Americans for Financial Reform

THE TRUMP TREASURY AND THE BIG BANK AGENDA

EXECUTIVE SUMMARY

The Trump Administration's Treasury Department recently released recommendations on changes to the regulation of the nation's largest banks. These recommendations closely track the requests made by The Clearing House, the major trade association for big banks:

- The Treasury report calls for deregulatory actions in seventeen of the twenty broad areas of prudential oversight where The Clearing House advocates for deregulation.

- The Treasury calls for action on thirty-one out of forty specific requests for risk deregulation by the Clearing House.

- Both the Clearing House and the Treasury recommend a comprehensive, across-the board reduction in post-financial crisis limits on bank risks, with no compensating increase in oversight in any area.

The Treasury report insists that sweeping bank deregulation is vital to economic growth. But the facts do not support this claim:

- Bank lending has grown rapidly since the passage of new post-crisis financial regulations. Over the five years from 2011-2016, real annual growth rates in commercial bank lending have substantially exceeded historical averages.

- Spurred by low interest rates, capital markets are also booming. For example, corporate bond issuance set new volume records every year from 2011 to 2016.

In fact, significant weakening of Wall Street risk controls poses major economic risks.

- Analyses of key risk controls such as capital requirements indicates that they are already weaker than what would be necessary to assure that the disastrous events of the 2008 financial crisis are not repeated.

- Yet the Treasury Department follows lobbyist recommendations to weaken big bank regulations in every major area, from capital requirements to the Volcker Rule.

- The Treasury Department also recommends moving the U.S. prudential oversight regime closer to the failed model of European banking regulation, even though the European banking system is dangerously unstable.

Most of the Treasury Department's recommendations can be executed without Congressional action. However, implementing them will require action by independent bank regulatory agencies, often through notice and comment rulemaking. This means that there are still opportunities for the public to oppose the full implementation of the big bank agenda.

The Trump Treasury and the Big Bank Agenda

In formulating its recommendations for addressing financial regulations imposed in response to the worst financial crisis since the Great Depression, the Trump Administration has followed the instructions of the nation's largest banks – the very banks at the heart of the crisis.

As this report documents, the Treasury Department's proposals closely track the changes advocated by The Clearing House, a trade association dominated by giant U.S. and international financial institutions such as Wells Fargo, JPMorgan Chase Deutsche Bank, and Bank of America.[1] In their submission to the Treasury Department, The Clearing House lays out a detailed list of desired regulatory and legislative changes to post-crisis regulations imposed to protect the safety of the banking system.[2] The attached Appendix table compares the detailed list of changes requested in The Clearing House report to the final Treasury recommendations. In almost every case the Treasury recommendation follows the lead of the big banks.

As the Appendix documents, the Treasury Department suggests deregulatory action in seventeen of the twenty broad areas where deregulation is recommended by the big banks. It fully or partially follows the Clearing House recommendation in thirty-one out of forty specific cases. This includes weakening every one of the key risk protections put on the major Wall Street banks after the financial crisis, from capital requirements to the Volcker Rule.

While the report does not propose completely eliminating any such protection – in part because this would often require Congressional action – in every case it directs regulators to weaken the protection. These regulatory steps can generally be taken through administrative action. In no case does the Treasury recommend strengthening any Wall Street regulation to compensate for the across-the-board weakening of rules proposed in the report.

Such a comprehensive weakening of systemic risk protections significantly increases risks to the financial system and the economy. For the reasons laid out below, the big bank agenda is unnecessary to help the economy and in fact poses grave economic risks.

Big Bank Deregulation – A "Solution" In Search of a Problem

Our economy faces various challenges, but none of them call for weakening the regulation of our largest banks. Since the passage of the Dodd-Frank Act and the implementation of new rules governing big banks, bank lending has grown at a healthy clip. As shown by the chart below, soon after Dodd-Frank passage in 2010 loan growth resumed after the disruption created by the 2008 financial crisis, and has continued to grow steadily.

