June 25, 2018

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

Re: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, Docket No. R-1603 and RIN 7100-AF 01

Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Board of Governors of the Federal Reserve System ("Board"), regarding amendments to various rules governing bank capital, capital planning, and stress testing.

INTRODUCTION AND SUMMARY

The capital, leverage, and stress testing requirements for banks and other financial institutions set forth in the Dodd-Frank Act and implemented by the Board and other prudential regulators since the financial crisis are among the most important regulatory reforms adopted in almost a century. They are critical for maintaining the financial stability of the domestic and global financial markets and ultimately the world-wide economy. Any changes to those rules and regulations must be undertaken with the utmost care and only for the most compelling reasons. Above all, they must not be weakened.

Unfortunately, the net effect of the Proposal will be to undermine these critical reforms. While some of the elements of the Proposal are conceptually sound, the inescapable fact is that it would materially alter several important assumptions underlying the supervisory stress tests,

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 83 Fed. Reg. 18160 (Apr. 25, 2018).

resulting in a decrease in the amount of capital that most large banks with over $50 billion in assets would have to maintain to avoid limits on their capital distributions.

This weakening of prudential safeguards is unwise on its face. As a general matter, bank capital requirements are still too low to adequately protect our financial system and our economy from crisis and meltdown. Moreover, when economic growth is strong, as it is today, regulators should be applying additional, countercyclical capital buffers, not shrinking existing capital requirements. And the Proposal is at a minimum premature, as any amendments to the bank capital requirements should await at least the completion of a full business cycle, a point in time that we have not yet reached.

Turning to the specifics of the Proposal, the Release fails to provide concrete and persuasive reasons for the proposed changes. The ostensible justification for the Proposal is essentially two-fold: A desire to simplify the capital buffer framework, and a desire to accommodate banks by liberalizing their ability to distribute capital in the form of dividends, repurchases, and bonuses—a practice that is already thriving under existing capital standards.[3] Such benefits, conferred on a relatively small class of bank shareholders and executives, can hardly justify the proposed thinning of capital reserves, which would undoubtedly increase the risk and severity of another financial crisis. And, as we have seen over the last ten years, such a crisis would impose widespread and crushing burdens not just on a select few but on virtually every one of America's 325 million citizens.

This is a poor trade-off and one that is especially unwise given the predominantly de-regulatory trend in bank oversight that is now underway. Alone, and even more so in combination with other de-regulatory measures that have recently been advanced in the banking arena, the Proposal represents an unnecessary and unwarranted threat to the stability of our financial system.

OVERVIEW OF THE PROPOSAL AND ITS IMPACT

Elements of the Proposal

The Proposal would materially alter some of the current requirements governing bank capital, capital planning, and stress testing. The net effect would be to reduce the amount of capital that the large banks—excepting only the GSIBs—must maintain to ensure their financial stability and avoid restrictions on their capital distributions. While the Proposal is expected to maintain or in some cases increase the required capital buffers at the GSIBs—a positive impact to be sure---it is unwise and unnecessary to do so at the expense of the capital buffers maintained at the more numerous and still systemically important banks outside the GSIB category.

- <u>Establish a new "stress capital buffer."</u> The Proposal would create a new component of the standardized approach capital conservation buffer, known as the "stress capital buffer." The new stress capital buffer would replace the current fixed "2.5% of risk-weighted assets" element of the standardized approach capital buffer. The stress capital buffer would

3 Alistair Gray and Ben McLannahan, *US Banks Poised for $170bn in Shareholder Payouts*, FINANCIAL TIMES (June 18, 20018).

be based on the results of the annual supervisory stress tests, but would have a floor or minimum of 2.5% of a firm's risk-weighted assets. According to the Release, the stress capital buffer would be "forward-looking, risk-sensitive, and firm-specific."[4] As a result of this change, a bank's required standardized approach capital conservation buffer would be comprised of the new stress capital buffer, any applicable GSIB surcharge, and any applicable countercyclical capital buffer amount.

- Preserve the advanced approaches buffer. Due to complexities and costs, the Proposal would not inject the stress-testing element into the advanced approaches capital conservation buffer, which would remain equal to the sum of 2.5% of risk-weighted assets plus any applicable GSIB surcharge and countercyclical buffer.

- Establish a new "stress leverage buffer." The Proposal would also create, again using the annual supervisory stress tests, a new "stress leverage buffer," which would not have a floor or minimum amount.

