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Postscript

Much happened between September 2016, when most of this volume was written, and mid-January 2017, when this postscript was completed. For bank-capital reform and stress testing, two recent developments merit particular attention.[1,2]

On November 8, 2016, Donald Trump was elected the next president of the United States. While the specifics of his administration's economic policies have yet to be announced, Trump reiterated his intention to make financial deregulation an important element of his plan to raise economic growth in the United States from its 2016 level of 1.6 percent to a target of 3 to 4 percent.

In a speech in late September 2016, Federal Reserve Governor Daniel Tarullo (2016) outlined the next steps in the evolution of the US stress testing program, including bringing risk-based capital surcharges for global systemically important banks (G-SIBs) into the tests' (baseline) capital hurdle rates.

In this postscript, I discuss the issues tied to these two developments and provide my preliminary reactions.

The Trump Administration and Financial Deregulation

Profiles of the Trump economic plan have emphasized large tax cuts, increased infrastructure spending, sweeping deregulation, and imposition of protectionist trade policies. On banking deregulation, the idea seems to be to "unleash the banks" in order to reduce regulatory compliance costs, increase risk taking, strengthen the role of market forces, and spur loan

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growth. As noted earlier, there has already been a sharp increase in bank equity prices since the election—presumably driven by the expectation that bank profitability will increase on the back of higher interest rates, an increased spread between long- and short-term interest rates, improved trading results linked to higher market volatility, and increased loan demand.

A Banking Industry Wish List

While it is still too early to know what specific proposals will be put forward by the new administration, there has been a lot of speculation on what the banking industry hopes to get in any broad deregulation program.[3] I have therefore put together a representative "wish list" for the industry. If nothing else, it should be informative about what kinds of issues are likely to be on the negotiating table with Democrats in Congress. My list includes the following:[4]

- Appoint individuals with a "light touch" regulatory philosophy to key regulatory positions, including the now vacant vice chair for supervision at the Federal Reserve. As the old saying goes, "People are Policy."
- Increase the threshold in the Dodd-Frank Act for enhanced supervision from $50 billion in total assets for bank holding companies (BHCs) to, say, $250 billion—or even to $500 billion.
- Rewrite Title II of the Dodd-Frank Act and replace the Orderly Liquidation Authority (OLA) with a new Chapter 14 special bankruptcy code (Scott and Taylor 2012). Resist efforts to have the banking industry fund (either ex ante or ex post) debtor-in-possession (DIP) financing.
- Repeal or weaken the Volcker Rule.
- Redesign the Financial Stability Oversight Council (FSOC) and remove its authority to designate large nonbanks as "systemically important."
- Replace the director of the Consumer Financial Protection Bureau (CFPB) with a board of commissioners appointed by the president. Also, narrow the CFPB's mandate and limit its funding.
- Restrict the mandate of the Office of Financial Research and perhaps seek to reduce its budget as well.
- Roll back the Durbin amendment (which limits the fees banks can charge on credit cards).
- Block any reform effort that proposes to increase minimum capital requirements for banks or to elevate the role of the leverage ratio in banking supervision. In this connection, attempt to delay or modify the proposed increases in capital requirements in the trading book;

repeat the Collins amendment and, working with European and Japanese bank supervisors, block the initiative in the Basel Committee on Banking Supervision to put a floor on risk-weighted assets (RWAs) (calculated from banks' internal models); and try to delay or derail the Federal Reserve's proposed incorporation of risk-based G-SIB capital surcharges into the Comprehensive Capital Analysis and Review (CCAR) stress tests.

- Seek to expand the definition of liquid assets in the liquidity coverage ratio, as well as the definition of instruments eligible for the Financial Stability Board's (FSB) total loss-absorbing capacity (TLAC) initiative.
- Reduce the severity in the CCAR stress tests by, among other things, reducing the stressed hurdle rates, reducing the assumed rise in the unemployment rate in the severely adverse scenario, and liberalizing further the treatment of capital distributions.
- Weaken the criteria for approval of living will submissions.
- Seek additional carveouts from regulations on the central clearing of derivatives.
- Seek to weaken mortgage underwriting standards.
- Seek additional regulatory relief for community and regional banks.
- Lower disclosure standards on compensation for senior management.
- Eliminate the Department of Labor's fiduciary duty standard for investment advice.
- Pay less attention to the standards promulgated by international regulatory agencies (e.g., Basel Committee on Banking Supervision, Financial Stability Board), so that priority can be given to US objectives.

