May 19, 2015

Dear Members of the Senate Committee on Banking, Housing and Urban Affairs:

As you all know well, the 2008 crash was the worst financial crash since the Great Crash of 1929 and it caused the worst economy since the Great Depression, which too many American families are still suffering from. This economic wreckage is going to cost the country tens of trillions of dollars and incalculable widespread human suffering.[1] The Dodd Frank financial reform law was passed to make sure that this type of catastrophe is never again caused by the financial industry and that U.S. taxpayers never again have to bail out reckless banks.

However, this crucially important law – **not five years old** – has been under relentless attack by some in the financial industry, led by the handful of too-big-to-fail banks on Wall Street and their many allies. These attacks, by design or effect, would often roll back essential financial reforms that protect American families, workers, the financial system and our economy. Worse, those attacks have too often either been disguised as claimed "relief" for small community banks or been smuggled into much larger bills which have only a few provisions related to small community banks.

Even worse, too many of these attacks have been fact-free talking points or outright misrepresentations. That is why Better Markets[2] issued the attached "Fact Sheet: Everything You Need to Know About the $50 Billion Threshold," which, as you may recall, was the subject of discussion at a Committee hearing on March 19th.[3] A key but often overlooked fact is that there are **about 6,500 banks in the U.S., but only 38 of those banks have $50 billion or more in assets**. That means that the $50 billion threshold, for example, is inapplicable to more than 99% of all the banks in the U.S.

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[1] *See* Better Markets, *Cost of the Crisis* (Sept. 15, 2012), *available at* www.bettermarkets.com/cost-crisis. *See also* Tyler Atkinson, David Luttrell and Harvey Rosenblum, *How Bad Was It? The Costs and Consequences of the 2007–09 Financial Crisis*, Federal Reserve Bank of Dallas (July 2013), *available at* http://dallasfed.org/assets/documents/research/staff/staff1301.pdf; U.S. GOV'T ACCOUNTABILITY OFFICE, REP. NO. GAO-13-180, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT (2013).

[2] Better Markets is an independent, nonprofit, nonpartisan organization that promotes the public interest in the financial markets by advocating for transparency, oversight and accountability. Our goals are a stronger, safer financial system that is less prone to crisis and failure while at the same time one that serves society by funding the real economy that creates jobs, growth and broad based prosperity.

[3] For your information, statements made by one of the witnesses at that hearing incorrectly stated that a part of the Fact Sheet was inaccurate. It was and is entirely accurate, as was detailed here: http://www.bettermarkets.com/reform-news/better-markets-statement-fed-governor-tarullo%E2%80%99s-criticism-today%E2%80%99s-senate-banking-committ

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This is one of the many reasons Better Markets is deeply concerned about the so-called "Financial Regulatory Improvement Act of 2015," which the Committee is scheduled to consider on Thursday, May 21st. The bill, as drafted, would open dangerous loopholes in the financial reform law and expose American families, workers and taxpayers to unacceptable risks not only of another financial crash, but to more taxpayer-funded bailouts due to high risk big-bank behavior. While some relief for some of the 6,500 community banks may be merited, those changes should be carefully targeted to genuine community banks, based on the facts of actual needed relief from specifically applicable provisions, and continue to protect the country, including community banks, from another financial calamity. The attached fact sheet would be helpful in thinking through these issues.

While there are number of significant problems with this bill, Better Markets would like to take this opportunity to highlight two prominent concerns:

> **Section 201** would dramatically raise the systemically important bank threshold from $50 billion to $500 billion, exempting all but the *seven largest banks in the country*. And it would immediately remove 31 large banks from the heightened protections designed to help prevent another devastating financial crisis. It should be remembered that Washington Mutual – which failed in 2008 and had to be acquired to prevent its collapse – held $327 billion in assets yet would have been exempted under this change in the law. Moreover, such an increase in the threshold is unnecessary: the banking regulators currently have ample authority to tailor – and do tailor – their regulations to the size and risk profile of each bank, to avoid the imposition of safeguards that may be unnecessary.
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> **Section 302** would significantly overhaul the process for designating firms as systemically important. This change would make it much more difficult for the Financial Stability Oversight Council ("FSOC") to ensure that nonbank institutions are properly subject to enhanced oversight if they threaten the financial stability of the U.S. While there are some potentially positive provisions in the bill, they are far outweighed by provisions that would turn FSOC into a de facto government consultant and subject the designation process to long delays, procedural burdens, and legal challenges in court.[4] Importantly, FSOC has recently demonstrated that it is listening carefully to those who comment on its activities and even those who criticize them, including Better Markets, and is responding with meaningful changes in its designation consideration and determination process. This simply is not the appropriate time to impose changes on FSOC, especially not changes mandated by Congress that would be written into law, thus depriving FSOC of essential flexibility to adapt to unseen, unanticipated, new, and emerging systemic risks.

Rather than attempting to roll back critically important financial reforms designed to prevent another financial crisis – and all the losses and suffering that would inevitably

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[4] For more information, *see* Testimony of Dennis M. Kelleher before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, *FSOC Accountability: Nonbank Designations* (Mar. 25, 2015), *available at* https://www.bettermarkets.com/sites/default/files/Kelleher%20Testimony%203-25-15.pdf.

accompany it – the legislative process should be targeted, tailored and limited to real community banks, which fund and finance businesses, jobs, and growth. If that happened, we have no doubt that a bipartisan supermajority would support such a bill.

Sincerely,

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Fact Sheet: Everything You Need To Know About the $50 Billion Threshold

The Dodd-Frank Act requires the Federal Reserve (Fed) to evaluate banks with assets of at least $50 billion more closely than those with fewer assets. Currently only 38 of the approximately 6,500 banks in the United States have assets exceeding $50 billion (less than 1 percent).[1] Put differently, the $50 billion threshold excludes over 99% of all banks in the United States from enhanced review by the Fed.

Size of Institution	Number of Institutions
$2 Trillion and Over	2
$1 Trillion and $2 Trillion	2
$500 Billion to $1 Trillion	3
$400 Billion to $500 Billion	1
$300 Billion to $400 Billion	3
$200 Billion to $300 Billion	4
$100 Billion to $200 Billion	14
$50 Billion and $100 Billion	9
$10 Billion and $50 Billion	66
$1 Billion and $10 Billion	Approximately 580
$1 Billion and Below	Approximately 5830

Source: FDIC and Federal Financial Institution Examination Council as of December 31, 2014

Although it is only applicable to 38 banks, there has been a lot of attention to changing the $50 billion threshold by either increasing it or removing it altogether. However, most of that has not been based on the facts or the statutory and regulatory language, which show that the Fed has discretion on all the standards and has exercised that discretion to tailor those standards on a sliding scale of risk.

The first fact to remember is that the $50 billion threshold is merely the beginning of the analysis of what the Fed might -- or might not -- require upon a closer look at an institution above the threshold. Those requirements are based on size, complexity, activities and other factors that lead to varying risk profiles for banks above $50 billion. As such, the Fed does not treat all banks above the threshold the same way. Indeed, the statute provides the Fed with a significant amount of discretion to tailor the enhanced standards that it applies. Therefore, to evaluate proposals to change the threshold it is necessary to understand what happens today when a U.S. bank holding company has $50 billion or more in assets. The answer lies in the text of the Dodd-Frank Act and in the regulation implementing the law.

[1] http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx

The starting point for an analysis of the $50 billion threshold is Section 165 of the Dodd-Frank Act. In particular, Section 165(a) of the Dodd-Frank Act requires the Fed to establish "enhanced supervision and prudential standards" for bank holding companies with more than $50 billion assets that are both (1) stronger than the standards applicable to smaller institutions and (2) increase in strength based on an evaluation of each bank holding company's unique riskiness.

The statute requires the Fed to apply certain standards and also provides the Fed with full discretion in applying other enhanced standards. Most importantly, the law grants the Fed broad discretion to tailor **any** standards that it applies under Section 165(a):

Standards the Fed MUST Apply, but MAY Tailor As Part of Enhanced Supervision:

(i) Risk-based Capital Requirements and Leverage Limits;
(ii) Liquidity Requirements;
(iii) Overall Risk Management Requirements including the Formation of a Risk Committee;
(iv) Resolution Plan and Credit Exposure Report Requirements;
(v) Concentration Limits; and
(vi) Annual Stress Tests.

Standards the Fed MAY Apply and MAY Tailor As Part of Enhanced Supervision:

(i) Contingent Capital Requirements;
(ii) Enhanced Public Disclosures;
(iii) Limitations on Short-term Debt; and
(iv) Such Other Prudential Standards as the Board Determines are Appropriate.

The law also gives the Fed discretion to establish, on its own, a threshold higher than $50 billion for the application of certain enhanced standards:

Standards From Which the Fed May Exempt Entirely Certain Banks Above $50 Billion:

(i) Contingent Capital Requirements;
(ii) Resolution Plan and Credit Exposure Report Requirements;
(iii) Concentration Limits;
(iv) Enhanced Public Disclosures; and
(v) Limitations on Short-term Debt.

