Kevin Dowd Submission to CP 2/2020

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CP2/20
Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

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Dear PRA,

**Response to Consultation Paper CP2/20 on
Capital Requirements and Macroprudential Buffers**

I am a professor of finance and economics at Durham University, and I am a co-founder and contributor to the Eumaeus blog, http://eumaeus.org/wordp/.

My first impression about CP 2/20 is one of overwhelming bafflement. The PRA has a statutory duty to consult when proposing new rules, but there is also an implied obligation to consult clearly and intelligibly.

It is one thing for the Regulatory 'Will' to be inscrutable, but it is quite another when that Will becomes inscrutable to the point of unintelligible. CP 2/20 reads as if it could have been written by Hegel on an off day.

As far as I can ascertain, the natural reading would seem to be either (a) to keep the banking system's loss-absorbing capacity unchanged, or (b) to reduce capital requirements. Note that these are not the same thing.

If (a) then why does the PRA see any need to issue CP 2/20 at all? The PRA could have done nothing and banks' loss-absorbency would have remained as it was, at least on paper using the PRA's own regulatory capital measures. Whether the PRA's regulatory capital measures are the ones it should be using is another matter.

If (b), then I would say that reducing capital requirements is a truly terrible idea, and especially at a time such as the present when the UK banking system is chronically under-capitalised already.

Please don't even think about it.

I would like to suggest an alternative proposal.

Set all buffers to exactly zero percent. Keep them there forever. Announce as much. Raise capital requirements to a much higher level, say, 20 percent in terms of market cap to total assets. Ban divs, buybacks and bonus payments to risk-takers until banks meet the new minimum.

And that's it.

Simple, clear and effective, and does away with the micro tinkering.

The underlying principle is that regulators should do no more than set key parameters to ensure that banks are highly capitalised and leave market participants free to take whatever risks they wish to take.

Under no circumstances should regulators take it upon themselves to forecast the risks facing the economy or presume to suggest how market participants should do so.

I recognise that the proposal for a 20 percent minimum market cap to total assets ratio might be controversial in some circles. However, what should not be controversial is the pointlessness and futility of the current overly complex system, the latest proposed tweaking of which poses a task so daunting to regulators that they seem unable to explain their own proposals to people who are expert navigators in this most arcane regulatory area.

Sincerely

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