Megabanks Scheme to Undermine New Capital Rules

By Alexa Philo

Instead of having his most talented employees figuring out how to better serve customers or allocate credit to the real economy, Jamie Dimon has his best and brightest scheming how to evade tougher rules on bank capital that regulators are writing to make the financial system safer.

In fact, it's a point of pride for the JPMorgan Chase CEO, something that, he boasts, distinguishes the largest bank in the United States – $3.67 trillion in assets – from others.

"We've got our smartest people figuring out every angle to reduce capital requirements for JPMorgan," Dimon said on the bank's first-quarter earnings call. "That's the difference."

The Federal Reserve is currently preparing new capital rules as part of the "Basel Endgame," the final phase of an international accord negotiated in that Swiss city that will apply to the nation's largest banks. And Fed Vice Chair for Supervision Michael Barr has announced a "holistic review" of capital rules, which could address damage done by his Trump-appointed predecessor, Randal Quarles. People and businesses need a more stable financial system to thrive, but banks don't like them because they can cut into profits and compensation for senior executives.

Early this year, American megabanks stepped up their lobbying campaign, aided by Republican lawmakers, to get the Fed to go easy on them. The collapse of Silicon Valley Bank has sufficiently transformed the atmosphere around banking regulation that they are now expecting tougher capital rules, though their pushback continues. So, they are also scheming over how to lessen the impact.

Using the Shadow Banks

To start, they are cribbing ideas from the shadow banks, while they simultaneously complain about the lower levels of regulation these entities face. And contrary to Dimon's boasting, they're all doing it.

Wall Street's megabanks often oppose tougher capital rules by citing the rapid growth of shadow banking, which includes, among others, private equity, hedge funds, and asset managers. None of these entities, bankers like to point out, face capital rules similar to banks. Striking a righteous tone about being well-regulated, traditional banks often invoke the shadow sector to argue that financial activity will migrate further into this sector if bank regulation is too tough.

"What keeps me up at night is the quantity and quality of activity in the shadow banking industry," Citigroup CEO Jane Fraser told analysts on a first-quarter earnings call. "It does not benefit from the same regulatory frameworks and protections."

Not Only JPMorgan Chase

And yet, megabanks are eager to use the shadow banking sector to game the rules. Dimon cited securitizations, the process by which loans are packaged into securities and then sold to investors, many of whom are hedge funds and asset managers. By transferring risk through securitization, a bank can reduce the amount of capital a bank must hold against the loans. He even seemed to make an explicit reference to how private equity firms use this trick at insurance companies they own. "I expect that we're going to come up with a whole bunch of different things over time," he said.

U.S. Bancorp CEO Andrew Cecere spoke on his earnings call about "credit transfers, risk transfers, a number of things to optimize the balance sheet that I think we ought to be focused on." In banker jargon, it's the same point Dimon is making.

Rather than buy this race-to-the-bottom argument, regulators should raise standards across the board by intensifying oversight of the shadow-banking sector. The Treasury Department took a useful step in this direction recently, and there is much more that must be done so we have consistent set of rules and regulators for like products, irrespective of the type of financial institution.

Capital or Buybacks?

Bank capital is not, as big bank lobbyists like to claim, money that is locked away that cannot be used for lending. Banks raise it by selling shares of stock or retaining earnings. Raising capital requirements limits money banks have for buying back shares or granting dividends, which puts downward pressure on share prices, which are often linked to executive pay. Despite their rhetoric, Wall Street lobbyists are defending high compensation for bank executives and payouts to shareholders, not lending to businesses and households.

The bank CEOs gave away the game with quarterly calls that were intensively focused on how they were balancing the need to retain earnings (to increase capital) versus distributing it to shareholders (via buybacks or dividends). What they *definitely did not discuss* was using that

money to increase lending to Main Street. Their allegiance to shareholders lies far ahead of their role in maintaining customers' access to credit.

"We feel good – very good – about our capital and you should expect us to continue to follow the idea to pay the dividend ... and buyback shares," Brian Moynihan, Bank of America's CEO, said on his earnings call.

Lending to the Real Economy

Dimon said JPMorgan is "penciling in" $12 billion in buybacks this year alone.

But they are quick to blame pending capital requirements for any credit squeeze that may come about, even though the Basel Endgame, designed to respond to the 2008 crisis, has been in the works for years. "It is the capital requirements which will increase for the large banks exacerbating any credit tightening going on," Fraser asserted, echoing the bank lobby's usual line.

Instead of planning multi-billion-dollar buybacks, banks should be reinforcing their commitment to maintain a strong capital base and access to credit for customers at a time when it is most needed – in the face of a possible economic downturn. But, seen clearly *in their own words*, that's not what they're doing. The Fed and other regulators need to act forcefully to finalize new, strong capital rules. Banks aren't acting in the public interest, but the regulators can, and must.