Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

March 17, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 1309, the "Systemic Risk Designation Improvement Act of 2015."[1] This legislation would make major deregulatory changes in Dodd-Frank directives concerning the oversight of some of the largest banks in the country. It would make it harder for regulators to take action to manage dangers to financial stability, and make it easier for individual large banks to use special pleading to escape from oversight.

HR 1309 would affect the regulation of large regional bank holding companies (BHCs). Large regional banks played a major role in the 2008 financial crisis. Congress appropriately responded by instructing prudential regulators to increase the oversight of these institutions. HR 1309 would effectively eliminate this mandate and replace it with an unprecedented requirement for bank holding companies to be individually designated by the Financial Stability Oversight Council (FSOC) as a precondition for increased oversight by their primary regulator. Decisions would be further constrained by requiring the FSOC to follow standards approved by the Financial Stability Board, an advisory body made up of international regulators, in making their decisions regarding risks to the U.S. financial system. Never before have U.S. financial regulators been subordinated to an international body in this way.

This cumbersome process would greatly delay and complicate the application of increased prudential standards to some of the largest banks in the country. It goes far beyond the narrow changes that some regulators have suggested regarding Federal Reserve discretion in Title I of Dodd-Frank. In fact, the changes in HR 1309 go far enough that they could call into question the general oversight authority of banking regulators, which far pre-dates the Dodd Frank Act.

Large Regional Banks, the Financial Crisis, and Systemic Risk

Large regional banks include about two dozen BHCs with over $50 billion in assets that are not among the eight major Wall Street banks classified as Global Systemically Important Banks (G-SIBs). These banks collectively hold $3.7 trillion in assets, or 21 percent of all the assets of the U.S. banking system.[2] Their individual sizes range from about $55 billion to almost $400 billion

[1] Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] These estimates are based on the latest FFIEC and FDIC data available as of the beginning of 2015. All BHCs that are under Federal Reserve supervision and are not classified as non-bank SIFIs (e.g. are not primarily insurance companies or thrift holding companies) were counted in the analysis, as were all BHC assets.

in assets. They are among the largest one-half of one percent of American banks, and all are at least ten times the size of the typical community bank which has under $5 billion in assets.[3]

Large regional banks played a significant role in the 2008 financial crisis. The failure of large regional BHCs like Washington Mutual, Wachovia, Countrywide, and Golden West placed a major burden on the financial system during 2007 and 2008. These banks were also among the major subprime mortgage lenders in the years leading up to the crisis, contributing to the bubble in housing prices and the proliferation of "toxic assets" that set the stage for the financial system's collapse. Many of those large regional banks that did not fail took substantial Federal assistance. Large BHCs with over $50 billion in assets received twice as much TARP capital assistance per dollar of assets as did banks with below $50 billion in assets.[4]

It is true that no single large regional bank is generally considered "too big to fail." But the failure of such a bank still presents significant risks to taxpayers and the financial system. Even a single large regional bank typically holds more FDIC-insured deposits than could be reimbursed by the entire FDIC deposit insurance fund.[5] Thus its failure creates potentially significant taxpayer exposure. It is difficult to manage even the failure of a moderate-sized bank using the conventional resolution methods used in the failure of a small community bank. For example, at the time of its failure during the financial crisis Indymac bank had only about $30 billion in assets, below the $50 billion line in Title I. However, Indymac's failure cost the Deposit Insurance Fund almost $11 billion in losses.[6]

Because the failure of a large regional bank poses such a threat of taxpayer loss, regulators seeking to manage such a failure are under great pressure to rapidly sell the bank's assets to a still larger bank. Such acquisitions increase the concentration in the banking system and also threaten financial stability by potentially creating losses for the acquiring bank. For example, during the financial crisis Bank of America acquired most of the assets of the failing Countrywide, increasing Bank of America's size, creating tens of billions of dollars in additional losses to the bank, and increasing stress on this too-big-to-fail bank.

In addition to difficulties in resolution, the failure of a large regional bank at a time of economic stress might trigger the failure of other banks and broader economic harm. As Federal Reserve Governor Daniel Tarullo stated in a May, 2014 speech[7]:

> "If a number of these [large regional] banks simultaneously came under pressure or failed, a harmful contraction of credit availability in significant regions or sectors of the economy could ensue."

