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COMPLEX CAPITAL CALCULATIONS ADD COST WITHOUT MAKING BANKS SAFER, NEW PAPER FINDS

Advanced capital rules for large, non-complex regional BHCs require as many as 200 million calculations, even though these rules are not the binding capital constraint, which adds cost without enhancing safety and soundness.

WASHINGTON, DC, June 14, 2017 — With the first marginal cost-benefit analysis of the advanced approach to U.S. risk-based capital standards, a new paper from Federal Financial Analytics, Inc. (FedFin) finds that these requirements do not enhance the safety of large, non-complex regional bank holding companies (BHCs), nor do they make the financial system safer. Coming after the U.S. Treasury Department argued for simplifying rules that don't raise risk, the FedFin paper details an option immediately at hand for U.S. regulators. Despite promises from regulators since 2007, there has been no comprehensive assessment of the costs and benefits to banks, borrowers, and the financial system of applying the Basel III advanced-approach capital requirements to larger banks that engage principally in traditional deposit-taking and lending.

"Much of the post-crisis rulebook is premised on the view that the more capital there is, the better a bank can withstand stress," said FedFin managing partner Karen Shaw Petrou. "This is true to a point, but marginal cost-benefit analysis makes it clear that one more capital rule that doesn't even require still more capital has a perverse impact on safety and soundness. In fact, adding complex requirements that do not bind big banks increases the likelihood of credit boom-bust cycles just like

the one that led to the 2008 collapse."

FedFin's study finds that the advanced approach adds considerable cost – for example, its models are highly complex and costly to run – but is unlikely to make non-complex banks any safer. Other capital requirements, as many as 28 for larger banks, are almost always the binding constraint governing each of these companies. As a result, one more capital standard, the advanced approach, does not ensure added capital for added risk, but rather mandates many calculations that have little to no bearing on how much capital the bank actually has to hold.

This new FedFin paper also highlights how the advanced approach may make financial markets riskier due to increased complexities and reduced risk-management and supervisory resources that can be deployed for unexpected threats. Indeed, the advanced approach could make the U.S. financial market riskier all on its own because of incentives embedded in it that increase the risk of boom-bust credit cycles. Addressing the question of how much systemic risk large regional banks may pose, the paper looks at an array of systemic-risk measures from numerous governmental agencies and finds that large non-complex banks are not likely to raise systemic risk or resolution concerns.

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