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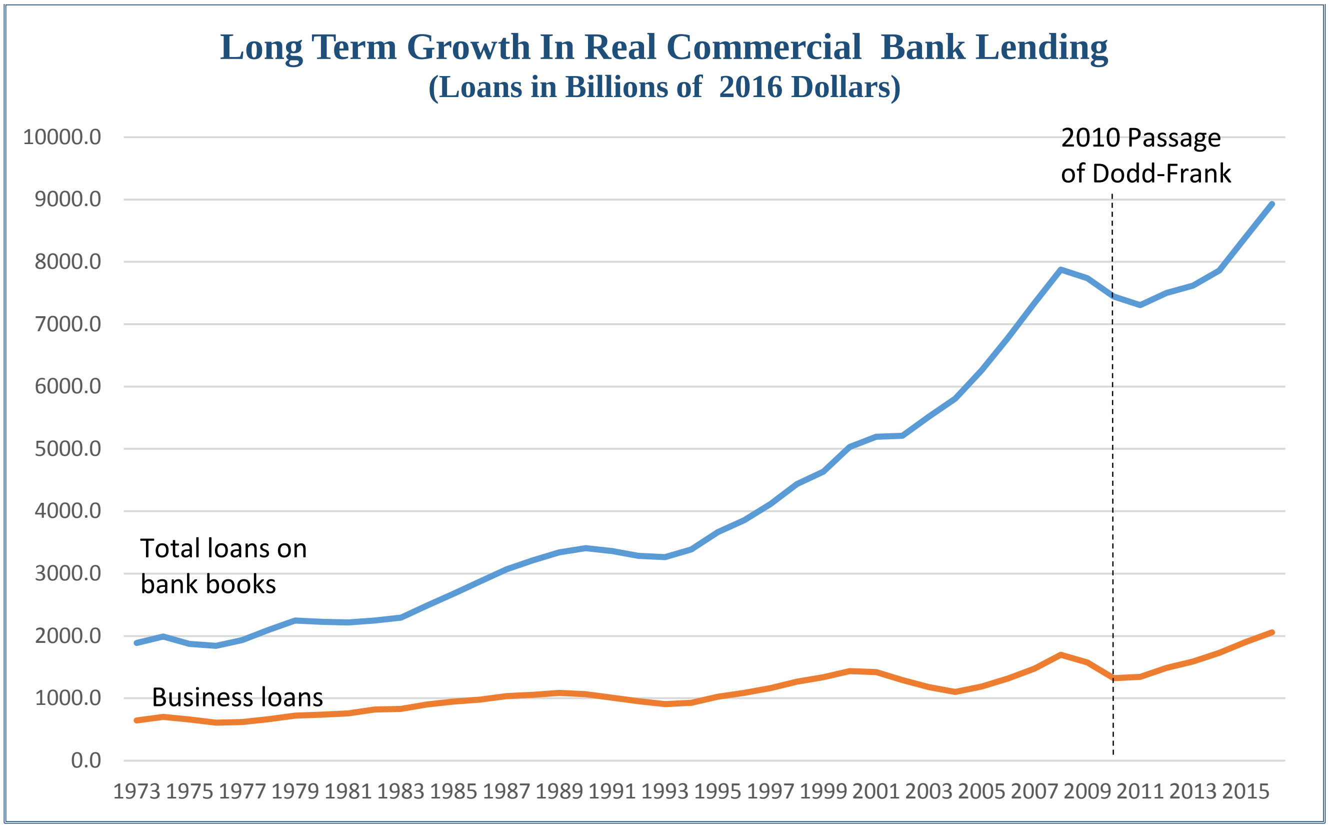
[1] United States Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions,* June 12, 2017. See https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf. Referred to in this document as the "Treasury Report"

[2] The Clearing House, *TCH Submission to UST Re Core Principles Study*, Washington, DC, May 7, 2017. See https://www.theclearinghouse.org/~/media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Submission_to_UST_re_Core_Principles_Study.pdf. This list of detailed policy requests is referred to in this report as the "big bank agenda."



SOURCE: Federal Reserve Release H-8, AFR Calculations

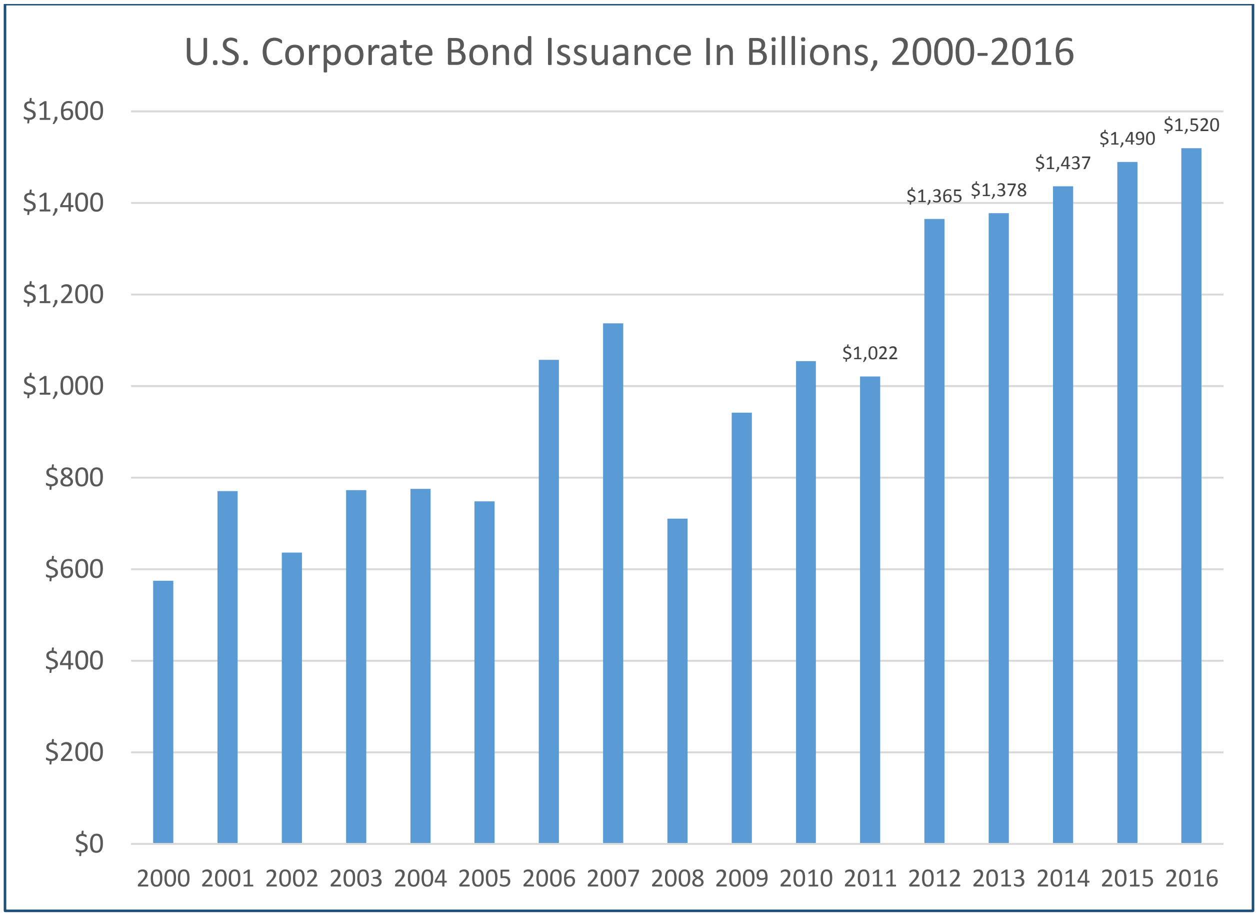
Loan growth today is not as fast as the unsustainable and unhealthy pace of loan growth set in the years immediately before the financial crisis. But it is faster than historical averages. From 2011-2016, inflation-adjusted bank lending has grown at 4.1% annually, faster than the economy as a whole and faster than the long-term average since 1973. Commercial and industrial lending (business loans) by banks have grown even faster, at a remarkable 8.9% annual rate, much faster than the historical average.