A Different Perspective

Not everyone thinks that the Trump administration's policies on financial regulation will amount to an across-the-board rollback of the post-2008 regulatory architecture.[5] Here, it is pointed out that in the election campaign Trump called for breaking up big banks and restoring Glass-Steagall; that at least two of the (alleged) leading candidates for the Fed's vice chair for supervision have in the past proposed a minimum leverage ratio of at least 10 percent; that big banks have already met the final targets for capital and liquidity in Basel III; that drastic regulatory regime switching—only seven years after the Dodd-Frank Act and Basel III—is costly to banks themselves; and finally, that both banks and the Trump administration understand that overdoing it on financial liberalization and deregulation will heighten market anxiety and ultimately raise risk premiums.

In their view, deregulation will be more measured and selective and a matter of trading off deregulation in some areas for higher capital ratios. As noted earlier, House Financial Services Chair Jeb Hensarling's (R-Texas) "Financial Choice Act" would swap elimination of the Volcker Rule and curbing the CFPB's powers (among other deregulation initiatives) for a 10 percent minimum leverage ratio combined with a high (CAMELS) rating by bank supervisors. As explained in chapter 8, I do not see that trade as a good one for financial stability: Hensarling is offering too little in terms of higher capital ratios and asking for too much in deregulation—but others may have different assessments.

Reactions

Speculation—even informed—is not a good substitute for seeing the new administration's detailed financial deregulation proposals themselves. Still, let me offer three cautionary reactions to the initiatives being discussed.

First, the Dodd-Frank Act and other financial reforms that were put in place after the 2007–09 global financial crisis did not come out of thin air. They were enacted because during the run-up to and during that crisis itself, major abuses (e.g., predatory lending), large gaps in regulation (e.g., resolution regimes for systemically important financial institutions, including nonbanks), and significant regulatory deficiencies (capital standards that were way too low) were revealed.[6] It is folly to assume that many of the risks that had such a devastating impact on Main Street less than a decade ago could not reappear if the policies put in place to contain those risks were removed. Thus, while some moderate pruning here and there in light of experience may be justified, a wholesale dismantling of those reforms would be dangerous. It would show that we have learned next to nothing from the worst financial crisis since the Great Depression.

In this connection, it is wise to recall the debate in US policy circles that led up to the 2007–09 crisis. Here, Reinhart and Rogoff (2009, 214) document that many senior officials concluded that risks were extremely low because "this time was different." Defending that view, they offered the following argument: "The United States, with the world's most reliable system of regulation, the most innovative financial system, a strong political system, and the world's largest and most liquid capital markets, was special." We should therefore be wary of claims that new broad-brush deregulation will be "special" and free of the defects that led many earlier financial deregulation initiatives to end in tears (see Reinhart and Rogoff 2009 for the link between deregulation and banking crises in a large sample of earlier banking crises around the world).

Second, if a bank lending boom is the mechanism by which "unleashing the banks" is to lead to much higher US economic growth, one should again consider the risks involved. Chief among them is the risk that the lending boom turns out to be larger and last longer than originally anticipated, that no one in officialdom is prepared to take away the punch bowl in time, and that not enough high-quality bank capital is in place to absorb the large losses.

Parsons (2016) reports that US bank lending growth eventually reverts to the mean when the industry's loan balances grow more than twice as fast as GDP. He reports that over the 1984–2016 period, bank loan growth averaged about 1.7 times GNP growth. But during 2003–07, loan growth jumped to 3.4 times GNP growth. And when this loan growth reverted to the mean with a vengeance soon after that, the sharp deceleration in loan growth brought a major crisis with it. When bank loan growth accelerates into double digits and stays there for an extended period, credit quality deteriorates, usually with dire consequences.[7] As emphasized in chapter 3, the leading early warning model of banking crises is a dual threshold one that forecasts a banking crisis when the ratio of credit to the private sector and real property prices simultaneously reach certain thresholds relative to their trend lines (e.g., Borio and Drehmann 2009). According to recent BIS (2016a) figures (for the second quarter of 2016), US credit ratios and real property prices are not yet near the danger zone—but that would of course change if unleashing the banks led to a large and sustained credit boom.[8] Moreover, higher bank profitability would not necessarily be a guarantee against a capital shortage if deregulation also meant that banks were free to distribute most of their higher retained earnings in the form of higher dividend payments and increased share buybacks. In that case, the numerator of the capital ratio would likely be growing more slowly than the denominator and, sooner or later, the market would notice.

