FedFin Daily Briefing

Tuesday, September 26, 2023

BIS Analysis Blasts Lax Capital Regs, But We See Study Flaws

A new BIS paper uses confidential data to defend tough regulatory capital charges because bank internal measures of expected loss (EL) are "excessively optimistic." However, this critique in our view is applicable only to internal models. It might be said that standardized-approach charges are also unduly optimistic if based on EL, but the entire Basel construct is intended to cover only EL, with loan-loss reserves, capital-conservation-buffers, the leverage ratio, and stress tests supposed to do the rest. Further, this excessive optimism is measured by the credit-GDP gap and bank profitability, unusual approaches to assessing credit risk given that one is more conventionally seen as a cyclicality measure and the other might reflect astute credit-risk management along with pricing. A wide gap between expected and actual losses is also found at only fifteen percent of surveyed banks, making it still less clear why the proposed remedy is higher capital requirements rather than better supervision. The paper also notes potential data challenges.

Basel Sees Large Bank Capital Improvements, Slight Liquidity Reductions

The Basel Committee today released the results of its monitoring exercise for the second half of 2022, finding that the largest banks' capital ratios increased above pre-pandemic levels while liquidity coverage ratios declined. Under the fully phased-in Basel III framework, the average common equity tier 1 capital ratio increased from 12.5% to 12.7% for Group 1 banks from the first half of 2022 to the end of the year. Group 1 banks also reported regulatory capital shortfalls of $3.42 billion under this framework as of December 31, 2022, all of which was GSIB Tier II capital. Group 1 banks' liquidity coverage ratio under the initial Basel III framework decreased from 138.2% in June 2022 to 132% by the end of last year but remained above pre-pandemic levels. Capital-distribution levels also began to rise.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **GSE-092523:** In her Congressional testimony last week, FedFin managing partner Karen Petrou focused on the unintended consequences wrought by new banking proposal based on their cumulative impact.
- **GSE-092023:** Or maybe it is, but not everyone has heard.
- **LIVINGWILL23:** Although a pending FDIC/FRB proposal imposes a raft of new requirements for resolution plans from IDIs with over $100 billion in assets, the FDIC has also issued a freestanding proposal doing the same, also setting information-filing standards for IDIs below $100 billion but above $50 billion.
- **CAPITAL235:** With HFSC Chairman McHenry (R-NC) leading the way, GOP Members of the panel's Financial Institutions Subcommittee today blasted the banking agencies' end-game proposal (see *Client Report* **CAPITAL234**).

- **LIVINGWILL22:** In conjunction with proposing a new long-term debt (LTD) requirement for categories II, III, and IV banks, the Fed and FDIC are pursuing other ways to enhance resolvability.

- **TLAC9:** Building on an advance notice of proposed rulemaking, the banking agencies have issued several proposals to enhance the resolvability of large banking organizations not covered by stringent GSIB standards.

- **GSE-083123:** As we noted yesterday, the global banking, securities, and insurance regulators who comprise the Financial Stability Board (FSB) are heading back to look again at securitization to see if the post-08 framework it crafted still works.

- **GSIB22:** As anticipated in the wake of recent bank failures, the FRB has proposed a significant revision to the current rules calculating systemic-risk scores that lead to GSIB designation.

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