The Systemic Risk Council

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File Number S7-08-12 (Proposed Rule Re: Capital, Margin & Segregation)

Dear Commission:

While we commend the Securities and Exchange Commission for raising the minimum capital required for the very largest broker-dealers that use the alternative net capital requirements, we remain concerned that the Commission (and other federal financial regulators) continues to allow large, complex financial institutions to use their own internal risk models to set their minimum regulatory capital. As the Systemic Risk Council\(^1\) recently noted:

> While we commend the financial agencies for seeking public comment on important rules that raise the overall level of capital required for large, complex financial institutions, we have strong concerns about regulators’ continued willingness to allow these giant institutions to use their own internal risk models to lower their minimum required regulatory capital.

Not only do models routinely fail in a crisis (precisely when we need loss absorbing shareholder equity most) -- their use for regulatory capital purposes can create perverse incentives for risk management and real competitive advantages for larger firms relative to smaller firms doing the same activity.

Minimum risk-based capital requirements should be just that: a minimum. If internal models identify additional risks that require higher capital, firms should be required to raise more equity. Management, boards, examiners, investors and counterparties deserve an objective and clear minimum risk-based capital baseline.

To get the necessary capital in place quickly, the SRC has encouraged the regulators to prioritize getting new higher standards in place for large, internationally active institutions, while at the same time strengthening limits against leverage.

\(^1\) Systemic Risk Council: The independent non-partisan Systemic Risk Council was formed by CFA Institute and the Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk. The statements, documents and recommendations of the private sector, volunteer Council do not necessarily represent the views of the supporting organizations. The Council works collaboratively to seek agreement on all recommendations. This letter fairly reflects the consensus views of the Council, but does not bind individual members.
It is important for the U.S. to exercise global leadership. Strong capital requirements are a competitive strength, not weakness, and essential to system stability.

We thank you for the opportunity to comment and strongly encourage the SEC to revisit its use of models for setting minimum capital requirements.

Respectfully submitted,

Sheila Bair, The Pew Charitable Trusts, Former Chair of the FDIC

The Systemic Risk Council
www.systemicriskcouncil.org

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