Third, let me reiterate a point made frequently in this volume: What happens in the banking sector reflects to a large degree what is happening elsewhere in the macroeconomy. Here, it is relevant to take note of another key element of the Trump economic program—namely, a large fiscal stimulus. Many would argue that the US economy is already close to full employment. While the sorry state of US infrastructure and very low long-term interest rates make it attractive to expand public investment in infrastructure, combining that with a large tax cut is likely to put increased pressure on the Federal Reserve to increase interest rates at a faster pace than they would otherwise. And that rise in interest rates will in turn almost surely result in a higher dollar, a larger trade deficit, and larger capital inflows.

If this increase in capital inflows to the US economy is large and persistent, it too could increase vulnerability to a banking crisis. Listen to what

former Federal Reserve Chair Ben Bernanke (2010, 25) had to say about the relationship between capital inflows and crisis vulnerability in the run-up to the 2007–09 crisis:

> ...whatever complex story we wind up telling about this crisis, clearly part of it was the fact that a lot of capital flowed into the industrial countries. The United States, of course, had a current-account deficit of about 6 percent of GDP, corresponding to large capital inflows, which would not be a problem if we had invested and managed that money appropriately. But evidently we were not able to do that. Our financial regulatory system, financial private-sector, and risk management mechanisms were overwhelmed and did not do a good job. As a result, there is a close association, I think, between capital inflows and the financial regulatory system.... [T]here's a clear parallel to literally dozens of crises that we've seen previously. We were too smug. We saw this happening in emerging markets. We said it wouldn't happen in the United States, but a very similar pattern existed here as existed in other countries.

Bernanke's (2010) conclusion about the link between banking crises and large capital inflows is supported by Reinhart and Rogoff's (2009) examination of the association between the two in 66 country cases over the 1960–2007 period. In short, they find that the probability of a country experiencing a banking crisis is higher when it also experiences large capital inflows (what the authors call "capital flow bonanzas").

Summing up, within say the next three or four months, we will get a clearer picture of the scope and structure of the Trump administration's financial deregulation plan, as well as its ideas on minimum capital requirements for banks. And if the administration does decide to go ahead with sweeping deregulation and a freeze on further increases in bank-capital requirements, we will see four years or so later the results of that experiment. Based on the evidence presented in this book and on the cautionary notes raised in this chapter, I fear that the outcome will not be one that makes America great again.

Next Steps for the US Stress Tests

Proposed Changes

After the 2015 stress testing cycle, the Federal Reserve conducted a review of its stress-testing program, including input from bank officials, debt and equity-side market analysts, public interest groups, and academics. In his speech on September 26, Tarullo (2016) announced the broad outlines of how the CCAR stress testing exercise is likely to be altered. From the perspective of this volume, five such proposed changes are most relevant.

First, the existing schedule of G-SIB risk-based capital surcharges will be included in the CCAR's baseline capital hurdle rates. He did not say that existing G-SIB surcharges would also be included for the leverage ratio.

Second, the existing (2.5 percent of RWA) capital conservation buffer (CCB) will be replaced by a firm-specific stress capital buffer (SCB). The SCB will be set equal to the decline in the BHC's common equity tier 1 (CET1) ratio during the severely adverse scenario. If that decline exceeds 2.5 percent of RWA, the actual decline will be used; if the decline is less than 2.5 percent, the SCB will be 2.5 percent—in order to avoid a decline in the severity of the test. To illustrate how the baseline hurdle rate would change, Tarullo (2016) offers the following example. Suppose that the decline in a BHC's CET1 ratio under the severely adverse scenario is 5 percent,[9] and that it is subject to a risk-based G-SIB surcharge of 3 percent. Then its baseline CET1 capital hurdle under the new procedures would be 12.5 percent—the sum of a 4.5 percent basic CET1 minimum, a 5 percent SCB charge, and a 3 percent G-SIB surcharge.[10]