- Eliminate the quantitative basis in CCAR for limiting distributions, while preserving the qualitative criteria. The Proposal would eliminate the quantitative assessment in CCAR as the basis for objecting to a bank's capital distributions. However, banks would still be required to submit their capital plans to the Board and describe their intended capital distributions. The Board would continue to have the authority to object to the capital plans of large and complex firms on **qualitative** grounds.

- Apply the most stringent standard. Under the Proposal, firms would continue to have to maintain capital ratios above all minimum capital levels plus buffer requirements to avoid restrictions on their capital distributions and discretionary bonus payments. The Release also makes clear that a firm would be subject to the most stringent distribution limitations, as determined by the firm's standardized approach capital conservation buffer requirement as amended by the Proposal; the firm's stress leverage buffer requirement; and any applicable advanced approaches capital conservation buffer requirement or enhanced supplementary leverage ratio standard.

- Materially alter the stress testing assumptions. The Proposal would change a number of assumptions that the Board currently uses in the supervisory stress tests, rendering those tests decidedly less rigorous. Under the Proposal,

  (1) the Board would no longer assume that a firm makes any repurchases or redemptions of any capital instrument;

  (2) the Board would scale back the assumption relating to dividend payments and assume that the firm will make only four quarters of planned common stock dividend payments (in quarters four through seven, which would be added to the

[4] Release at 18163.

> firm's projected decline in capital under stress), as opposed to the current level of payments, which assumes dividends are paid through the entire planning horizon of nine quarters;
>
> (3) the Board would assume that the firm does not make any planned issuances of regulatory capital instruments, in parallel with the assumption that the firm would not repurchase any regulatory capital instruments;
>
> (4) the Board would dispense with the assumption that any capital plan implying a common stock dividend payout above 30 percent warranted heightened scrutiny in the qualitative assessment of the firm's capital planning process; and
>
> (5) the Board would no longer assume that the credit supply remains unconstricted and that a firm's balance sheet grows throughout the planning horizon; instead, the Board would adopt the "no growth assumption" that firms take action simply to maintain their current levels of assets, including loans, securities, and trading assets.
>
> These changes in the assumptions are significant in part because they represent amounts that would no longer be added to the reductions in capital predicted by the stress tests, thus making the stress tests less rigorous.

It is fair to say that some of these proposed changes are unobjectionable. For example, the proposed stress capital buffer is a sound concept, as is the stress leverage buffer. Furthermore, it is certainly prudent for the Board to establish a floor or minimum, as proposed for the stress capital buffer. And it is critically important to preserve the GSIB surcharge and any future countercyclical capital buffers as components of the overall capital conservation buffer, which the Proposal does. However, the overriding effect of the Proposal is negative, since, as shown in the impact analysis, it will reduce the size of the capital buffer for most banks, and liberalize their ability to distribute capital freely to shareholders and executives.

Impact Analysis

The Release sets forth the results of the Board's impact analysis. For that exercise, the Board reviewed the levels of capital required under the current regime—compliance with which is necessary to avoid limitations on capital distributions—and compared those amounts to the levels of capital that would be required under the Proposal.[5]

The Board concludes that for most banks i.e. firms with over $50 billion in assets that are not GSIBs, "the proposal would generally result in a **reduction** to a firm's required level of capital to avoid capital distribution limitations relative to what is required today."[6] For example, based on the most recent data from 2017, the Release estimates that the reduction in required capital for

[5] *Id.* at 18167.
[6] *Id.* (emphasis added).

non-GSIBs would amount to **$45 billion**. The Release attributes these reductions to the modified assumptions regarding capital distributions and balance sheet growth. Those assumptions would lower the amount of Tier 1 capital that a firm would need to maintain, and those lower amounts would not be offset by any other cushioning requirements, since the new stress capital buffer applicable to the non-GSIB banks would not include a GSIB surcharge buffer (nor would it be affected by a countercyclical capital buffer amount, which is currently set at zero).

For the GSIBs, the Board estimates that the Proposal would generally maintain or in some cases increase the CET 1 capital requirements. For example, again using the recent 2017 data, the Board estimates the Proposal would lead to an increase in required capital in the range of $10 billion. Such increases could be expected to occur because the GSIB's capital conservation buffer under the Proposal would include not only the new "stress capital buffer" but also the GSIB surcharge currently in place. In combination, those requirements could exceed the levels of capital required under the current supervisory post-stress capital assessment. This effect of the Proposal is of course a positive one, and as the Board crafts the final version, it should ensure that this feature is preserved.

