November 28, 2016

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to H.R. 6392, the "Systemic Risk Designation Improvement Act of 2016."[1] Far from improving systemic risk regulation, this legislation increases the likelihood of big bank failures that could put at risk the economic security of millions of families. It puts unprecedented new constraints on the ability of the Federal Reserve to provide basic oversight of large bank holding companies, including provisions that grant an unaccountable council of international regulators statutory powers over U.S. regulatory decisions. It would also politicize bank regulatory decisions, granting the Treasury Secretary of the incoming Administration new powers to pick and choose which big banks must follow basic safety rules.

HR 6392 affects oversight of 27 large bank holding companies (BHCs), which each hold over $50 billion in assets but are not among the eight U.S. global mega-banks. These banks, while smaller than the very largest Wall Street mega-banks, are still are among the largest one-half of one percent of all banks in the U.S. – enormously larger than community banks. Collectively, they hold over $4 trillion in assets, around a quarter of all banking system assets. Over sixty percent of deposits in the state of Ohio and over half of deposits in the state of Pennsylvania are held by large regional banks deregulated by this legislation. Should these banks become insolvent, there could be major economic impacts on regions that depend on them.

Large regional banks of a similar size to those affected by this bill played a major role in the 2008 financial crisis. Banks such as Countrywide, Washington Mutual, Wachovia, and Indymac were all significant participants in the housing bubble, and all of them failed during the 2007-2008 period. Their failures placed major stress on the financial system.

Congress appropriately responded to the failure of regulatory oversight for these large banks by demanding that regulators do a better job at controlling the consolidated risks of large bank holding companies. H.R. 6392 would eliminate the requirement that the Federal Reserve improve its oversight of these large BHCs. It would also limit Federal Reserve authority over large banks in a manner that is completely unprecedented since the passage of the Bank Holding Company Act in 1956. The legislation requires that BHCs be individually designated through a two-thirds vote of the Financial Stability Oversight Council (FSOC), a council of ten different regulators chaired by the Treasury Secretary, before the Federal Reserve can impose basic elements of safety and soundness regulation. In performing these designations, the legislation requires that the FSOC must follow the standards established by an unaccountable body of

[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/

international regulators, the Basel Committee on Banking Supervision, instead of making their own judgements concerning risks to the financial system.

The designation process mandated in this bill would create almost insurmountable barriers to consolidated prudential regulation of some of the largest banks in the country. It goes far beyond the narrow technical changes that some regulators have suggested regarding Federal Reserve discretion in Title I of Dodd-Frank. In fact, the changes in HR 6392 are so extreme that they would call into question regulatory oversight powers that long pre-date Dodd Frank, creating a negative inference concerning traditional Federal Reserve regulatory authorities.

Large Regional Banks, the Financial Crisis, and Systemic Risk

The large regional banks affected by this legislation include 27 BHCs that have over $50 billion in assets but are not designated among the eight major Wall Street banks classified as Global Systemically Important Banks (G-SIBs). The affected banks collectively hold over $4 trillion in assets. They are among the 35 largest banks out of 6,800 total banks in the U.S.

Large regional banks played a significant role in the 2008 financial crisis. Large regional BHCs like Washington Mutual, Wachovia, and Countrywide were 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. For example, in the year 2006, Countrywide, holding less than $200 billion in assets, originated 17 percent of all the mortgage lending in the U.S.[2] All of these large regional banks failed during 2007-2008 period. The need to manage these multiple bank failures involving over $1 trillion in total assets placed an unprecedented burden on the financial system. Many large regional banks that did not fail took substantial Federal assistance. Large BHCs with more than $50 billion in assets received twice as much TARP capital assistance per dollar of assets as smaller banks did.[3]

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.[4] Thus its failure could create significant taxpayer exposure. It can be difficult to manage even the failure of a moderate-sized bank using 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

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[2] Freeman, Willoe and Wells, Peter Alfred and Wyatt, Anne, "Insights from the Failure of the Countrywide Financial Corporation," March 14, 2013.

[3] 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.

[4] For example, PNC Financial Services holds over $320 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 some $53 billion in FDIC-insured assets, roughly equivalent to the entire FDIC deposit insurance fund.

Insurance Fund almost $11 billion in losses.[5] Because the failure of a large regional bank poses such a threat of taxpayer loss, regulators faced with 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.

In addition to difficulties in resolution, the failure of a large regional bank at a time of economic stress would likely trigger broader economic harm. As Federal Reserve Governor Daniel Tarullo stated in a May 2014 speech[6]:

> "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."

The leading role of these banks in particular regions means that their failure could have a devastating effect on local economies. For example, over sixty percent of deposits in the state of Ohio are held by large regional banks that would be deregulated by this legislation. About half of all deposits in the state of Pennsylvania are held by large regional banks.

H.R. 6392 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. Title I 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.[7] However, the Fed was granted broad discretion in designing these controls. The Dodd-Frank Act specifically instructs the Federal Reserve to tailor the application of prudential standards depending on the size of the institutions involved and their activities. The Federal Reserve is required to make such standards stronger than those applied to community banks, but standards must also be scaled according to the size of the bank.

The Federal Reserve has followed this directive and has scaled its prudential requirements to bank size and complexity. For example, additional leverage capital requirements 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

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[5] 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.
[6] Tarullo, Daniel, "Rethinking the Aims of Prudential Regulation", May 8, 2014
[7] 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.

$250 billion in assets, and in a recent proposed rule the Federal Reserve has committed to relaxing a number of quantitative stress test requirements for banks under $250 billion.[8]

H.R. 6392 would eliminate the Congressional mandate to strengthen rules for large regional banks and instead drastically weaken Federal Reserve oversight authority by requiring that the Financial Stability Oversight Council (FSOC) must individually designate a large regional bank as ”systemically significant” before various prudential standards could apply to that bank. Such designation requires a two-thirds majority of ten voting members of the FSOC. Furthermore, the legislation mandates that the FSOC may only make such a designation if a bank passes specific metrics established by international regulators on the Basel Committee to designate global systemically significant banks – metrics designed to designate the largest global banks, not large regional banks critical to local U.S. economies.

The decisions of primary banking regulators regarding prudential oversight have never before been subject to the kind of external vetoes that this legislation would impose. Never before have primary banking regulators been forced to gain a supermajority of other financial regulators in making basic safety and soundness decisions. Never before have U.S. financial regulators been subordinated by statute to international regulators in the way this legislation proposes to do. Many in Congress have been critical even of the advisory role of international bodies in providing recommendations on financial regulatory standards; it is remarkable that Congress would now consider granting these unprecedented powers to such a body.

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 decades. In a purely technical sense, H.R. 6392 does not modify this pre-existing authority. But if Congress acts to prevent the Federal Reserve from imposing a range of prudential requirements without approval from a council of other U.S. regulators, this would raise difficult interpretive questions for the courts. The HR 6392 requirements would almost certainly lead to lawsuits if the Federal Reserve attempted to exercise similar oversight using pre-Dodd Frank authorities.

The requirement to use an FSOC designation process for each individual bank would multiply litigation and red tape prior to even time-sensitive agency action. Mandating that the FSOC must pick and choose which large banks will be subject to full safety and soundness regulation would also politicize bank regulation, and would be an invitation to backroom lobbying by each bank that might be designated.

In sum, H.R. 6392 would dramatically restrict prudential oversight of some of the largest banks in the country. We strongly urge you to reject it. For more information please contact AFR’s Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672.

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[8] Federal Reserve Board, “Amendments to the Capital Plan and Stress Test Rules”, Federal Register, Volume 81, Number 190, September 30, 2016.