Third, the treatment of planned dividends and share repurchases will be changed. Under the existing CCAR, the maintained assumption is that the BHC would implement its planned dividends and share repurchases over the two-year planning horizon regardless of the amount of stress the bank is under. Since capital distributions drain capital, assuming instead that the BHC suspends capital distributions or reduces them from planned levels under stress will produce a higher poststress capital ratio, thereby decreasing the severity of the test. Under the new CCAR procedures, the Fed will assume that the BHC will maintain its dividends for one year while reducing its share repurchases. This new treatment of capital distributions will also replace the existing "soft limit" on dividend payouts under which the Fed has closely scrutinized planned dividend payout ratios of more than 30 percent.

Fourth, after considering suggestions for improving the treatment of contagion and amplification mechanisms and for improving interactions between the banking and shadow banking sectors, the Fed will intensify its research in this direction and work toward including funding shocks and fire-sale dynamics in some future scenarios. That said, the Fed also concludes (Tarullo 2016, 5) that "to this point, even the most conceptually promising of the ideas are a good ways from being realized in specific and well-supported elements of our economic models." Going farther, Tarullo (2016) explains that modeling the knock-on effects of first-round losses in the financial system depends on the vulnerabilities and responses of other (nonbank) major actors in the financial system—including many that the Fed does not regulate—and that information on the latter's behavior may not be observable either to those firms or to the Fed.

And fifth, the Fed is proposing that banks with less than $250 billion in total assets and without significant international or nonbank activity would no longer be included in the qualitative part of the CCAR tests. Instead, these BHCs' progress on risk management and capital planning would be evaluated through the normal supervisory process, supplemented with horizontal reviews of discrete aspects of capital planning. This proposal would be implemented in 2017; in contrast, the other proposals summarized above would not be implemented before 2018.

Reactions

My preliminary reactions to the Fed's revised stress testing program can be summarized as follows.[11]

Incorporation of the G-SIB risk-based surcharges into the CCAR tests is a welcome step forward, as it will increase the minimum risk-weighted CET1 ratio for G-SIBs. That said, I can give it only one thumb up because there is no indication in the Tarullo (2016) speech that the Fed is yet prepared to incorporate the leverage-based G-SIB surcharge into the CCAR, and because treatment of the minimum leverage ratio is more important than the minimums for the risk-based capital measures.

On replacement of the capital conservation buffer with the new stress capital buffer, I agree with the Fed that the previous coexistence of dividend restrictions in the CCB and in the CCAR was prone to inconsistency and that the establishment of the SCB removes it. In addition, because there is a floor of 2.5 percent of RWA in the SCB and because the likely average size of the SCB appears to be about 5 percent, the introduction of the SCB into the CCAR should raise the minimum baseline hurdle rate for CET1 capital. Since the decline in the CET1 ratio in the severely adverse scenario differs across BHCs, the SCB also introduces more risk differentiation (across banks) into the tests—generally a good thing. However, basing the SCB exclusively on the capital decline in the severely adverse scenario increases the risk that the test may miss other important risks. In a recent review of the Fed's stress tests, the Government Accountability Office (GAO 2016, iii) concluded that "while there are advantages to using one scenario—including simplicity and transparency—many different types of financial crises are possible, and the single selected scenario does not reflect a fuller range of possible outcomes."[12] It was partly because of this single-scenario risk that the plan outlined in chapter 7 includes a firm-specific risk surcharge based on a set of indicators. In other words, I think the SCB would work better if it were supplemented by other firm-specific risk factors not currently captured in the severely adverse scenario.

The proposed more lenient treatment of capital distributions in the CCAR is a retrograde step. As Tarullo (2016) acknowledges and as emphasized in chapters 4 and 7, large US banks—including those that received assistance under the Troubled Asset Relief Program (TARP)—made large dividend payments during the 2007–09 crisis, depleting capital that was sorely needed (see Stein 2016). There is no assurance that in a future severe crisis, those banks would not wish to do so again—or that the Federal Reserve will have the requisite determination to say no to those requests. As such, I see no point in allowing banks to get, by assumption in the CCAR tests, a treatment of dividends that does not accord with their (less than responsible) behavior in crises.