In addition to the problematic decrease in required capital for many large banks, the Proposal would also create uncertainty. The Release explains that these impact assessments can be expected to vary through the economic and credit cycle, depending on "the risk profile and planned capital distributions of individual firms, as well as on the specific severely adverse stress scenario used in the supervisory stress test."[7] Thus, to the extent that the stewards of future tress testing scenarios make the tests less rigorous, the decrease in required capital resulting from the Proposal would be correspondingly larger and more destabilizing.

COMMENTS

I. Bank capital standards and stress testing requirements are critically important in protecting the stability of our financial system, and the lessons of the 2008 financial crisis should guide the Board as it revises and finalizes the Proposal.

Any proposed changes to the current capital and stress testing framework must be evaluated with the critical role of those regulatory reforms foremost in mind. The Release appropriately reviews the enormous importance of bank resiliency in preserving the stability of the financial sector, and the key role of capital requirements in achieving that goal:

> The resiliency of large financial institutions is critical to the stability of the financial sector. As shown in the 2007-2008 financial crisis, problems at large financial institutions can lead to significant market disruptions, spread rapidly throughout the financial system, and cause a credit crunch, worsening economic downturns. To be resilient, a financial institution must maintain sufficient levels of capital to support the risks associated with its exposures and activities. In the years leading

[7] *Id.*

> up to the financial crisis, neither the regulatory capital regime nor financial institutions' own models sufficiently captured the actual risk exposures of financial institutions, resulting in a level of capital that was inadequate to cover losses as conditions deteriorated.[8]

In reality, the only thing that stands between a failing bank and a taxpayer bailout is the bank's capital cushion. As we saw just ten short years ago, insufficient capital can be catastrophic for the banks, the financial system, the taxpayers, and the entire country. The sheer scale of the bailouts, backstops, and credit facilities provided to the GSIBs during the financial crisis was staggering, totaling over ten trillion dollars, as detailed on the attached Addendum.

Those bailouts were only a part of the costs of the 2008 crash and the massive effort to mitigate the consequences, which Better Markets has calculated to exceed $20 trillion in lost GDP.[9] And although the economy in general is much stronger, those costs continue to overshadow the financial lives of many Americans, who received no bailout.

While the crash and its devastating consequences had numerous causes, the lack of adequate bank capital was most prominent, and the subsequently enacted capital rules were key reforms designed to prevent the recurrence of such a crisis. The goal was not only to prevent bank failures or systemic crises, but also to avoid the human devastation inflicted on so many American families. Those goals must be the prism through which policy decisions about capital are viewed, particularly if those decisions will result in reduced capital levels and, therefore, fewer protections for American families who have already suffered so much.

It is no wonder then, that Congress and the financial regulators constructed a multi-layered framework of regulatory safeguards designed to protect the stability of our financial system. The Release canvasses many of those reforms, which are appropriately scaled to the size of a bank or other financial institution. Among them are capital requirements, including capital buffers as well as surcharges for the largest banks; leverage requirements, including the supplementary leverage ratio ("SLR") and the enhanced SLR for the largest banks; and supervisory and company-run stress tests, including the Comprehensive Capital Analysis and Review ("CCAR") process which the larger banks must undergo.

The Release also appropriately acknowledges the efficacy of these reforms:

---

8 *Id.* at 18160.

9 Better Markets, The Cost of Crisis, $20 Trillion and Counting (July, 2015), *available at* https://www.bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

> Strengthening the regulatory capital regime, including the introduction of capital planning and stress testing requirements, has been an important supervisory response to the financial crisis. . . . As a result of this program and the enhancements made to the Board's regulatory capital regime, large U.S. bank holding companies are much more resilient to stress than in the past.[10]

Given this backdrop, commendably laid out in the Release, it should be evident that any proposal to alter these bank capital requirements and related reforms must be accompanied by a robust, evidence-based justification clearly showing that the serious risks attending lower capital requirements are offset by exceptionally clear, broad-based, and tangible benefits not just to the banks themselves but to the real economy and the American public at large. Here, the case has not been made.

II. The Proposal is premature and unwise, especially at a time when bank capital buffers should be increased, not scaled back.

The Proposal conflicts with three basic principles that must govern bank regulation, especially in the aftermath of a financial crisis of historic proportions.