---

[3] As of the close of 2013, over 99.7% of banks classified as 'community banks' by the FDIC held below $5 billion in assets. Only 15 out of 6,310 FDIC-classified community banks had over $5 billion in assets.

[4] See data on p. 91 in Government Accountability Office, "Government Support for Bank Holding Companies: Statutory Changes To Limit Future Support Are Not Yet Fully Implemented", GAO-14-18, November 2013.

[5] For example, PNC Financial Services holds $324 billion in FDIC-insured assets, while the entire FDIC deposit insurance fund holds about $50 billion. Zions Bank alone, the smallest of the large regionals, holds $53 billion in FDIC-insured assets, roughly equivalent to the entire FDIC deposit insurance fund.

[6] See Office of the Inspector General, Department of the Treasury, "Safety and Soundness: Material Loss Review of Indymac Bank", OIG-09-032, February 26, 2009.

[7] Tarullo, Daniel, "Rethinking the Aims of Prudential Regulation", May 8, 2014

HR 1309 and the Regulation of Large Regional Bank Holding Companies

In Title I of the Dodd-Frank Act Congress responded to the financial crisis experience by demanding improved oversight of large regional banks. The Title I framework requires the Federal Reserve, as the primary regulator of bank holding companies, to create a strong regime of risk controls for all BHCs over $50 billion, including increased loss-absorbing capital, stress testing, and exposure limits.[8] However, the Fed was granted very broad discretion in designing these controls and was specifically instructed to tailor the application of prudential standards according to the size and complexity of each bank.

The Federal Reserve has followed this directive and has scaled its prudential requirements to bank size and complexity. For example, additional capital requirements under the "supplementary leverage ratio" apply only to banks over $250 billion, and the toughest capital and risk management rules apply only to eight of the largest and most complex U.S. banks designated as Global Systemically Important Banks (G-SIBs). Likewise, the full rules for liquidity risk management apply only to banks with over $250 billion in assets. However, certain stress testing, risk exposure, and simplified liquidity risk management rules apply to all banks with over $50 billion in assets.

HR 1309 would drastically modify this regime by stating that the Financial Stability Oversight Council (FSOC) must individually designate a large regional bank as "systemically significant" before the new tailored prudential standards imposed under the Dodd-Frank Act would apply to that bank. This designation requires a two-thirds majority of ten voting members of the FSOC. Furthermore, the FSOC may only make such a designation using the specific quantitative indicators established by international regulators on the Financial Stability Board to designate the largest systemically significant banks at the global level.

This requirement is unprecedented. Never before have independent banking regulators been required to seek the approval of a supermajority of ten other U.S. regulators in order to exercise their prudential oversight over a bank. Likewise, U.S. financial regulators have never before faced a statutory requirement that effectively subordinated them to an unaccountable body of international regulators in order to make judgments regarding risks to the U.S. financial system. These unprecedented new requirements could raise questions regarding even traditional Federal Reserve authority as the primary regulator of bank holding companies - authority that pre-dates the financial crisis and the Dodd-Frank Act by many years. While HR 1309 does not modify this authority in a technical sense, the fact that Congress has acted to subordinate the Federal Reserve's ability to act in the Dodd-Frank context to both a council of other U.S. regulators and to international regulatory bodies would raise difficult interpretive questions for the courts.

The requirement to use an FSOC designation process for each individual bank would also be likely to create enormous delays in the application of prudential standards to large regional banks. In almost five years since its creation, the FSOC has only designated four major non-bank entities as systemically significant. It took several years for the FSOC even to designate entities

---

[8] Title I also mandates the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to require some form of resolution planning for large regional banks in case of bank failure.

that received large-scale assistance during the financial crisis, such as AIG and GE Capital. The FSOC has established an involved 10-step process for entity designation which allows multiple opportunities for appeal, and designated entities may also challenge an FSOC designation in the courts. A requirement for FSOC designation prior to enhanced prudential oversight under Dodd-Frank would multiply litigation and red tape prior to even time-sensitive agency action.

In sum, HR 1309 would hamper prudential oversight of some of the largest banks in the country, and drastically alter the Dodd Frank Act. With the financial crisis still casting a shadow on the nation's economy, regulators would have a harder time taking action to deal with systemic risks. HR 1309 would impose unprecedented new requirements that would subordinate U.S. financial regulators to unaccountable foreign regulatory bodies. We therefore urge you to reject this legislation.

Thank you for your consideration. For more information please contact AFR's Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform