February 15, 2018

Ms. Ann Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R 1569, Large Financial Institution Rating System

Dear Ms. Misback,

On behalf of Americans for Financial Reform (AFR), thank you for the opportunity to comment on this proposal, which lays out a new rating system to be applied to the consolidated rating of large banks and financial institutions.[1]

In general, this ratings system has many positive aspects and maintains strengths of the current RFI system while reflecting Federal Reserve advances in supervision since the crisis. Several strengths are:

1) The "capital" component is explicitly forward looking, integrated with the capital stress testing process (CCAR), and focuses not simply on current capital position but on capital planning and adequacy under possible future stress.

2) Likewise, the "liquidity" component is integrated with the forward looking liquidity stress testing process (CLAR).

3) The "governance and controls" component highlights the importance of independent and effective risk management that is properly supported both by the Board and senior management. Also critical is that the discussion of risk management and governance explicitly requires aggregating risk across the entire consolidated institution, rather than simply managing risk separately within each line of business.

With that said, we have two concerns with the proposal as described here.

Our first concern relates to the consequences of the ratings. The proposal states that a "Deficient-1" rating in any of the component areas "could" be a barrier to a bank engaging in new or expansionary activities. However, such new or expansionary activities would be permitted if the financial institution demonstrated that "it is making meaningful, sustained progress in resolving identified deficiencies" and that such new activities would not exacerbate deficiencies or distract the board from addressing issues at the bank.

[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 AFR members is available at http://ourfinancialsecurity.org/about/our-coalition/

According to the proposal, a "Deficient-1" rating means that the financial institution's safety and soundness is at "significant risk" under feasible conditions. We do not believe it is appropriate that a large financial institution be permitted to expand or launch new activities under such circumstances. It also seems highly unlikely that expansion or opening new lines of business would not in some way distract the organization from addressing these significant risks. At the most basic level, if a large financial institution is already seriously deficient in any of the critical areas of capital adequacy, liquidity, or risk management it needs to address these issues *before* further growth or expansion. Any expansion of an institution that is not properly managing these crucial areas would only increase the damage that its mismanagement could do.
We therefore recommend that a "Deficient-1" rating be an automatic bar to expansion.

Our second, more conceptual, concern is that the new ratings system removes the explicit focus of the RFI system on protecting depository institutions from the activities of non-depository or capital markets subsidiaries. This was the "impact" component of the previous RFI system. When the RFI system was put in place in 2005 this "impact" component was explicitly in response to the passage of Gramm-Leach-Bliley and the end of the separation of commercial banking and other activities.[2] The events of the financial crisis soon after showed that this concern was well placed.

In some ways this ratings system indirectly addresses this issue by its focus on consolidated oversight and its emphasis on risk aggregation across the entire organization. And as the proposal mentions in footnote 38 and the comparison chart between the RFI and LFI systems, the source of strength doctrine should be a general principle informing oversight. However, this still fails to explicitly prioritize the issue of how commercial banking is shielded from losses in non-traditional subsidiaries and activities.

We suggest that this issue be highlighted in the area of management and governance. This could be done through the recovery planning element of management and governance. This should include a special emphasis on recovery situations where the largest non-bank subsidiaries failed or were taking heavy losses. Through examining this element, regulators could determine whether the bank was prepared to protect bank subsidiaries from non-bank losses and could keep bank subsidiaries operating even if non-banks became insolvent. A failure to advance a realistic recovery scenario that protected bank subsidiaries should be grounds for downgrading management and governance. This would be a much more concrete way of addressing non-bank impacts on depository subsidiaries than the general assurances offered in the proposal.

Thank you for the opportunity to comment on this proposal. If you have questions, please contact AFR's Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

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[2] Bleier, Michael, "The Federal Reserve's New Ratings System for Bank Holding Companies and Financial Holding Companies", Annual Review of Banking and Financial Law, 2007.