First, lowering the existing bank capital requirements to any degree is unwise because those requirements, while much improved since the financial crisis, are still inadequate. At current levels, they cannot ensure financial system stability in the face of stresses like those seen during the financial crisis. As Better Markets has demonstrated, empirical evidence measuring the devastating impact of the crisis on just four banks (Washington Mutual, Wachovia, Citigroup, and Bank of America) shows that "banks require equity well in excess of 10 percent of their tangible assets to survive financial crises of the severity" witnessed in 2008.[11] Losses alone can exceed this amount, and to reassure counterparties and account for rapid asset devaluations during a crisis, banks must actually have equity equal to 20-25% of assets to protect against failure.[12] Other analyses conducted by academics, the Financial Stability Board, and the Board itself, which are based on data reflecting actual losses incurred during the financial crisis, all support the conclusion that a capital cushion of at least 20% is appropriate and necessary to protect banks against the ravages of a financial crisis.[13] Lowering capital requirements to **any** degree is a step in the wrong direction.

---

10 Release at 18161.

11 *See* Comment Letter from Better Markets to the Board of Governors of the Federal Reserve System, *et al.*, on Regulatory Capital Rules, RIN 1557-AD46, at 3-5 (Oct. 22, 2012), *available at* https://bettermarkets.com/sites/default/files/documents/FRS%2C%20OCC%2C%20FDIC-%20CL-3nprs-%2010-22-12.pdf.

12 *Id.*

13 *See* Comment Letter from Better Markets to the Board of Governors of the Federal Reserve System on Total Loss-Absorbing Capacity, Docket No. R-1523 (Feb. 19, 2016), *available at* https://bettermarkets.com/sites/default/files/FRS%20-%20CL%20-%20Total%20Loss-

Second, when the economy and the banking sector in particular appear to be strong and stable, regulators should be considering and imposing countercyclical measures that would fortify banks against the economic downturn that will inevitably follow. As Board Governor Lael Brainard has cautioned, at a time when cyclical pressures are building, "we should be calling for large banking organizations to safeguard the capital and liquidity buffers they have built over the past few years. . . . Indeed, if cyclical pressures continue to build and financial vulnerabilities broaden, it may become appropriate to ask the largest banking organizations to build a countercyclical buffer (CCyB) of capital to maintain an adequate degree of resilience against stress."[14] Former FDIC Vice Chairman Thomas M. Hoenig has also highlighted the importance of staying the regulatory course throughout the business cycle: "We know that when the business cycle shifts and losses materialize, the absence of capital intensifies the downturn as the market suspects there is not sufficient capital to absorb the shock and it worries about bank insolvency suddenly becoming real."[15] And he made the broader point that we must not succumb to amnesia:

> Another common element of most crises is the aftermath, in which new laws and regulations are enacted with the intent to prevent new crises. But memories are short and with an improving economy, these laws and regulations—which early in the recovery are viewed as essential—are eventually recast as burdensome constraints that need to be eased or ended. . . . I caution against eroding the post-crisis capital standards that have contributed to the strength of the U.S. banks and the long-awaited recovery of the U.S. economy. Weakening those standards will undermine the long-term resilience of not only the banking system, but the broader economy as well.[16]

Third and finally, even setting aside these axioms of prudential regulation, it is simply too early to be altering the bank capital requirements that were so painstakingly and incrementally instituted over a period of years following the financial crisis. Leading policy-makers have recently confirmed that post-crisis reforms under the Dodd-Frank Act relating to capital and liquidity should not be re-visited until they have been tested through an entire business cycle. As Board Governor Brainard has explained:

> I support efforts to identify improvements that make regulations less burdensome. But it is vital to be prudent regarding any material changes to the core capital and

Absorbing%20Capacity%20-%20Long%20Term%20Debt%20and%20Clean%20Holding%20Company%20Requirements%202-19-2016.pdf.

14 *See* Lael Brainard, Member of the Board of Governors of the Federal Reserve, Remarks at the Global Finance Forum, *Safeguarding Financial Resiliencies Through the Cycle*, at 7, 10 (Apr. 19, 2018) (emphasis added), *available at* https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

15 Thomas M. Hoenig, *Finding the Right Balance,* Keynote Speech, Peterson Institute for International Economics, at 2 (Mar. 28, 2018).