PERIOD	**REAL ANNUAL GROWTH RATES IN BANK LENDING**	
	TOTAL	BUSINESS LENDING
Historical Average: 1973-2016	3.7%	2.7%
Pre Financial Crisis: 2003-2008	7.4%	7.6%
Post Dodd-Frank: 2011-2016	4.1%	8.9%

SOURCE: Federal Reserve Release H-8, AFR calculations.

Current lending growth has slowed in comparison with the 2003-2008 period immediately prior to the financial crisis, but that level of lending growth was unsustainable and contributed directly to the 2008 collapse. Bank lending today is growing faster than typical rates over the past four decades.

Claims that financial regulations have crippled credit availability through capital markets are also refuted by the facts. Spurred by low interest rates, U.S. corporate bond issuance set new volume records each year between 2012 and 2016, and is on track to do so again in 2017. Other metrics of bond market health, such as trading volumes and costs, are also strong, with trading volumes reaching new heights and trading costs dropping to record lows.[3]



SOURCE: SIFMA

[3] Adrian, Tobias, Michael Fleming, Or Shachar, and Erik Vogt, "Market Liquidity After the Financial Crisis", Federal Reserve Bank of New York Staff Reports No. 796, October, 2016. See https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr796.pdf?la=en

The Big Bank Agenda Endangers The Economy

The 2008 financial crisis caused over $10 trillion in economic losses in the U.S. alone, cost millions of jobs, and led to millions of American families losing their homes.[4] The big bank agenda calls for significantly weakening almost every restraint on megabank risk-taking put in place in response to that crisis. Most of the steps called for by the big banks can be done through seemingly technical changes in regulations, without Congressional action. While these changes may seem technical, they can have a profound impact on financial stability.

One example is the key area of risky borrowing practices by the big banks. Excessive borrowing, or leverage, allows big banks to multiply their profits in good times – but often means that they will be unable to pay back their debts when bad times come. That's exactly what happened in the financial crisis, when big banks borrowed as much as forty dollars for every dollar of hard capital their owners contributed. When the financial crisis hit, Wall Street megabanks couldn't pay back their borrowed money and turned to the taxpayer for a bailout.

Since the crisis, regulators have required the largest banks to raise additional investor capital to avoid a similar crash. Facing Wall Street opposition every step of the way, regulators have already settled for levels of additional capital that outside observers think are dangerously low:

- Minimum capital levels required for big banks are less than the losses they incurred in the 2008 financial crisis, meaning that banks could not survive similar losses in the future without taxpayer assistance.[5]

- Minimum capital requirements at big banks are lower than even regulators' own estimates of what it would take to survive a future financial crisis without a bailout.[6]

- Minimum capital levels at big banks are lower than the optimal levels called for by experts such as Thomas Hoenig, the current Republican Vice-Chair of the FDIC and

[4] Americans for Financial Reform, *The Costs of the Crisis*, July 2015. Available at http://ourfinancialsecurity.org/wp-content/uploads/2012/09/CostCrisis2015July-Long-1.pdf

[5] See discussion of the calibration of total loss absorbing capacity (TLAC) in Federal Reserve Board of Governors, "Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements", Final Rule, Federal Reserve System 12 CFR 252, Federal Register Volume 82, Number 14, January 24, 2017; available at https://www.federalregister.gov/documents/2017/01/24/2017-00431/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically. See also Strah, Scott, Jennifer Hynes and Sanders Shaffer, "The Impact of the Recent Crisis On The Capital Positions of Large Financial Institutions", Working Paper, Federal Reserve Bank of Boston, July 16, 2013. Available at https://www.bostonfed.org/-/media/Documents/bankinfo/capital-positions/capital-positions-large-financial-institutions.pdf .

