AFR Americans for Financial Reform

December 18, 2017

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to urge you to oppose 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 process laid out in this bill puts unprecedented new constraints on the ability of the Federal Reserve to address risks at some of the largest bank holding companies in the U.S. economy, 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 these large banks.

Besides being dangerous, there is no evidence that the drastic changes in H.R. 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]

Banks Deregulated by H.R. 3312, Systemic Risk, and the 2008 Financial Crisis

H.R. 3312 deregulates 26 large bank holding companies (BHCs) which range from $50 billion to almost $500 billion in asset size (US Bancorp). These banks include both the U.S subsidiaries of giant global megabanks such as Deutsche Bank, and large regional U.S. banks critical to the economy of particular regions. All of these banks are in the largest one percent of banks in the U.S., and enormously larger than community banks.

Collectively, banks that would be deregulated by this bill 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.

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[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

Should these banks become insolvent, there could be major economic impacts on regions that depend on them.

Banks similar to those affected by this bill played a major role in the 2008 financial crisis. U.S. subsidiaries of foreign banks such as Deutsche Bank and BNP Paribas were key players on Wall Street and received hundreds of billions in Federal Reserve bailout money.[3] Despite the fact that they are owned by multi-trillion dollar global banks and are key players in Wall Street markets, these U.S. subsidiaries would be deregulated by H.R. 3312.

Large regional U.S. banks such as Countrywide, Washington Mutual, Wachovia, and IndyMac were significant participants in the housing market bubble that led to the 2008 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.[4] All four of these regional banks failed during the 2007-2008 period, and the need to manage these 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.[5]

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 BHCs. 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 narrow or limited technical changes.

H.R. 3312 and the Regulation of Large 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 BHCs, to apply enhanced safety and soundness standards to all BHCs

[3] Clark, Stephen, "Federal Reserve Under Fire for Lending Big to Foreign Banks During the Financial Crisis", Fox News. December 2, 2010. http://fxn.ws/2CZaw3i

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

[5] 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.

over $50 billion, including increased levels of loss-absorbing capital, stress testing, and credit exposure limits.[6]

The Dodd-Frank Act specifically instructs the Federal Reserve to tailor the application of prudential standards to the size of the institutions involved and the risks posed by 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.[7]

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 other large 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 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.

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[6] 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.
[7] Federal Reserve Board, "Amendments to the Capital Plan and Stress Test Rules", Federal Register, Volume 82, Number 22, February 3, 2017.

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. H.R. 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 H.R. 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.

Sincerely,

Americans for Financial Reform