16 *Id.*

> liquidity framework, and not lose sight of the need to safeguard financial resilience through the cycle. Prudence would argue for waiting until we have tested how the new framework performs through a full cycle before we make judgments about its performance. At this point in the cycle, it is premature to revisit the calibration of core capital and liquidity requirements for the large banking institutions. [17]

Of course, we have not yet experienced a complete business cycle since the crisis, and it is therefore premature to be modifying the capital buffer requirements as proposed in the Release.

III. <u>The Release offers no persuasive rationale for reducing the size of the capital buffer.</u>

The Proposal fails to provide a convincing justification for a measure that will weaken capital standards by allowing banks even more leeway in making capital distributions. Such relief is unnecessary, as banks are thriving and distributions are already robust. In addition, the new assumptions that underlie the Proposal are based on flawed reasoning, and it is those questionable assumptions that ultimately account for the projected decrease in capital buffer levels.

The Release offers a number of reasons for the Proposal. It generally explains that "the Board has reviewed the CCAR program to assess its effectiveness and to identify any areas that should be refined."[18] The Release further notes that in light of the review process, which involved both internal assessment and external "feedback," "the Board has identified several areas where the capital plan rule and CCAR could be further refined or improved." The Release describes the principal purpose of those changes as "reducing burden for non-GSIBs," "addressing inconsistencies," and "simplifying certain supervisory stress test assumptions."[19] Elsewhere, the Release focuses on the multiple regulatory limitations that restrict a bank's ability to make capital distributions, and it explains that the Proposal would "simplify and integrate these requirements, eliminating the need for firms to manage to both potential sources of limitations on capital distributions."[20]

In reality, the ultimate impact of the Proposal would be "a reduction to a firm's required level of capital to avoid capital distribution limitations relative to what is required today."[21] Thus, the Proposal would weaken a critically important component of the bank capital regime for the purpose of simplifying and easing regulatory burdens and freeing up bank capital for the benefit of shareholders and bank executives.

Neither justification is persuasive. With respect to the notion of easing burdens, with each passing quarter, we see the banking industry's already record-breaking profits soar even higher.

---

17 *See* Brainard, *supra* note 14, at 6.
18 Release at 18161.
19 *Id.* at 18162.
20 *Id.* at 18167.
21 *Id.*

The trend over the past year and half is clear. The banking sector across the board, and especially at the top tier, is undeniably thriving by every measure—from huge profits and bonuses to full lending portfolios. And the credit needs of the real economy are being fully met.[22] For example, FDIC data from 2017 shows that the financial sector has seen record profits, the rate of loan growth for the industry has exceeded the growth rate of GDP, and loan balances for community banks have been up a robust 7.7 percent year-over-year.[23] The former FDIC Chairman Martin J. Gruenberg reviewed this data in testimony before the Senate Banking Committee and noted that "annual increases in industry net income have averaged 7.8 percent per year since 2011. FDIC-insured institutions reported a record $171.3 billion in net income in 2016, marking a net increase of 44 percent over the prior five years."[24] The American Banker, a trade publication, also reviewed the evidence and concluded:

> Republicans have repeatedly asserted that the 2010 financial reform law has increased the cost of consumer lending and cut off access to credit. . . . Yet the available data indicates otherwise. Consumer credit has roared back in the six years since Dodd-Frank, with a 46% jump in outstanding consumer credit to $3.8 trillion. . . . [T]he fact remains that mortgage, auto and credit card lending have all gone up since 2010. [Mortgage] lending standards are as loose as they've been since the downturn. . . . Auto lending has been on a tear since the financial crisis . . . . Credit card lending has returned to pre-crisis levels with total lending hitting an all-time high of $996 billion. . . .[25]

Analysts at Bloomberg reached a similar conclusion:

> Lending declined initially after 2008, when the entire banking industry was almost wiped out by the collapse of the U.S. housing market. But it's grown steadily since

---

22 Former FDIC Vice Chairman Thomas Hoenig and former FDIC Chair Sheila Bair recently confirmed that there is no evidence of a shortage of credit: "Surveys of small businesses show that their credit needs are being met; leveraged loans to large companies are up; and the residential real estate market is hot. There may even be too much debt buildup in certain sectors." Thomas M. Hoenig & Sheila C. Bair, Opinion, "*Relaxing Bank Capital Requirements Would Risk Another Crisis*, WALL ST. J. (Apr. 26, 2018), https://www.wsj.com/articles/relaxing-bank-capital-requirements-would-risk-another-crisis-1524784371.