[6] Cline, William R. *The Right Balance For Banks,* Peterson Institute Policy Analyses In International Economics 107, June 2017. Passmore, Wayne and Alexander Haften, "Are Basel's Capital Surcharges Too Small?", FEDS Notes, February 27, 2017. Available at ttps://www.federalreserve.gov/econresdata/notes/feds-notes/2017/are-basels-capital-surcharges-for-global-systemically-important-banks-too-small-20170223.html

former President of the Kansas City Federal Reserve, by the staff of the Minnesota Federal Reserve, and others.[7]

In part due to the manifestly low minimum capital requirements, they have been supplemented by a range of other risk protections imposed on the largest banks. These include the following.

1. Stress tests are a process by which regulators attempt to ensure that banks have adequate resources to remain solvent through an economic downturn, by predicting bank losses under economic stress. Regulators currently require large banks to conduct annual stress tests and to reserve additional capital (in excess of minimum levels) if they fail the test.

2. Liquidity requirements mandate that banks hold ready cash or liquid securities available to pay unexpected bills, as the failure to meet such demands can trigger bank failure.

3. Long term debt requirements enhance banks Total Loss Absorbency (TLAC) by requiring banks to issue long-term bonds that can safely be written down in the event of a bank failure without triggering financial panic.

4. Living will requirements oblige large banks to annually submit a plan for how they will resolve themselves in a conventional bankruptcy, without creating significant economic disruption. The living will process requires banks to plan for having cash (liquidity) available to maintain crucial operations while going through bankruptcy.

5. The Volcker Rule is an activity restriction that requires banks to focus their trading and capital markets activities on customer service, not hedge-fund like speculation. Unlike other rules that are focused on increasing loss absorbency, the Volcker Rule is directed toward changing the business model of large Wall Street banks to make it both safer and more focused on productively serving the real economy.

The big bank agenda calls for significantly weakening *every one* of these multiple levels of big bank regulation. The Clearing House document recommends lowering minimum capital requirements, undermining the effectiveness of stress tests, reducing holdings of liquid assets, loosening requirements to issue long-term debt, relaxing living will requirements, and permitting a greater range of risky speculative activities under the Volcker Rule. For good measure, the trade group also asks regulators to weaken limits on interconnections between big banks and reverse supervisory efforts to restrict high-risk "leveraged loans" used in corporate buyouts.

Calls for weakening each regulation are often couched in technical terms, and rarely ask for the regulation to be eliminated completely. In part this is because the complete elimination of many of these regulations would call for statutory changes in the Dodd-Frank law that might be

[7] Minneapolis Federal Reserve, *The Minneapolis Plan To End Too Big to Fail*, November 16, 2016. Available at https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-2016.pdf?la=en

difficult to pass in Congress. But weakening the regulation can easily be accomplished by regulators acting independently to change their calculations or practices.

For example, the big bank lobbyists criticize the calculation methods regulators used to set almost every quantitative detail of their regulations, including minimum risk-based and leverage capital requirements for the largest banks, models used to test bank risks in stress tests, long-term debt requirements, and standards for both the liquidity needed in normal operations and liquidity necessary to fund a conventional bankruptcy. They claim that in every case these calculations overestimate risks to banks and ask regulators to "recalibrate" standards based on more bank-friendly assumptions.

Such systematic across-the-board lowering of standards effectively subjects the post-crisis regulatory protections to a "death by a thousand cuts".

The Big Bank Agenda Calls for The U.S. To Move Closer to the Failed Model of European Banking Regulation

The European banking system was even more damaged by the 2008 financial crisis and subsequent events than the U.S. banking system was. European regulators did not act as forcefully as U.S. regulators to strengthen oversight of their banks, because European banks were in a weaker position and were far more vulnerable to the European sovereign debt crisis that followed the global financial crisis. Today the European banking system is far weaker than the U.S. system, with banks less profitable and much greater fears of a potential banking crisis.[8]

But despite the relative success of U.S. regulators compared to European ones, big bank lobbyists are calling for the U.S. to increase dependence on European banking regulators and to follow Europe's lead in weakening bank oversight.

