The Effects of Risk Based Capital Requirement on Credit Allocations in the US

In response to the subprime mortgage crisis that hit the US in 2008, regulators passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law includes an increase in risk-based capital requirement (RBC). It requires that banks hold a minimum amount of liquid asset as a cushion against banks' risky assets. Regulators use RBC as a threshold to measure a bank's safety and soundness.

RBC influences banks' capital management that affects credit allocation. This paper explores several questions: 1) To meet the RBC requirement, do banks choose to raise their equity or adjust the compositions of their portfolio? 2) Is the effect different among banks of different size? 3) What kind of loans are most and least affected by portfolio adjustment? 4) In giving out loans, do banks prefer high-risk-high-return loans or are they risk averse?

To test the effect, I will examine five types of loans: 1) individual loans 2) real estate loans for household 3) real estate loans for property managers 4) commercial and industrial loans 4) Treasury holding. Data on US banks from 2003 to 2013 will be used to estimate the effect.