23 Federal Deposit Insurance Corporation, Quarterly Banking Profile: First Quarter 2017, https://www.fdic.gov/bank/analytical/qbp/2017mar/qbp.pdf.

24 Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, *Fostering Economic Growth: Regulator Perspective before the Committee on Banking, Housing, and Urban Affairs, United States Senate,* June 22, 2017, *available at* https://www.fdic.gov/news/news/speeches/spjun2217.pdf.

25 Kate Berry, *Four Myths in the Battle over Dodd-Frank*, AMERICAN BANKER (March 10, 2017), https://www.americanbanker.com/news/four-myths-in-the-battle-over-dodd-frank (emphasis added).

> then, expanding by 6 percent a year since 2013, far faster than the economy. Banks now have a record $9.1 trillion of loans outstanding.[26]

All of these trends from 2017, showing a remarkably robust financial services industry, have continued into 2018.[27] Recent assessments of the state of the banking sector again show that "U.S. bank lending has been healthy over recent years and profits are strong. . . . The current level of capital is a sign of strength."[28] This collection of data belies any claim that banks need further relief from the supposed burdens of regulation.

Nor is there any need to ease restrictions on banks' ability to distribute capital. Indeed, this represents an even less convincing rationale for the Proposal. Banks are **already** free to bestow vast sums upon their shareholders and executives, and they are taking full advantage of that opportunity. Recent reports illustrate the trend:

> Large U.S. banks are poised to hand over more capital to investor than they are generating from their businesses for the first time since the 2008 crisis, lowering their defenses against another catastrophic shock to the financial system. Shareholders in 22 of the country's biggest listed banks are in line for a record haul of $170 billion in dividends and stock buybacks over the coming year.[29]

Easing limits on the distribution of bank capital is not only unnecessary but also extremely unwise, given the prominent role of such distributions in exacerbating the financial crisis. The Release itself repeatedly makes the point by reviewing some of the relevant history:

> The risks to the ability of the financial system to support economic growth were exacerbated by actions taken by firms during the crisis. Rather than conserve loss-absorbing resources, many firms continued to distribute capital to shareholders in an attempt to reassure the market of their health and resiliency. . . . The capital rule and the capital plan rule each place separate limitations on firms' capital distributions to address the fact that many firms made significant distributions of capital in the lead up to and during the financial crisis without fully considering the effects that a prolonged economic downturn could have on their capital adequacy.[30]

It follows from these incontrovertible facts about the financial crisis that any effort to shrink the capital buffer and allow greater distributions of capital would **weaken** the ability of

---

26 Zeke Faux, Yalman Onaran, and Jennifer Surane, *Trump Cites Friends to Say Banks Aren't Making Loans. They Are*, BLOOMBERG, Feb. 4, 2017, https://www.bloomberg.com/news/articles/2017-02-04/trump-cites-friends-to-say-banks-aren-t-making-loans-they-are (emphasis added).

27 *See* Federal Deposit Insurance Corporation, Quarterly Banking Profile: First Quarter 2018, https://www.fdic.gov/bank/analytical/quarterly/2018-vol12-1/fdic-v12n1-4q2017.pdf. Record profits would likely have been achieved again in 2018 but for the anomalous effects of the tax cuts.

28 *See* Lael Brainard, *supra* note 14, at 6.

29 *See* Alistair Gray and Ben McLannahan, *supra* note 3.

30 Release at 18160, 18192.

individual firms and the banking system to weather another financial crisis. Because the Proposal would indeed thin the capital buffer for most large banks, it is imprudent.

Finally, the specific changes in the assumptions underlying the supervisory stress tests set lack a satisfactory rationale. Consider the two most important alterations. First, the Proposal would dramatically scale back the assumptions regarding capital actions. Currently, the Board assumes that a firm will make all of its planned capital actions, including dividends, repurchases, and issuances of capital instruments, throughout the planning horizon.[31] The purpose of this assumption was to bring rigor to the test and to enable the Board "to assess whether a firm could meet minimum capital requirements during severe stress conditions even if the firm did not reduce its planned capital distributions."[32] Under the Proposal, however, the Board would no longer assume that a firm makes **any** repurchases or redemptions of any capital instrument, and it would cut by more than half the assumed level of dividend payments.[33] These payouts would no longer be added to the projected decline in the firm's capital under stress, rendering the test less effective.