This occurs in several ways. First, they call for the U.S. to weaken or eliminate standards that were set at a higher level than global regulatory minimums.[9] But these minimums were set at a lower level than the U.S. desired, in order to accommodate European regulators who did not want to stress their weaker banking system.

Second, they ask U.S. regulators to weaken prudential standards for so-called "Foreign Banking Organizations" (FBOs), including European banks active in the U.S. such as Barclays, Deutsche Bank, and UBS, and instead placing greater reliance on home country European regulators of these banks. Since FBOs account for some twenty percent of U.S. banking activity, this is a major change. Indeed, European banks are so important to the U.S. banking system substantial

[8] The Economist, "American Banks Have Recovered Well, Many European Banks Much Less So", Economist Special Report, May 6, 2017; available at http://www.economist.com/news/special-report/21721502-most-european-banks-were-slow-mark-after-crisis-american-banks-have-recovered ; https://www.ft.com/content/c8cbe6c2-5aed-11e6-9f70-badea1b336d4

[9] See The Clearing House recommendations regarding the supplementary leverage ratio, the G-SIB surcharge, TLAC, and liquidity coverage ratios.

amounts of the emergency assistance provided in 2008-2010 by the Federal Reserve and U.S. taxpayers flowed to these foreign banks.[10]

Combined, these steps would be a significant move toward lowering U.S. regulatory oversight toward the global "lowest common denominator", specifically the weaker level of bank regulation that has led to the current precarious state of European banking.

The Trump Administration Is Adopting the Big Bank Agenda Almost Completely

Examining the report released by the Trump Administration's Treasury Department this week shows that the Administration is following the lead of the big banks and adopting almost every element of their agenda.

The attached appendix table cross-walks the specific prudential regulatory recommendations made by The Clearing House with the recommendations made by the Treasury Department in their report on the regulation of banks.[11] The table demonstrates that the Treasury Department takes deregulatory action in 17 out of 20 of the broad areas recommended by the big bank lobby, and fully accommodates some three quarters of the specific requests made by the industry.

Most importantly, the Treasury report closely follows the central elements of big bank recommendations. Like the Clearing House report, the Treasury proposes that regulators lower both leverage and risk-based capital minimums for big banks, weaken the stress testing process, permit a greater range of risky activities under the Volcker Rule, allow banks to reduce liquid asset holdings, relax bankruptcy planning requirements for big banks, and more. There is no recommendation to strengthen regulation in any manner to make up for such changes.

The Treasury recommendations also follow the lead of the big bank lobby in weakening the oversight of European banks active in the U.S. The Treasury appears to favor lowering the U.S. lower safety and soundness standards for Wall Street banks to align with weaker European standards, specifically stating that U.S. regulatory standards that exceed international floors "can make U.S. institutions less competitive globally" and "sometimes create an undue burden of higher costs to our economy".[12] It also follows the Clearing House recommendation that home country (European) regulators be given a substantially greater role in the regulation of foreign banks active in the U.S.

The Treasury does not recommend stronger regulatory oversight of big banks in any area, as would seem to be called for to counterbalance such a comprehensive agenda of lowering regulatory standards.

