered the banking industry as an investment analyst and as such have written thousands of pages of text on the subject of good banking practices, and conversely poor banking practices. I have also been a senior executive at one of the nation's largest regional banks and spent a great deal of time assisting in the management of the bank's performance during the global financial crisis, European financial crisis, other "disruptions" such as credit concerns in the wake of the oil and gas recession of 2014-2016, and the banking crisis of 2023 that resulted in the failure of Silicon Valley Bank among others. I am currently a professional investor, serving primarily institutional investment firms. I am also an American citizen that deeply values the state of this country, both today and in its future state. I hope this context will be helpful when weighing my comments. While some of the comment letters delivered to you have been exceptionally lengthy, the issue of the proposed changes to the Basel III regulations can be quickly summarized in a single word: "unnecessary." If there was a second word, it would be "harmful." Why are the changes unnecessary? First, this "endgame" proposal came as a result of the banking crisis

that occurred in March of 2023. It lasted for a period of about two weeks, or less than 1% of the time (measured in weeks) since the global financial crisis. Yes, three larger banks failed. But I would argue that public policy should not protect all companies (banks or otherwise) from failing. Failure is a healthy process of "thinning the herd" and needs to happen on occasion, especially as long as taxpayers do not fund the bill. Failure reminds the survivors of good and bad practices better than any individual regulator (i.e. "examiner in charge"), regulatory or political body, or even investors and owners in the companies. The FDIC insurance fund paid for the costs of closing the banks in the spring of 2023. The banking system is quickly recapitalizing the insurance fund. The costs of the failures were entirely born by the banking system and ultimately the owners and investors of the banks. That's the American Way. Freedom to succeed or fail, with costs borne by private citizens (via mutual funds, pension funds, hedge funds, individual shareholders, etc.) More specifically, increasing capital requirements for banks would not have prevented the failure of Silicon Valley Bank, First Republic, or Signature. Much has been written about this, so I won't repeat it here. But if there was one thing that could be fixed to prevent such failures again would be an accounting standard that is either (a) fully mark-to-market, or (b) fully amortized cost. A hybrid system of a small fraction of a balance sheet (the "available for sale securities" portfolio) being marked to market while all the rest of the assets and liabilities are left as amortized cost (I'm simplifying here a bit for brevity, but that's effectively the case) creates a very, very distorted view of a bank's balance sheet when interest rates are changing relatively quickly (e.g. 2004, 2020, and 2022-2023). In simple terms, it's easily one of the three dumbest accounting standards ever to have been written. Finally, it is self evident that more regulation is inefficient on many levels. The more regulation, the greater the difficulty to properly enforce (Silicon Valley Bank's regulators were aware of the risk but failed to take action with any degree of urgency); the more regulation, the greater the "frictional costs" - expense that doesn't create economic growth within the country (i.e. it enriches consultants, government employees, and attorneys, but produces zero GDP); and it costs taxpayers via reduced GDP growth (e.g more government employees to managed the increasingly wieldy pile of regulation, and in an increasingly uncompetitive banking system compared to banks headquartered in other countries with less onerous regulatory systems). In conclusion, while the Basel III Endgame proposals haven't been - and truly can't be - studied sufficiently to see whether it would prevent any and all bank failures, it is self evident that (a) the system worked as designed (unhappily for Silicon Valley Bank shareholders, but to the benefit of JP Morgan shareholders); (b) taxpayers were unaffected thanks to a working FDIC insurance fund that is paid for entirely by the banking system; (c) the changes proposed would not have prevented the bank failures; and (d) the banking system is already somewhat uncompetitive with other larger global banks - we should not make changes that will clearly hurt our competitive position in a global economy, as that will most definitely hurt the taxpayers of this country. I urge you to abandon completely the Basel III Endgame proposal. Regards, James Abbott Co-Founder, Chief Executive Officer and Chief Investment Officer Diligence Capital Management[/span]