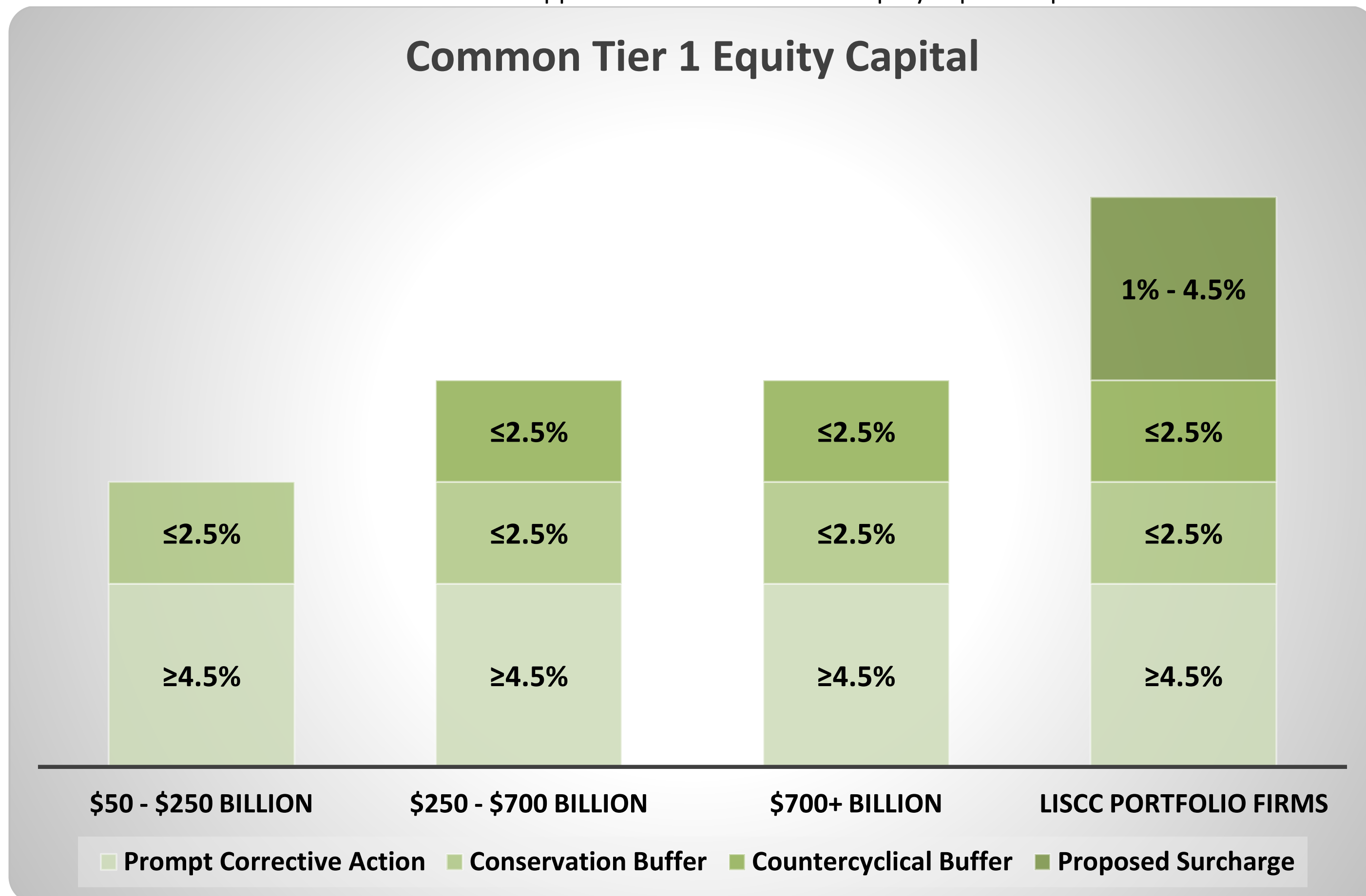
As is clear, the statute gives an immense amount of flexibility and discretion to the Fed. Indeed, even as to the standards that the Fed must apply, the law gives the Fed discretion as to how and how much to apply each standard.

The next point of analysis is the implementation of the law by the Fed. Through a series of rulemakings, the Fed has further explained how it will apply such enhanced standards. In general, the standards increase as the bank holding company's total consolidated assets and risk profile increase. These standards do not apply to nonbank financial companies designated by FSOC (which are subject to other standards).