[10] Labonte, Mark, *Federal Reserve Emergency Lending*, Congressional Research Service, January 6, 2016.
[11] The table focuses on the core safety and soundness recommendation in The Clearing House report and omits certain recommendations addressing the Community Reinvestment Act, Cyber-Security, and Anti Money Laundering. Including these recommendations would not change the conclusions of this report. In addition, the table does not cover Treasury Department recommendations on issues not addressed in The Clearing House report, including the Consumer Financial Protection Bureau and community banks,
[12] Page 54, Treasury report

Even in areas where the Treasury Report does not accommodate a specific industry request, it often takes another step that would accomplish the same thing. For example, the banks recommend that regulators completely abandon the use of independent regulatory models in stress testing and rely completely on bank internal models. While the Treasury does not recommend this step, it does recommend that independent regulatory models be made fully public to banks in advance of stress tests. This would give banks the opportunity to sue in court to challenge details of such models they found too strict, and also allow banks to "game" the details of what is intended to be an independent regulatory test.

In sum, the Trump Administration has followed the lead of lobbyists for the nation's largest banks in proposing an across-the-board weakening of key Wall Street risk protections put in place after the 2008 financial crisis.

Looking Ahead: Will the Big Bank Agenda be Adopted?

The Treasury Department has laid out a road map for a significant and dangerous weakening of risk controls at the nation's largest banks. The majority of these recommendations could be accomplished without Congressional action. Of the 31 Treasury recommendations listed in the Appendix to this report, 29 could be accomplished through purely regulatory action.[13]

At the same time, the Treasury recommendations are the beginning of a process, not the conclusion of one. The bank regulatory agencies that would implement these recommendations are formally independent of the Treasury and will get their own say in whether and how these recommendations are implemented. The individuals selected to lead and staff these agencies will be critical to whether the full agenda is realized.

Many of the Treasury recommendations will also require notice and comment rulemaking to be executed.[14] In such cases, the public will have an opportunity to see the new version of regulations, to comment on details, and possibly to challenge the regulation in court if it does not comply with pre-existing statutory commitments. Most of the recommendations are stated in a broad manner that will require significant interpretation in order to be implemented. While the desired direction of change is clear from the text of the Treasury report – weakening of loss absorbency and risk controls – there are still significant decisions to be made about the magnitude of the changes.

It is important that Congress and the public provide a strong voice in opposing the more dangerous changes in systemic risk protections that are advocated in the Treasury report, and demand that we maintain strong safeguards against any repeat of a disastrous financial crisis.

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[13] Exceptions are some (but not all) of the Volcker Rule changes, and "tailoring" regulatory standards to fully exempt certain classes of banks over $50 billion, which would require Congressional action in a number of cases. Note that "tailoring" is a significant recommendation that would have multiple sub-parts.

[14] However, some recommendations could be implemented purely through the supervisory process, without the need for rulemaking. This includes a number of critical recommendations such as changes to stress testing.

APPENDIX

Clearing House Recommendations Compared To Final Treasury Report

Only prudential supervisory recommendations are included and in some cases multiple similar recommendations are combined into one; see notes and sources at bottom of the table.

Clearing House Recommendation	Treasury Report Follows	Treasury Report Recommendation
CCAR/Stress Tests		
Switch to use of bank internal models	No	
End pass/fail qualitative assessment of risk controls	**Yes**	
Subject stress test details to notice and comment	**Yes**	Includes making details of regulatory stress testing models public in advance
Introduce more bank-friendly assumptions to models	**Yes**	
Streamline process for midyear tests	**Yes**	Eliminate midyear DFAST tests
Leverage Capital Ratio		
Eliminate enhanced supplementary leverage ratio for biggest banks	**Partial**	Promises recalibration and "significant" adjustment of enhanced leverage ratio; unclear if this will result in elimination
Eliminate leverage capital requirement for liquid assets	**Yes**	
Eliminate leverage capital requirement for derivatives margin	**Yes**	
Megabank Capital Surcharge		
Switch to a more bank-friendly means of calculation that reduces the surcharge	**Yes**	
Other Capital Charges		
Change operational risk capital regime to end subjective assessments	**Yes**	Recommends switch to formal rules-based approach
Delay internationally agreed reforms to trading book capital	**Yes**	
Withdraw proposal for increased capital for merchant banking and commodities	Not Addressed	Future report will address commodity activities

