Countercyclical Capital Buffer Issue Summary

The countercyclical capital buffer (CCyB) is a tool that allows the Federal Reserve to raise capital requirements on only the largest banking organizations when it observes heightened risks of a financial crisis. The CCyB is a "macroprudential" policy tool. Macroprudential policy tools can reduce the economic costs of financial crises in two ways: by reducing the odds of a crisis, or by reducing the cost of a crisis if one occurs. The Federal Reserve has argued that the CCyB can increase the resilience of large banks and may moderate the impact on lending in a crisis.

BPI's Position

The CCyB is an unnecessary and counterproductive policy tool. Stress tests, which simulate how banks would fare under a severe economic downturn, already ensure that the largest banks have sufficient capital to deal with financial imbalances during a crisis. For example, the most recent stress test scenario includes declines in equity, house, and commercial real estate prices, and a worsening bond market, that are materially more sudden and severe than actually occurred in the recent financial crisis. Thus, the Fed has already ensured that the largest banks are resilient sufficiently to withstand an unprecedented worsening of market conditions combined with an economic downturn more severe than the great recession. Raising the buffer would very likely mask risk by shifting activity from the banks to which it applies to smaller banks, or less regulated financial institutions, with no meaningful reduction in systemic risk.

Recommendation: Increasing capital requirements by potentially tens of billions of dollars on large banks above what is required under the Comprehensive Capital Analysis and Review (CCAR) would impose significant economic costs that would greatly exceed any potential benefits. There is good evidence to suggest that the CCyB would not effectively moderate financial risks or increase lending.

The Time to Raise CCyB is Not Now

The Federal Reserve Board's regulation implementing the CCyB states that it would only raise the CCyB when financial system vulnerabilities are "meaningfully above normal." As recently as a June 13th press conference Federal Reserve Chairman Jerome Powell said that condition was not being met, instead describing conditions as "moderate." He stated, "I wouldn't look at today's financial stability landscape and say that the risks are meaningfully above normal" and he added that today "banks are highly capitalized, so that's not really a concern."