The Clearing House

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The Honorable Timothy Geithner
Secretary of the Treasury
Chairman, Financial Stability Oversight Council
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

I am pleased to provide you with a copy of The Clearing House Association's newly-released study, entitled *How Much Capital Is Enough? Capital Levels & G-SIB Capital Surcharges*.

For more than a year we have been working with our member banks to empirically study the capital proposals advanced by global and U.S. banking regulators. We trust this study will prove beneficial to you and other members of the Financial Stability Oversight Council in determining the appropriate levels of bank capital necessary for ensuring financial stability while also fostering economic prosperity and job growth.

The Clearing House Association and our members are strongly supportive of robust capital standards for systemically important banks – standards that enhance the quality and amount of loss absorbing capital and promote a level playing field among financial institutions around the globe. However, our findings in this study strongly suggest that, as regulators shift policy toward using capital as a macroprudential tool, there will be significant unintended negative consequences for consumers, market participants, and the global economy that are inconsistent with achieving your objectives. Among the key findings of the study are:

- Since 4Q 2007, U.S. banks have added approximately $200-250 billion in additional Tier 1 common equity and, with Basel III fully phased-in, an additional $300 billion more will be added;
- Relative to pre-crisis levels, banks will hold 100% more capital, or $500-550 billion in common equity, to meet Basel III's common equity capital requirement;
- If the global systemically important bank (G-SIB) surcharge is imposed, these banks will need to raise approximately 20% more capital, or $200 billion beyond those levels required by fully-phased-in Basel III requirements;
- No bank that had a common equity ratio greater than or equal to the Basel III minimum of 7% before the crisis experienced serious distress during the crisis;

- Using the Federal Reserve's adverse stress scenario (March 2011), we found that, if banks began at Basel III's minimum common equity ratio of 7%, the banks on average would only suffer a 0.6 percentage point reduction in their Basel III common equity ratios – well within the 2.5 % buffer included in the Basel III minimums;
- With a G-SIB surcharge, banks are likely to increase the borrowing costs to their customers by 60 basis points (a 15% increase in their net interest margins) or reduce their non-interest expense ratios by almost 11 percentage points (a 19% reduction in expenses); and
- We estimate that the cumulative impact of the Basel III minimum capital requirements and G-SIB surcharges would decrease return on equity (ROE) by up to 4.9 percentage points for most U.S. banks.

Based upon these empirical findings, we urge you to proceed with caution and to take into account both the current and impending financial reforms impacting the U.S. banking industry and the significant steps U.S. banks have taken in increasing their capital reserves, when considering the framework for U.S. implementation. Furthermore, the evidence in our study demonstrating that banks would have endured the crisis had they held the level of capital now required under Basel III (equivalent to on average approximately 12-14% of Basel I levels) strongly suggests that additional capital requirements may serve little benefit at best, and most likely will burden market participants with unnecessary costs. These costs can be expected to dampen prospects for economic and job growth and potentially create additional systemic risks by shifting the credit intermediation function to the shadow banking system.

We would be pleased to discuss this study in greater detail and answer any questions that you or your staff may have in regard to our findings. Along these lines, please do not hesitate to contact me at (212) 649-0138 or Dan McCardell, Senior Vice President and Director of Regulatory Affairs, at (212) 613-0164. Additionally, we look forward to providing you with our studies on liquidity and on the social benefits of large banks within the coming weeks.

Respectfully,

Paul Saltzman

Paul Saltzman
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The Clearing House Association

cc: The Honorable Neal Wolin
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Department of the Treasury

Mr. Lance Auer
Deputy Assistant Secretary
Department of the Treasury

Mr. Mark Patterson
Chief of Staff
Department of the Treasury

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