CECL Loan Loss Accounting		
Delay and possibly reverse implementation of accounting reforms for loans	**Partial**	Requires action by FASB outside of prudential jurisdiction, but Treasury recommends prudential regulators review CECL
TLAC Long Term Debt Rules		
Align U.S. long term debt rule with weaker European standard in several key areas	**Yes**	Promises recalibration of U.S. TLAC rule in light of differences with European/Basel minimum
Other capital issues		
Conduct comprehensive review of capital requirements	**Yes**	"Recalibration" promised of leverage capital, G-SIB surcharge, risk based capital
Liquidity Coverage Ratio		
Recalibrate liquidity rules to be more bank-friendly	**Yes**	
Expand list of assets that qualify as liquid	**Yes**	
Net Stable Funding Ratio		
Withdraw proposed implementation of this liquidity rule in the U.S.; renegotiate new rule	**Yes**	
Bank "Living Wills"		
Eliminate requirement for annual submission	**Yes**	
Regulatory expectations for credible resolution should be established through formal notice and comment rulemaking	**Yes**	
Weaken standards for subsidiary-level liquidity	**Partial**	Treasury report suggests re-examination of liquidity requirements in living wills
Eliminate living will at insured depository level	No	
Leveraged Lending Guidance		
Rescind leveraged lending guidance to supervisors; any leveraged lending restrictions should be done through formal rulemaking	**Yes**	Also suggests loosening restrictions in guidance

Volcker Rule		
Loosen key restrictions on proprietary trading to facilitate market-making	**Yes**	
Loosen restrictions on relationships with "covered funds"	**Yes**	
Eliminate certain compliance and attestation requirements	**Partial**	Recommends reduction in compliance requirements but does not eliminate attestation
Limit application of Volcker Rule to non-U.S. operations of U.S. banks	**Yes**	
Designate lead agency for rule	No	
Supervision – CAMELS rating		
Replace CAMELS system	No	
Eliminate restrictions on bank expansion bases on CAMELS	No	
Enforcement		
Coordinate enforcement to end duplicative and excessive penalties	**Partial / Unclear**	Interagency reassessment of how regulatory issues are remediated; recommends restricting CFPB enforcement
Board Governance		
Review burden of rules, guidance, and supervision on bank Boards of Directors	**Yes**	
Bank Risk Models		
Reduce number of required models	No	
Accelerate regulator review of models	No	
Single Counterparty Credit Limits		
Revise proposal to reduce compliance burden	**Partial**	Suggests revision of SCCL and reduced scope of application
Revise proposal to reduce measures of exposure, permit additional transactions	**Yes**	
Bank Bonus Compensation		
Rescind proposed restrictions on "take the money and run" short-term bank bonuses	No	

"Tailoring" Regulatory Standards		
Review Dodd-Frank prudential standards and reconsider whether they could be applied to a smaller number of banks	**Yes**	Makes numerous recommendations narrowing the scope of application of various prudential standards
Foreign Banking Organizations		
Reduce U.S. safety and soundness requirements on foreign banks operating in U.S.	**Yes**	Recommends greater reliance on foreign regulators; limit prudential restrictions to those triggered by U.S. instead of global asset size.
Reduce requirements for foreign banks operating in U.S. to hold loss absorbing debt (TLAC)	**Yes**	

Notes and Sources: Specific recommendations are paraphrased for greater clarity. Includes prudential supervisory recommendations drawn from submission by The Clearing House to the U.S. Treasury in response to White House Executive Order on Financial Regulation.[15] Recommendations by The Clearing House on Anti-Money Laundering, Community Reinvestment Act, Cybersecurity, and Vendor Management are not included, nor are corresponding recommendations in the Treasury Report. Treasury Report recommendations in areas not related to areas addressed by The Clearing House are also not included. In some cases similar recommendations on the same topic are combined into a single general description.

[15] Clearing House submission is available at https://www.theclearinghouse.org/~/media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Submission_to_UST_re_Core_Principles_Study.pdf/. Treasury report available at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf