Press Release

New Oxford Economics Study Confirms Negative Impact of Increased Bank Capital Levels on U.S. Economic and Job Growth

- *Study Projects Range of Losses in GDP, Jobs Due to New Capital and Liquidity Regulations*
- *Oxford Economics research finds that official studies underestimate GDP impact*
- *TCH urges policymakers to carefully examine economic and employment tradeoffs as they consider further increases to bank capital levels*

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New York – April 10, 2013 – The Clearing House Association (TCH) today released a study by Oxford Economics that reaffirms the expert consensus that increased capital and liquidity requirements on banks will have a negative impact on U.S. economic growth and future employment.

The study analyzed five of the most prominently and frequently cited capital cost studies using the *Oxford Global Economic Model* – the most widely used commercial international economic forecasting and scenario model in the world. The results demonstrated that while there is a wide range of conclusions on the *severity* of the impact of increased capital and liquidity requirements, *all* the studies conclude that there will be an economic and job cost to the U.S. economy.

"Our study's findings clearly demonstrate the need for any regulatory program to be carefully structured to avoid any unintended consequences to economic growth and employment," said Adam Slater, Senior Economist at Oxford Economics.

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Oxford reviewed the potential effects of bank capital and liquidity regulation in five key studies – the IMF study of Elliot et al. (2012), the study by the IIF (2011), the OECD study of Slovik & Cournede (2011), the BIS/MAG studies (2011), and the Bank of England study of Miles et al. (2011). Four of these studies were considered 'official' efforts (i.e. from international regulatory and financial organizations) while the IIF study was from an organization representing global financial institutions.

When reviewing the studies, Oxford identified three key factors by which regulations could impact bank behavior and the economy:

- increased capital levels that push up the cost of bank credit (bank lending rates);
- requirements to hold more liquid assets, which may also raise the cost of bank credit; and
- shrinking of risk-weighted assets (RWA) by banks to try to meet higher minimum capital ratios, which could lead to a rationing of the quantity of credit, or increase the cost of credit, as other credit providers could require higher rates to hold the assets.

In its own separate analysis of the data, Oxford sought to improve upon the assumptions of prior studies to better align them to the economic and regulatory reality in the United States.

Oxford estimated that a 'worse case' scenario of higher capital requirements could lead to a drop in GDP of 2% with a real dollar cost of $300 billion and a loss of one million jobs over nine years.

It also noted that if the phase-in period should be shortened, the decline in GDP would be significantly greater and the cushioning effects of any accommodative monetary policy on lending rates and GDP would be relatively smaller. In the 'worst case' scenario with this shorter transition period, GDP would be 1.5% ($230 billion) lower and unemployment would increase by 800,000 after just four years. Increasing capital levels beyond Basel III levels could result in more significant GDP declines and the loss of up to 1.7 million jobs over nine years.

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The study also finds that there is a risk that the cost of enhanced capital regulations could be higher still if banks reduce risk-weighted assets – rather than raise fresh capital – to try to meet higher minimum regulatory capital ratios. The study concludes that, under such an approach, a 3% increase in the required capital ratio would reduce GDP by over 2%. Moreover, while this risk has been overlooked by some prior studies, there is evidence that banks in the Eurozone have reacted to regulatory pressures by cutting risk-weighted assets, and stress tests organized by the European Banking Authority have attempted to prevent this outcome.

To conduct its analysis, the Oxford study used the Oxford Global Economics Model which is used by more than 100 clients, including central banks, institutional organizations, and multinational companies to study future macro-economic effects of policy. Additionally, it employs a loan pricing model to assess effects of variables on bank lending rates, which is a model that is commonly used across academia to conduct similar evaluations of the effects of capital regulation. In order to achieve more accurate results than previous studies, this study refines a variety of assumptions driving earlier academic research so as to better reflect real economic conditions. Some of those assumptions include cost of equity, cost of debt, credit spreads, administration costs, baseline capital levels, size of capital buffers, size of liquidity requirements, and length of transitional period for phase-in.

“The Clearing House supports enhanced levels of bank capital to strengthen bank balance sheets. However, the Oxford study conclusively demonstrates that maintaining higher levels of capital does come with an economic cost,” said Paul Saltzman, President and General Counsel of The Clearing House Association. “While we agree that banks need to hold greater levels of loss absorbency than were held during the financial crisis, at some point the additional benefit from new capital diminishes and is outweighed by the cost to the economy. We urge policymakers to carefully consider the economic and employment tradeoffs as they debate further increases to bank capital levels.”

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About Oxford Economics: Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college to provide economic forecasting and modelling. It is now one of the world's foremost independent global advisory firms, providing reports, forecasts. and analytical tools on 190 countries, 100 industrial sectors, and over 2,600 cities. Its global economic and industry models and analytical tools give Oxford Economics an unparalleled ability to forecast external market trends and assess their economic, social, and business impact.

The Oxford Global Model The key framework in which Oxford Economics' analysis is conducted is its Global Economic Model, which is the most widely used commercial international forecasting and scenario model, and is widely used to quantify the impact of developments such as changes in banking regulation, the fall in the dollar, the credit crunch and fiscal consolidation programs.

The model covers 46 economies in detail (including the most important emerging markets), with each country's model containing a large system of equations. The model is also used to feed forecasts for a further 140 or so countries. The country models are fully interlinked via trade, prices, exchange rates and interest rates. In addition, the model includes a bloc of world variables such as oil and commodity prices, world GDP, and industrial production.
This framework provides a rigorous and consistent structure for forecasting, and allows the implications of alternative scenarios and policy developments to be readily analyzed at both the global and UK level.
www.oxfordeconomics.com

About The Clearing House Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ more than two million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs, and white papers – the interests of its owner banks on a variety of systemically important banking issues. The Clearing House Payments Company L.L.C. provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-

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Studies analyzed:

- D. Elliott, S. Salloy & A.O. Santos 'Assessing the Cost of Financial Regulation' IMF Working Paper WP/12/233 (2012)
- Institute for International Finance 'The Cumulative Impact on the Global Economy of Changes in the Financial Regulatory Framework' (2011)
- Macroeconomic Assessment Group (MAG) 'Assessing the Macro-Economic Impact of the Transition to Stronger Capital and Liquidity Requirements' Basel: Bank of International Settlements (2010)
- D.Miles, J.Yang and G.Marcheggiano 'Optimal Bank Capital' External MPC Unit Discussion Papers No.31, revised and expanded version (2011)
- P.Slovik and B.Cournede 'Macroeconomic Impact of Basel III' OECD Economics Department Working Papers, 844 (2011)