This new assumption suffers from a number of flaws. First, it discounts lessons learned during the financial crisis. The Release itself notes that assuming a firm will make all planned capital distributions "reflect[s] the historical experience from the financial crisis in which the largest banking organizations **continued to repurchase shares and pay dividends** to shareholders well after the financial system came under severe stress."[34] Second, this new assumption conflicts with an important regulatory objective acknowledged in the Release. The Release explains that the Proposal would continue to include at least four quarters of planned common stock dividends (cut back from nine) in the capital buffer "to preserve the current incentives for a firm to engage in disciplined, forward-looking dividend planning."[35] But if incentivizing such "disciplined, forward-looking planning" is necessary and appropriate, then the same approach should apply to assumptions about repurchases and redemptions, not just dividends. Finally, the decision to eliminate or dramatically scale back the current assumptions about capital actions appears to be arbitrary. Even if some adjustments might be deemed appropriate, the Release offers no empirical basis for the specific choices that the Board has made.

Similar concerns surround another major change in the stress testing assumptions. Currently the Board assumes "that a firm's credit supply does not contract, resulting in growth in the firm's balance sheet in stress scenarios."[36] Under the Proposal, however, the Board would adopt a "no-growth" assumption, stipulating only that a firm will maintain its current level of assets, including securities, trading assets, and loans, over the planning horizon.[37]

---

31 Release at 18165.
32 *Id.*
33 *Id.*
34 *Id.* at 18162.
35 *Id.* at 18165.
36 *Id.* at 18166.
37 *Id.*

This new assumption is also flawed. It conflicts with one of the Board's guiding principles for strengthening the financial system against instability and crisis. As explained in the Release, the existing, more robust assumption—

> furthered the Board's macroprudential objectives by evaluating whether firms could pass the supervisory post-stress capital assessment while continuing to lend and support the real economy. In implementing this assumption, the Board used a model calibrated to historical data that tended to project that a firm's balance sheet and risk-weighted assets would grow over the planning horizon, even in the severely adverse scenario.[38]

Thus, the test was designed to ensure not just that firms could survive conditions of extreme stress but also that they could continue to serve the real economy in a meaningful way, thus avoiding the tightening of credit markets, the crisis of confidence, and the downward spiral that perpetuate and intensify the early stages of a financial crisis. The Proposal dramatically alters this assumption, and it does so without a persuasive justification, merely noting that it would "simplify the current stress test assumptions" and at least prevent firms from planning to reduce credit supply and shrink their balance sheets in a period of stress.[39] This compromised approach to an important prudential safeguard mistakenly exalts "simplicity" over substance.

IV. <u>The Proposal is especially dangerous in the current de-regulatory climate, because it will act in concert with other de-regulatory initiatives to further weaken our defenses against another financial crisis.</u>

The Proposal is just one in a series of initiatives that will weaken important financial reforms adopted in the wake of the financial crisis. Because it would operate in conjunction with those other de-regulatory initiatives, it would pose a comparatively greater threat to the regulatory framework that helps protect and preserve the stability of our financial system. Just as the benefits of a single new regulation must be evaluated not only in isolation but also in terms of the larger benefits of the entire framework of which it is a part, the threats and risks of a single de-regulatory measure must be viewed in terms of the overall impact of a collection or series of related de-regulatory measures.

Unfortunately, the new Administration has ushered in a new era of financial de-regulation. The prime example at the legislative level is the so-called "Economic Growth, Regulatory Relief and Consumer Protection Act," signed into law on May 24, 2018, [40] which will scale back a number of the basic reforms embodied in the Dodd-Frank Act. Within the executive branch and at the independent agencies, de-regulatory measures abound. The President has issued a series of executive orders and memoranda sharply curtailing the ability of executive branch agencies to promulgate important regulations to protect the health, safety, and economic welfare of the

---

[38] *Id.* at 18162.

[39] *Id.* at 18166.

[40] S. 2155, Public Law No. 115-174.

