AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

Americans for Financial Reform
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November 2, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to H.R. 1309, the "Systemic Risk Designation Improvement Act of 2015."[1] This legislation dramatically weakens central elements of the Dodd-Frank Act, undermining regulatory oversight of some of the largest banks in the country.

H.R. 1309 would significantly weaken oversight of 25 large regional bank holding companies (BHCs), which each hold over $50 billion in assets but are not among the eight U.S. mega-banks with a global footprint. These large regional banks, while smaller than the very largest Wall Street mega-banks, are still a major part of the financial system. The 25 large regional banks are among the largest one-half of one percent of all banks in the U.S. – enormously larger than community banks. Collectively, they hold almost $4 trillion in assets, around a quarter of all banking system assets.

Large regional banks 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. All of them failed during the 2007-2008 period. Their failures placed major stress on the financial system. Many large regional banks that did not fail took substantial Federal assistance. Large BHCs with over $50 billion in assets received twice as much TARP capital assistance per dollar of assets as banks with below $50 billion in assets.[2]

Congress appropriately responded to the failure of regulatory oversight for these large banks by instructing the Federal Reserve to increase risk controls at these institutions. H.R. 1309 would effectively eliminate this mandate and instead limit Federal Reserve regulatory oversight of large regional banks in unprecedented ways. The legislation imposes a radical requirement for bank holding companies to be individually designated by the Financial Stability Oversight Council (FSOC), a council of ten different regulators, before the Federal Reserve can impose the increased regulatory standards mandated under Dodd-Frank. This lengthy and cumbersome process would create major obstacles to regulatory oversight. The decisions of primary banking regulators regarding prudential oversight of banks have never before been subject to the kind of sweeping external veto that this legislation would impose.

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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] 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.

Decisions regarding bank oversight would be further constrained by requiring the FSOC to follow standards approved by the Basel Committee, an advisory body made up of international regulators, in making their decisions regarding risks to the U.S. financial system. 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 of the advisory role of international bodies in providing recommendations on financial regulatory standards; it is ironic that Congress would now consider granting these unprecedented powers to such a body.

This cumbersome designation process would greatly delay and complicate the application of increased prudential standards to 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 1309 are so extreme that they would call into question regulatory oversight powers that long pre-date Dodd Frank, creating a negative inference concerning even traditional Federal Reserve prudential authorities.

Large Regional Banks, the Financial Crisis, and Systemic Risk

Large regional banks include about two dozen BHCs with over $50 billion in assets that are not among the eight major Wall Street banks classified as Global Systemically Important Banks (G-SIBs). These banks collectively hold almost $4 trillion in assets. They are among the 33 largest banks out of 6,800 banks in the U.S. Each is at least ten times larger a typical community bank, the great majority of which hold less than $5 billion in assets.[3]

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.[4] 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.

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.[5] Thus its failure could create potentially 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

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[3] According to FDIC data, as of the close of 2013, over 99.7% of banks classified as “community banks” held below $5 billion in assets. Only 15 out of 6,310 FDIC-classified community banks had over $5 billion in assets.
[4] Freeman, Willoe and Wells, Peter Alfred and Wyatt, Anne, “Insights from the Failure of the Countrywide Financial Corporation,” March 14, 2013.
[5] 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.

assets, below the $50 billion line in Title I. However, Indymac's failure cost the Deposit Insurance Fund almost $11 billion in losses.[6]

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. For example, during the financial crisis Bank of America acquired most of the assets of the failing Countrywide, increasing Bank of America's size, creating tens of billions of dollars in additional losses on troubled assets, and increasing stress on this Too-Big-to-Fail bank.

In addition to difficulties in resolution, the failure of a large regional bank at a time of economic stress might trigger the failure of other banks and broader economic harm. As Federal Reserve Governor Daniel Tarullo stated in a May 2014 speech[7]:

> "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."

H.R. 1309 and the Regulation of Large Regional Bank Holding Companies

In Title I of the Dodd-Frank Act Congress responded to the financial crisis experience – and the failures in regulatory oversight that were such important causes of the crisis – 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.[8] However, the Fed was granted very 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 capital requirements under the "supplementary leverage ratio" 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. However, certain stress testing, risk exposure, and simplified liquidity risk management rules apply to all banks with over $50 billion in assets.

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[6] 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.

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

[8] 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.

H.R. 1309 would eliminate this Dodd-Frank mandate and 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 prudential standards imposed under the Dodd-Frank Act could apply to that bank. This 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 using the specific quantitative indicators established by international regulators on the Basel Committee to designate the largest systemically significant banks at the global level.

These requirements are unprecedented. Never before have independent banking regulators been required to seek the approval of a supermajority of ten U.S. regulators in order to exercise their prudential oversight over a bank. Likewise, U.S. financial regulators have never before faced a statutory requirement that effectively subordinated them to an unaccountable body of international regulators in order to make judgments regarding risks to the U.S. financial system. These 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. 1309 does not modify this pre-existing authority. But if Congress acts to prevent the Federal Reserve from imposing Dodd-Frank without approval from a council of other U.S. regulators, this would raise difficult interpretive questions for the courts. The HR 1309 requirements would almost certainly lead to lawsuits if the Federal Reserve attempted to exercise similar oversight using its traditional authorities.

The requirement to use an FSOC designation process for each individual bank would also create enormous delays in the application of prudential standards to large regional banks. In almost five years since its creation, the FSOC has only designated four major non-bank entities as systemically significant. It took several years for the FSOC even to designate entities that received large-scale assistance during the financial crisis, such as AIG and GE Capital. The FSOC has established an involved 10-step process for entity designation which allows multiple opportunities for appeal, and designated entities may also challenge an FSOC designation in the courts. A requirement for FSOC designation prior to enhanced prudential oversight under Dodd-Frank would multiply litigation and red tape prior to even time-sensitive agency action. It is also an invitation to extensive behind the scenes special interest lobbying by each institution that might be designated, as it seeks to escape heightened regulation.

In sum, H.R. 1309 would dramatically restrict prudential oversight of some of the largest banks in the country. With the financial crisis still casting a shadow on the nation's economy, this legislation would make it far more difficult for regulators to address systemic risk in the heart of the banking system. We urge you to reject this legislation.

Thank you for your consideration. For more information please contact AFR's Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,
Americans for Financial Reform