The sections below describe how the Fed has implemented these standards.[2]

Risk-Based Capital Requirements and Leverage Limits: Under rules implementing the Basel 3 capital standards, banks with total consolidated assets between $50 billion and $250 billion are subject to enhanced capital and leverage standards under the "standardized approach." Banks with total consolidated assets in excess of $250 billion are subject to the "advanced approach," which imposes a more stringent standard that the "standardized approach." Additionally, under the "advanced approach" banks with total consolidated assets in excess of $700 billion and those subject to the Large Institution Supervision Coordination Committee are subject to additional capital and leverage surcharges.

The chart below describes the Fed's tailored approach to common tier 1 equity capital requirements.



Liquidity Requirements: Banks with total consolidated assets between $50 and $250 billion are subject to a less stringent review by the Fed than banking organizations with total consolidated assets in excess of $250 billion.

Overall Risk Management Requirements including the Formation of a Risk Committee: Under the statute, institutions with more than $10 billion in assets are required to establish a risk committee. For banks with total consolidated assets greater than $50 billion, regulations require the committee to be independent and report directly to the board of directors.

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[2] Federal Reserve Board, *Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations*, 79 Fed. Reg. 17240 (Mar. 27, 2014); Dodd-Frank Act Stress Test 2015: Supervisory Stress Test Methodology and Results at 15 (March 2015); Office of the Comptroller of the Currency, et al., *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*, 79 Fed. Reg. 61440 (Oct. 10, 2014); Federal Reserve Board, *Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies*, 79 Fed. Reg. 75473 (Dec. 18, 2014).

Resolution Plan and Credit Exposure Report Requirements: U.S. financial institutions engaged primarily in banking activities with less than $100 billion in non-depository institution assets may submit a tailored proposal under the "Less Detailed Resolution Plan Alternative."

Concentration Limits: The statute limits the ability of any company subject to enhanced prudential standards from having credit exposure to any unaffiliated company that exceeds 25 percent of the bank's capital. Each bank, through its risk management process, is required to adhere to this limitation, although the Fed has the discretion to exempt an institution entirely if it deems it appropriate.

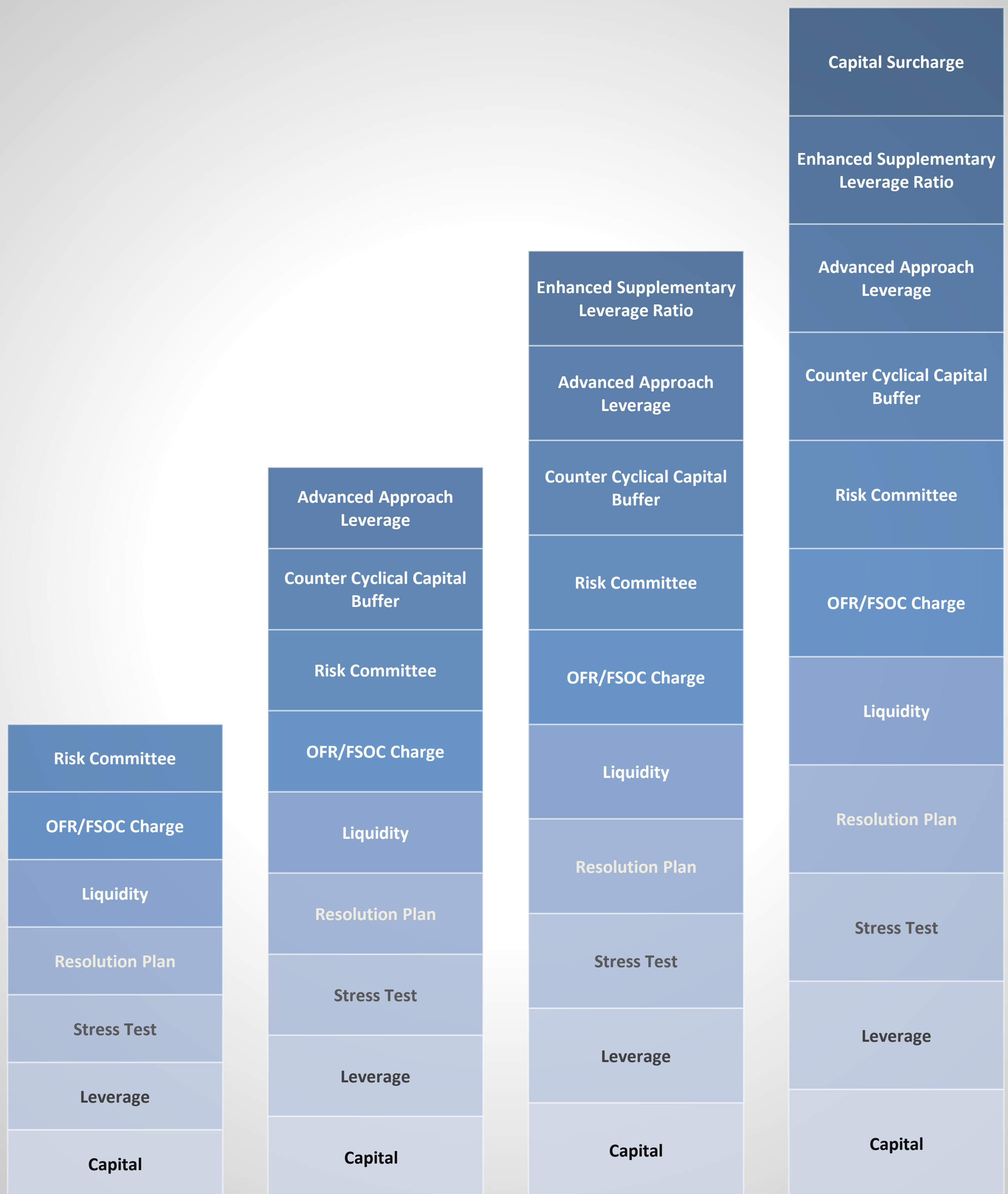
Annual Stress Tests: While the statute applies the annual stress test requirement to all banks with assets in excess of $10 billion, regulators have provided less stringent requirements for banks with assets between $50 and $250 billion, and lesser still requirements for banks with assets between $10 and $50 billion. Banks under $10 billion are exempt.