American public.[41] The Treasury Department has issued several extensive reports setting forth blueprints for altering, and in most cases weakening, the regulatory framework that was established to maintain the stability, fairness, and transparency of our financial markets.[42] And recently, the Board and other prudential regulators have issued rule proposals that will reduce capital requirements[43] and weaken critical limits on the ability of insured banks to engage in high-risk proprietary trading.[44]

This de-regulatory context intensifies the threat of any single proposal that seeks to unwind, rollback, or dilute the measures that were carefully put in place to prevent and mitigate any future financial crisis. For this reason, as well those articulated above, the Board should re-consider the

---

41 Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Orderly Liquidation Authority (Apr. 21, 2017) (requiring the Treasury Secretary to review the orderly liquidation authority); Executive Office of the President, Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council (Apr. 21, 2017) (requiring the Treasury Secretary to review the FSOC designation processes); Enforcing the Regulatory Reform Agenda, Exec. Order No. 13,777, 82 Fed. Reg. 12285 (Feb. 24, 2017) (requiring agencies to appoint Regulatory Reform Officers and Task Forces to oversee implementation of regulatory reform initiatives); Core Principles for Regulating the United States Financial System, Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (requiring the Treasury Secretary to review all financial regulations); Executive Office of the President, Presidential Memorandum for the Secretary of Labor on the Fiduciary Rule (Feb. 3, 2017) (requiring the Labor Secretary to examine the fiduciary duty rule to determine if it may adversely affect the ability of Americans to gain access to advice); Reducing Regulation and Controlling Regulatory Costs, Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017) (requiring the repeal of two regulations for every new regulation that is promulgated and that any cost to the industry be balanced by the repeal of other regulations, regardless of the benefits of the new or rescinded rules).

42 U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Capital Markets, Oct. 2017, https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf; U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Asset Management and Insurance, Oct. 2017, https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf; U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Banks and Credit Unions, June 2017, https://www.treasury.gov/press-center/press-eleases/Documents/A%20Financial%20System.pdf.

43 Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, Joint Notice of Proposed Rulemaking re modifications to the enhanced supplementary leverage ratio, OCC RIN 1557-AE35, Federal Reserve RIN 7100 AF-03, 83 Fed. Reg. 17317 (Apr. 19, 2018), and Better Markets comment letter in response thereto, *available at* www.bettermarkets.com.

44 *See, e.g.*, Notice of Proposed Rulemaking, Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Board of Governors of the Federal Reserve System (May 30, 2018), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180530a1.pdf.

Proposal and the assumptions in particular to ensure that it does not reduce the capital buffers that our large banks must maintain.

CONCLUSION

We hope these comments are helpful as the Board finalizes the Proposal.

Sincerely,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Legal Director and Securities Specialist

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
shall@bettermarkets.com
www.bettermarkets.com

Addendum

GSIB	TARP Funds	Non-TARP Funds	TARP Mortgage Funds	Total Bailout funds
JP Morgan Chase	$25,000,000	$391,000,000	$2,940,110	$418,940,110
Bank of America	$45,000,000	$1,344,000,000	$2,118,070	$1,391,118,070
Citigroup	$45,000,000	$2,518,000,000	$719,000	$2,563,719,000
Deutsche Bank		$354,000,000		$354,000,000
HSBC		$4,000,000		$4,000,000
Bank of China				$0
Barclays		$868,000,000		$868,000,000
BNP Paribas		$175,000,000		$175,000,000
China Construction Bank				$0
Goldman Sachs	$10,000,000	$814,000,000		$824,000,000
Industrial and Commercial Bank of China Limited				$0
Mitsubishi UFJ FG		$84,000,000		$84,000,000
Wells Fargo	$25,000,000	$159,000,000	$3,050,000	$187,050,000
Agricultural Bank of China				$0
Bank of New York Mellon	$3,000,000	$12,900,000		$15,900,000
Credit Suisse		$262,000,000		$262,000,000
Groupe Credit Agricole				$0
ING Bank				$0
Mizuho FG		42,300,000		$42,300,000
Morgan Stanley	$10,000,000	$2,041,000,000		$2,051,000,000
Nordea				$0
Royal Bank of Canada				$0
Royal Bank of Scotland		$541,000,000.00		$541,000,000
Santander			$26	$26
Societe Generale		$124,000,000		$124,000,000
Standard Chartered				$0
State Street	$2,000,000	$103,300,000.00		$105,300,000
Sumitomo Mitsui FG		$56,000,000		$56,000,000
UBS		$287,000,000.00		$287,000,000
Unicredit Group		$97,000,000		$97,000,000
Total	**$165,000,000**	**$10,277,500,000**	**$8,827,206**	**$10,451,327,206**

(Dollars in Thousands)

Sources:

Sources:

https://projects.propublica.org/bailout/list/index (TARP)

https://www.gao.gov/new.items/d1169f6.pdf (Non-TARP)