AFR Americans for Financial Reform

September 6, 2016

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to H.R. 3312, the "Systemic Risk Designation Improvement Act of 2017."[1] This legislation is a gift to some of the largest banks in the country. The cumbersome regulatory process laid out in this bill puts unprecedented new constraints on the ability of the Federal Reserve to engage in safety and soundness regulation of large regional bank holding companies even when regulators come to the conclusion that action is needed. It would also end requirements on the Federal Reserve to improve their previously inadequate oversight of large regional banks, a class of bank which contributed significantly to the financial crisis.

Besides being dangerous, there is no evidence that the drastic changes in HR 3312 are actually needed or called for. As detailed below, the Federal Reserve already tailors its supervisory regime to the size and risk of banks, with the strongest rules for the largest and most systemically significant Wall Street banks and less stringent requirements for banks below $250 billion in size. With the latest FDIC data showing record revenues for banks and rates of return at their highest levels in a decade, Congress should not be considering deregulatory gifts to large banks.[2]

Large Regional Banks, The Financial Crisis, and Systemic Risk

HR 3312 affects oversight of 27 large bank holding companies (BHCs), which each hold over $50 billion in assets but are not one of the eight largest U.S. banks with global operations. These banks, while smaller than the very largest Wall Street mega-banks, are well within the largest one percent of the 5,800 insured 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. They hold an even larger portion of assets in particular regions. For example, 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. Large regional banks such as Countrywide, Washington Mutual, Wachovia, and IndyMac were all significant participants in the housing bubble. For example, in the year 2006, Countrywide, holding less than $200 billion in assets, originated 17 percent of all the

[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] Federal Deposit Insurance Commission, *Quarterly Banking Profile, Second Quarter 2017*, Available at https://www.fdic.gov/bank/analytical/qbp/2017jun/qbp.pdf

mortgage lending in the U.S.[3] All of these large regional banks failed during the 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.[4]

In all of these cases, the Federal Reserve and other key banking regulators missed signs of instability at these banks and failed to act until it was too late. Congress responded to the failure of regulatory oversight for these large banks by demanding that regulators do a better job at controlling the risks of large bank holding companies. H.R. 3312 would reverse that change, and eliminate the requirement that the Federal Reserve engage in improved oversight of these large BHCs. But this is not all. The bill would also limit Federal Reserve authority over these large banks in a manner that is unprecedented since the passage of the Bank Holding Company Act in 1956. The changes in this legislation go far beyond the narrow or limited technical changes that some regulators have suggested regarding the application of Title I of Dodd-Frank.

H.R. 3312 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 the nation's largest banks. Title I requires the Federal Reserve, as the primary regulator of bank holding companies, to apply enhanced safety and soundness standards to all BHCs over $50 billion, including increased levels of loss-absorbing capital, stress testing, and credit exposure limits.[5] Dodd-Frank requires a tailored and graduated system of risk controls which ensures that all banks over $50 billion are more strictly regulated than community banks, but that regional banks are not regulated as stringently as the very largest Wall Street banks that are systemically critical to the national and global economy.

The Dodd-Frank Act specifically instructs the Federal Reserve to tailor the application of prudential standards to the size of the institutions involved and their activities. 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 $250 billion in assets, and in a recently finalized rule the Federal Reserve relaxed quantitative stress test requirements for banks under $250 billion.[6]

[3] Freeman, Willoe and Wells, Peter Alfred and Wyatt, Anne, "Insights from the Failure of the Countrywide Financial Corporation," March 14, 2013.
[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] 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.
[6] Federal Reserve Board, "Amendments to the Capital Plan and Stress Test Rules", Federal Register, Volume 82, Number 22, February 3, 2017.

H.R. 3312 would eliminate the Congressional mandate to strengthen rules for large regional banks. It would also drastically weaken Federal Reserve oversight authority by effectively eliminating the Federal Reserve's discretionary authority over large banks in cases where such banks had not been determined to be individually critical to the entire U.S. financial system.

The legislation mandates that enhanced prudential oversight would apply to only the eight largest banks in the U.S., which have already been designated as globally systemically significant. If the Federal Reserve wished to apply enhanced prudential standards to large regional banks it would be subject to a complicated set of hurdles that would be difficult if not impossible to meet:

- The Federal Reserve could apply enhanced safety and soundness standards to a single large regional bank, but only if it could demonstrate that the individual bank posed a threat to the financial stability of the United States, and that the bank was not being treated differently from other banks of similar size and complexity.

- The Federal Reserve could also pass regulations applying enhanced prudential standards to a new class of banks such as large regional banks, even if they were not individually designated as global systemically significant banks. However, such a regulation would have to be approved by two-thirds of all financial regulators (members of the Financial Stability Oversight Council, or FSOC) as well as the Secretary of the Treasury.

These restrictions represent major new limitations on the capacity of the Federal Reserve to make basic decisions on bank safety and soundness. For many decades, well before the 2008 financial crisis, bank supervisors have had clear discretionary authority to take action to address risks at major banks. HR 3312 would for the first time place major restrictions on this authority as it applies to core safety and soundness protections such as capital requirements, stress testing, credit exposure limits, and more. This legislation goes beyond reversing Dodd-Frank and weakens regulatory authority even compared to the period before the 2008 financial crisis.

Section 4 of the legislation does include a "Rule of Construction" which states that the legislation should not be construed to prohibit the Federal Reserve from prescribing enhanced prudential standards for any individual bank. But this "Rule of Construction" in no way reverses or affects the unprecedented restrictions placed on the Federal Reserve's authority elsewhere in the bill. These restrictions do not strictly speaking "prohibit" action, but they make it prohibitively difficult. If HR 3312 passed and the Federal Reserve attempted to exercise its authority to control risks at large regional banks, affected banks would be quick to either lobby the FSOC and the Treasury Secretary to block new regulatory measures, or to mount a lawsuit claiming that the Federal Reserve had not met requirements to demonstrate that a particular bank could single-handedly threaten the financial stability of the United States.

In sum, H.R. 3312 dramatically restricts oversight of some of the largest banks in the country, increasing risks to regional economies and to financial stability, and therefore to the prosperity of families and communities. We 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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