Contingent Capital Requirements: The rule requires banks to have a contingency funding plan, which must have at least a quantitative assessment and an event-management process. The Fed does not itself say what should be in the plan.

Enhanced Public Disclosures: Enhanced disclosure in a number of areas is required, and such disclosure is not tailored by bank size.

Limitations on Short-term Debt: Regulations for this section are not yet written.

The chart below details which key elements of the Fed's enhanced prudential regulations apply to banks of different asset size:



Tailored Key Elements of Enhanced Prudential Regulation
Risk Committee
OFR/FSOC Charge
Liquidity
Resolution Plan
Stress Test
Leverage
Capital
Advanced Approach Leverage
Counter Cyclical Capital Buffer
Risk Committee
OFR/FSOC Charge
Liquidity
Resolution Plan
Stress Test
Leverage
Capital
Enhanced Supplementary Leverage Ratio
Advanced Approach Leverage
Counter Cyclical Capital Buffer
Risk Committee
OFR/FSOC Charge
Liquidity
Resolution Plan
Stress Test
Leverage
Capital
Capital Surcharge
Enhanced Supplementary Leverage Ratio
Advanced Approach Leverage
Counter Cyclical Capital Buffer
Risk Committee
OFR/FSOC Charge
Liquidity
Resolution Plan
Stress Test
Leverage
Capital
$50 - $250 BILLION
$250 - $700 BILLION
$700+ BILLION
LISCC PORTFOLIO FIRMS

A number of other sections of the Dodd-Frank Act – unrelated to prudential standards that may or may not apply under Section 165 discussed above – impose certain requirements on bank holding companies in excess of $50 billion. However, in only two circumstances do regulators lack flexibility to tailor those requirements:

Provisions that Apply to Companies with Assets in Excess of $50 Billion:

- Section 163, which limits bank's ability to acquires ownership or control of any other bank without notifying the Fed; and
- Sections 723 and 763, which prevent banks in excess of $50 billion from receiving an exemption as an end-user from the requirement that swaps be cleared.

Other provisions of the Act provide the regulators with the ability to tailor requirements imposed on institutions with assets in excess of $50 billion:

Provisions that May be Tailored to Apply to Companies with Assets in Excess of $50 Billion:

- Section 144, which allows the Treasury to impose assessments and fees on these banks to fund the Office of Financial Research ("OFR");
- Section 318, which allows the Fed to collect assessments and fees necessary to conduct enhanced supervision;
- Section 116, which allows the Office of Financial Research to require reports from companies to inform the work of the Financial Stability Oversight Council (FSOC);
- Section 121, which allows the Fed, if it determines that a company poses a "grave threat to the financial stability of the United States," and has the determination upheld by a 2/3 affirmative vote of FSOC to: limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company, restrict the ability of the company to offer a financial product or products, require the company to terminate one or more activities, impose conditions on the manner in which the company conducts 1 or more activities, or require the company to sell or otherwise transfer assets; and
- Section 765, which requires the SEC to limit conflicts of interest in control of swap execution facilities or swaps clearing agencies.

In summary, the Fed, in conjunction with the other banking regulators, has used its discretion under the Dodd-Frank Act to tailor enhanced prudential standards so that a $50 billion bank is not treated the same as a $250 billion bank or a $2 trillion bank.

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