Moreover, switching to a more lenient treatment on capital distributions dilutes the increase in (risk-based) capital requirements derived from incorporation of G-SIB surcharges and from substitution of the SCB for the CCB. Indeed, Tarullo (2016, 7) explains that, for the eight US G-SIBs, the new assumptions on capital distributions (in concert with a slightly more lenient treatment of balance sheet assumptions) would forfeit less than half of the capital increases owing to the G-SIB surcharges and the SCB. In a context in which capital ratios held by G-SIBs—inclusive of the new CCAR proposals—would still be way below their optimal levels, making concessions on capital distribution assumptions is unwarranted.

On the integration of contagion and amplification effects into the modeling of crises, the Fed's conclusion that existing approaches are not yet ready for prime time (in the CCAR tests) is, at least to my taste, too pessimistic. To be sure, and as acknowledged in chapters 2 and 3, this is a formidable analytical challenge. Yes, incorporating stronger contagion and amplification effects before they are fully refined carries risk of model error. But *not* incorporating these effects—which were proven to be so potent during the 2007–09 global crisis—also carries risks of model error. In short, the risks of underdoing it may well be larger than doing it imperfectly.

Finally, eliminating the qualitative part of the CCAR tests for BHCs with less than $250 billion in total assets (and without significant international or nonbank activity) is ill advised. In explaining the rationale for this decision, Tarullo (2016, 3) observes that officials from these smaller CCAR participants complained that:

> CCAR qualitative assessment was unduly burdensome because it created pressure to develop complex processes, extensive documentation, and sophisticated stress test models that mirrored those in use at the largest, most complex firms, in order to avoid the possibility of a public objection to their capital plan.[13]

The question is: Can these concerns of the smaller BHCs be addressed without having them drop out of the qualitative part of the CCAR tests? I think they can. The Fed has on many occasions indicated that it sets lower risk-management standards for smaller, less complex BHCs than for the largest, most complex ones. Maybe the problem is one of communication. In this regard, the GAO (2016, i) concluded in its review of the qualitative part of the CCAR that "The Federal Reserve…has not disclosed information needed to fully understand its assessment approach or the reasons for decisions to object to a company's capital plan." If the (lower) standards expected of smaller CCAR participants were better explained, these firms would not feel that they had to mirror the costlier risk management practices of the larger test takers. I am afraid what will be lost by dropping the qualitative test for these smaller firms is the incentive for improvement provided by potential "public" objection to their capital plans in the CCAR; this public spotlight of the CCAR has no analogue in what Tarullo (2016, 6) calls "the normal supervisory process." Remember too that these "smaller" CCAR participants all have at least $50 billion in total assets, and that BHCs in the $50 billion to $250 billion asset class are hardly free of systemic risk.

To sum up, the Federal Reserve's new set of proposals for the CCAR stress tests represents at best a mixed bag. The de facto increase in risk-based capital requirements for G-SIBs—especially those with the largest G-SIB surcharges—is welcome. The switch to a more lenient treatment of capital distributions is not. The most disappointing aspect of the new approach to the CCAR is what is *not* being recommended. The Fed does not propose integrating the existing G-SIB surcharges for the leverage ratio into the CCAR, nor does it propose increasing the size of these surcharges. In fact, because there is no proposed SCB mechanism or surcharge integration for the leverage ratio and because of the proposed easing of the capital distribution assumption, the de facto hurdle rate for the leverage ratio in the CCAR will actually be *lower* than before. With an (estimated) gap of roughly 800 basis points between the actual leverage ratio for G-SIBs and the optimal ratio, such a setback is precisely the opposite of what is needed.

If the broad Trump financial deregulation initiative (discussed above) is actually implemented, there is also a risk that the administration would abandon or delay the Fed's plans to incorporate G-SIB surcharges into the test and to replace the CCB with the SCB but simultaneously go ahead with plans to ease the capital distribution assumptions and exempt smaller CCAR-participating BHCs from the qualitative part of the tests. In my view, this would amount to a serious setback to the US bank stress testing program.

Taking a broader and longer-term view post–2007–09 crisis, the Fed has been moving in the right direction on capital standards for the largest banks. But when it comes to minimum leverage ratios—the most important of the bank-capital metrics—it is making progress at a snail's pace. Pardon the urgency, but if US regulators and supervisors are going to get minimum leverage ratios within shouting distance of their socially optimal levels, I (at 72 years old) admit to having a preference for getting it done while I am still above ground.

Endnotes

1. It is also worth mentioning several market developments that took place during the last quarter of 2016. The Standard and Poor's 500 bank index for the United States gained 22 percent since Trump's election, while the Euro Stoxx banks index registered a 26 percent gain in the fourth quarter of 2016 and an even larger 40 percent gain from its low in the weeks after June's Brexit referendum in the United Kingdom (see Eric Platt, "Ascent of Trump Caps an Exceptionally Testing Year Marked by Wide Asset Price Fluctuations," *Financial Times*, December 31, 2016). Deutsche Bank's share price has climbed over 50 percent since September 2016. The latest (December 2016) EMED Consensus Survey forecasts US and euro area (real GDP) growth in 2017 at 2.2 and 1.5 percent, respectively, and 2017 consumer price inflation at 2.3 and 1.3 percent, respectively. Note that in 2016, euro area consumer price inflation was only 0.2 percent, so deflation risk there has fallen considerably. In Italy, the ECB recently informed Italian officials that the capital shortfall for Monte dei Paschi di Siena (MPS) had increased to 8.8 billion euros (up substantially from the estimate in the July 2016 EU-wide stress test). After attempts to fill the MPS shortfall with private funds failed, the Italian government pushed through legislation for a 20 billion euro bank recapitalization fund, of which about 6.5 billion euros are expected to be used for MPS. The size of haircuts for MPS debtholders—in line with the provisions of the EU Bank Recovery and Resolution Directive—is not yet final, but retail holders of junior bonds are expected to be compensated because of alleged mis-selling (see James Politi, "Rome Attacks ECB Over 'Rigid' Approach to Monte dei Paschi," *Financial Times*, December 30, 2016).

2. In November 2016 the Federal Reserve Bank of Minneapolis (2016) released the initial draft of its plan (the Minneapolis Plan) to end "too big to fail" at the largest US banks. In brief, the plan has four steps: (1) a minimum risk-weighted capital ratio of 23 percent of risk-weighted assets (that is, a minimum 15 percent leverage ratio) for all US bank holding companies (BHCs) with total assets of $250 billion or more; (2) an additional capital requirement equal to 5 percent of risk-weighted assets each year after the five-year transition to step 1 for those BHCs deemed "systemically significant" by the US Treasury secretary—until either they are no longer systemically important or their capital reaches a maximum of 38 percent of risk-weighted assets; (3) a financing-cost equalization tax equal to 120 basis points on shadow banks with more than $50 billion in assets (so as to prevent large-scale migration to the shadow banking system); and (4) a commitment to reform the supervisory regime for community banks to make it simpler and less burdensome.

   Although the Minneapolis Plan concludes that the optimal leverage ratio is 15 percent for banks with more than $250 billion in assets—close to the 16 percent optimal leverage ratio for G-SIBs proposed in chapter 7 of this volume—I have doubts about several of the study's findings and recommendations. Cline (2017) argues that the Minneapolis Plan significantly overestimates the optimal leverage ratio because it greatly underestimates the probability of banking crises at the lower end of the capital ratio spectrum. I am also skeptical of the implicit assumption that the Japanese banking crisis of the 1990s and the Korean banking crisis of 1997, both of which drive much of the results on optimal leverage ratios for systemically important banks (SIBs), are good reference points for expected losses in a future US banking crisis; instead, as explained in chapter 4, I find the US banking crisis of 2007–09 a much better comparator. Finally, I worry that the intended deleveraging induced by such large differences in proposed minimum leverage ratios across the three groups of banks (38 percent for SIBs, 15 percent for banks with

more than $250 billion in assets, and 4 percent for all other banks)—will be a recipe for a huge fire sale of assets if implemented over a relatively short period. Such discontinuities in minimum leverage ratios across different groups of banks do not exist under my plan: Recall that they are 10 percent for smaller banks, 11 to 13 percent for non-G-SIB large banks, and 14 to 18 percent for G-SIBs. Also, the transition period under my plan is 10 years, not five. I am grateful to Bill Cline for helpful discussions on the pros and cons of the Minneapolis Plan.

In December 2016, the Board of Governors of the Federal Reserve System (2016c) issued its final rule on TLAC and eligible long-term debt for US G-SIBs. In brief, this final rule is likely to result in an all-in (inclusive of regulatory buffers) risk-based TLAC requirement of 21.5 to 23.0 percent of RWA for the eight US G-SIBs, with JPMorgan Chase and Citigroup at the high end of this range and State Street and Bank of New York Mellon at the low end; see Davis Polk and Wardwell (2017). The all-in TLAC leverage ratio requirement will be 9.5 percent of total leverage exposure. The risk-based requirement for external long-term debt will be 6 percent of RWA plus applicable regulatory surcharges (that is, about one-third the size of the external TLAC minimum); the leverage-based requirement for long-term debt will be 4.5 percent of total leverage exposure (that is, one-half the size of the TLAC leverage ratio requirement). The Fed estimated that implementation of the TLAC initiative would result in a rise in G-SIB lending rates of between 1 and 6 basis points—an increase it regards as too small to meaningfully affect the level of real US GDP. The Fed also decided on a more rapid phase-in of TLAC than outlined in the international (FSB) TLAC proposal. US G-SIBs have to comply with the US final TLAC rule by January 1, 2019. Since the final US TLAC rule is so similar to the international TLAC rule discussed in chapter 8, the comments I offered on the international version also apply to the US version.

3. See, for example, William Cohan, "Why Wall Street Is Suddenly in Love with Trump," *Politico*, November 14, 2016; Steven Solomon, "Conflicts Exist, but Financial Overhaul Proposals Have Merit," *New York Times*, November 23, 2016; "Small Banks Cheer Trump's Victory. So, After a Pause, Do Big Ones," *New York Times*, November 23, 2016; and Ben Mcannahan and Barney Jopson, "What Wall Street Wants," *Financial Times*, January 12, 2017.

4. I put aside here the question of whether Senate Republicans will have the votes necessary to repeal the Dodd-Frank Act.

5. See, for example, Adam Creighton and Ryan Tracy, "Donald Trump Might Be Bad News for Banks After All," *Wall Street Journal*, December 26, 2016.

6. Departing US Treasury Secretary Jacob Lew (2016) recently offered a comprehensive and spirited defense of the Wall Street reforms enacted over the past eight years.

7. Lee and Rose (2010) report that annual growth of US bank loans and leases was in double digits continuously throughout the 2004–07 period. In 2016, bank loans and leases grew by 6½ percent (Board of Governors of the Federal Reserve System, Assets and Liabilities of Commercial Banks in the United States). It is not clear in Parsons (2016) which series on US bank loan growth he is using for his analysis.

8. The Bank for International Settlements (BIS 2016a) credit-to-GDP gap figures define credit as total credit to the private, nonfinancial sector. This means that it includes both bank credit and credit from shadow banks.

9. In the 2016 CCAR, the average decline in the CET1 ratio under the severely adverse scenario was 5.1 percent (see Board of Governors 2016a).

10. This example also assumes that the countercyclical capital buffer (CCL) is not active during this period. If it were active, this could add as much as 2.5 percent to the baseline hurdle rate.

11. I say "preliminary" because not all the relevant details of the revised approach have been published.

12. Although the CCAR tests contain two stressed scenarios—adverse and severely adverse—the second is basically a more extreme version of the first. While the Federal Reserve was, on the whole, quite receptive to the recommendations of the Government Accountability Office (GAO 2016), it pushed back on the criticism of the single scenario, arguing that "promulgating and evaluating more scenarios would increase the burden on the banks participating in the exercise and the Federal Reserve" (GAO 2016, 110).

13. Tarullo (2016, 6) also notes that the smaller BHCs have already met supervisory expectations on their capital planning and risk management processes and could continue their progress through the normal supervisory process.