



**AMERICANS  
FOR FINANCIAL REFORM**  
ACCOUNTABILITY \* FAIRNESS \* SECURITY

**Americans for Financial Reform**  
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August 5, 2011  
Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW.  
Washington, DC 20551

Re: *Capital Plans*, Y; Docket No. R-1425; RIN 7100-AD 77

Dear Ms. Johnson:

American for Financial Reform (“AFR”) appreciates this opportunity to comment on the Proposed Rule regarding Capital Plans. AFR is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial sector. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent economists and other experts.

AFR supports this proposed rule on capital planning, although we have several suggestions for strengthening it below. Many elements of this rule are critical to ensuring the maintenance of sufficient high-quality capital at major U.S. bank holding companies during the long transition to full Basel III enforcement. Certain aspects also provide assurance against the potential weakening of Basel III rules relative to current U.S. supervisory practice. Particularly useful elements of this rule include:

- The basic requirement to plan capital adequacy so as to maintain a 5 percent ratio of Tier 1 common capital even under stressed conditions.
- The definition of Tier 1 common capital in accordance with Federal Reserve supervisory practice in the Comprehensive Capital Analysis and Review (CCAR), as opposed to the Basel definition.
- The limitations on distributions of capital without a specific finding from supervisors that such distributions will not lead to unacceptably low capital levels under stressed conditions at any point within the planning horizon.

If effectively implemented, these basic requirements would make real progress toward addressing some of the issues with capital regulation that occurred prior to the crisis. As the rule points out, in the years prior to the financial crisis many of the large bank holding companies covered by this rule made capital distributions proper consideration of the impact that an economic downturn could have on their capital adequacy. Another lesson of the crisis was that, in the words of the recently retired vice-chair of the Federal Reserve, there is “no substitute for common equity” during tough times.<sup>1</sup> The CCAR Tier 1 capital definition is limited to common equity while the current Basel definition is not.

However, AFR urges the Federal Reserve to strengthen the rule in the following areas.

**Increased capital levels:** The minimum 5 percent tier 1 common ratio under stressed conditions does represent a significant improvement on current Basel requirements. However, the tier 1 common equity ratio for the top 19 bank holding companies in Q4 2008 was 5.4 percent, higher than the required minimum here.<sup>2</sup> It is clear that neither the market nor regulators believed that the 5.4 percent common equity ratio in late 2008 was sufficient. This level of capital still mandated extensive government intervention to support the banking system through loan guarantees and the 2009 SCAP stress testing process. Given the many reasons to believe that the social (as opposed to the private) costs of additional bank capital are limited at most, AFR advises regulators to set higher minimum capital levels.<sup>3</sup>

**Minimum leverage ratios:** In light of the evidence of widespread arbitrage of risk-based capital requirements under Basel II, both the Dodd-Frank Act and Basel III requirements have shifted toward supplementing risk-based capital ratios with pure leverage metrics. The rule does refer to the need for capital planning to maintain at least the minimum regulatory leverage level under stressed conditions. However, regulators should also consider mandating leverage levels that are somewhat higher than the Basel minimums, as has been done with capital ratios here.

**Mandated stress tests:** Both this rule and the recent Federal Reserve guidance on stress testing reflect a fundamental tension in relying on stress testing. On the one hand, it is very difficult for a single mandated stress test to capture all of the possible risks or stress scenarios that a particular bank might be confronted with, or to sufficiently reflect the diversity of bank portfolios. Given this, supervisory guidance so far has leaned toward directing banks to design a wide variety of stress tests tailored to their particular circumstances. (As this rule states, these tests will be supplemented by stress scenarios provided centrally by supervisors).

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<sup>1</sup>Baker, Blair, “[Interview With Donald Kohn](#)”, Risk Magazine, August 16, 2010.

<sup>2</sup> See p. 6 of “[Comprehensive Capital Analysis and Review](#)”, Board of Governors of the Federal Reserve System, March 18, 2011.

<sup>3</sup> See Admati, Anat, R. DeMarzo, Peter M., Hellwig, Martin F. and Pfleiderer, Paul C., “[Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is not Expensive](#)” (March 23, 2011). Rock Center for Corporate Governance at Stanford University Working Paper No. 86.

However, a stress testing regime involving a large variety of bank-designed scenarios has several potential flaws. One is that a large number of stress scenarios with no clear single focus or priority could lead to stress testing becoming a paper exercise, since the results of multiple tests will disagree and offer bank management the capacity to pick a relatively rosy scenario. Another is that bank-designed tests will be too lenient. A third is that a multiplication of stress scenarios across banks will cause regulators to lose the benefits of the “horizontal” view of systemic risk obtained when all major banks test a single scenario simultaneously.

It is clear that the Federal Reserve is sensitive to some of these issues. A very positive element of the recent stress testing guidance is the reference to the need for stress tests to incorporate extreme and unprecedented scenarios and not simply be based on historical experience. However, we hope that supervisors will design a small number of focused stress scenarios based on extreme yet plausible conditions that are administered simultaneously across multiple banks. The enforcement of Section 165 of the Dodd Frank Act could provide a framework for such tests, and they could change over time to reflect shifts in the market.

**Address potential evasion:** While this rule has many positive elements, it covers only large U.S. bank holding companies. We urge the Federal Reserve to act aggressively to prevent evasion of this rule by preventing companies from shifting out of a bank holding company status. This is especially important in light of the evidence that major financial institutions are reorganizing to shed their bank holding company status. For example, Deutsche Bank is maneuvering to eliminate its bank holding company status for its U.S. subsidiary the Taunus Corporation specifically in order to evade new capital requirements.<sup>4</sup>

Where appropriate, we also urge the Federal Reserve to expand this rule or a similar framework to incorporate systemically critical financial institutions that are not bank holding companies once these are designated by the Financial Stability Oversight Committee. Regulators should also carefully monitor major subsidiaries of financial institutions that are not U.S. based but have a large U.S. presence in order to ensure capital adequacy. This seems especially important given that the Tier 1 capital definition in this rule diverges from the Basel definition and that the EU stress tests for parent European banks differ substantially from those performed in the U.S.

Thank you very much for the opportunity to comment on this rule. Should you have further questions, please contact Marcus Stanley, AFR’s policy director, at (202) 466-3672 or [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org).

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<sup>4</sup> David Enrich, Laura Stevens, and Alexandra Berzon, “[Deutsche Maneuvers Around New Law](#),” *Wall Street Journal*, April 13, 2011.

## **Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- A New Way Forward
- AARP
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research

- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

### *Partial list of State and Local Signers*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY

- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI

- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET



