



August 26, 2018

The Honorable Jerome H. Powell  
Chairman  
The Honorable Randal K. Quarles  
Vice Chairman for Supervision  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Re: Response to Congressional Letters Regarding Capital

Dear Chairman Powell and Vice Chairman Quarles,

Recently, a number of members of the U.S. House of Representatives' Financial Services Committee and the Senate Banking Committee sent you separate letters regarding the capital surcharge that is imposed on the very largest U.S. financial institutions.<sup>1</sup>

The letters, which asked you to lower the capital buffers for eight of the largest banks in the United States, overstate the impact of the capital surcharge on these banks, and dramatically understate the important role that these surcharges play in promoting the protection of the American taxpayer and our financial system. Consequently, we write to encourage you to reject these and any other similar requests to reduce the capital surcharge on the small number of global systemically important banks (GSIBs) which are currently subject to it.

Contrary to claims made in both letters, the Federal Reserve's capital surcharge poses no threat to U.S. banks' international competitiveness. Indeed, all available evidence shows that U.S. banks are dominating nearly every category of banking activity globally, as their foreign counterparts are still hobbled with distressed assets on their balance sheets, having not

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<sup>1</sup> July 27, 2018 [Letter](#) from Congressman Barr, et al., to Vice Chairman Randall K. Quarles; August 2, 2018 [Letter](#) from Senator Rounds, et al., to Chairman Powell (Politico Pro cite, subscription required); see also "[House Republicans ask Fed to lower capital requirements for megabanks](#)," John Heltman, American banker, July 30, 2018; "[GOP Senators join criticism of Fed over capital rules for megabanks](#)," Neil Haggerty, American Banker, August 2, 2018; "[Big banks struggle to win broad lawmaker support in push to ease rules](#)," Zachary Warmbrodt, Politico, August 13, 2018; "[Lobbyists, letters and money: How banks are taking aim at post-crisis regulation with help from Congress](#)," Lydia Moynihan and Charles Gasparino, FOX Business News, August 10, 2018.

yet recovered from the financial crash. That is why, for example, it is widely recognized that U.S. banks “beat their European rivals on almost every financial measure.”<sup>2</sup> As former Federal Reserve Board Chair Janet Yellen testified before Congress last year, “U.S. banks are generally considered quite strong, relative to their [international] counterparts. They built up capital quickly, partly as a result of our insistence that they do so, following the financial crisis.... They’re gaining market share and they remain quite profitable.”<sup>3</sup>

No less an authority than Gary Cohn, former President of Goldman Sachs and most recently former Chairman of President Trump’s National Economic Council, agreed:

Almost all US banks took our medicine [recapitalizing, restructuring and implementing financial reform rules] early. We went out and raised capital really early in the process and then we went out and raised capital a second time....We really built our balance sheet up. We really de-leveraged ourselves. We really built enormous excess liquidity....And we made ourselves as financially secure as we could. We’re subject to enormously robust stress tests here in the United States, and I give the Fed enormous credit for what they’ve done in stress testing the major banks here in the United States. [It’s t]o the point where no one should question the viability of the big U.S. banks. I think some of the European banks have been slow to getting themselves recapitalized and getting their financial balance sheet in the best place it can be.<sup>4</sup>

The latest confirmation that capital is a key for stability, financial protection, lending through the cycle as well as a significant competitive advantage comes from Adam Tooze in his just released book [Crashed: How a Decade of Financial Crises Changed the World](#). Agree or disagree with everything in his book, his thought-provoking and indispensable analysis definitively refutes any attempts to argue that US banks are at any competitive disadvantage.<sup>5</sup>

Moreover, the GSIB capital surcharge works, as you know, alongside and in conjunction with other layers of financial reform rules to protect our financial system from another 2008/2009-style crisis. As FDIC Director Gruenberg (who was Chairman of the FDIC at the time) noted, the capital surcharge, the 2013 capital rule, and the 2014 enhanced SLR rule, “[W]ere designed to improve safety and soundness and reduce the probability of failure of banking organizations, as well as to reduce the consequences to the financial system if such a failure were to occur.”<sup>6</sup> Indeed, the letter from the members of the Senate Banking Committee notes “the significant progress made since the crisis in increasing the resiliency of our financial

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<sup>2</sup> <https://www.ft.com/content/65eb0710-e3bd-11e5-a09b-1f8b0d268c39> ;

<sup>3</sup> <http://www.cnn.com/2017/02/14/janet-yellen-banks-are-lending-and-quite-profitable.html>

<sup>4</sup> <https://www.bloomberg.com/news/articles/2016-02-09/u-s-banks-safer-than-europeans-due-to-early-medicine-cohn-says>

<sup>5</sup> Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (2018).

<sup>6</sup> Statement of Martin J. Gruenberg, on Notice of Proposed Rulemaking on Supplementary Leverage Ratio by the Federal Reserve and OCC (Apr. 11, 2018), available at <https://www.fdic.gov/news/news/speeches/spapr1218.pdf>

institutions and our financial system.” The GSIB capital surcharge is an essential part of the progress that has been made.

The GSIB capital surcharges are reasonable, prudent, carefully tailored and support lending through the business-cycle. They permit banks to thrive, while also protecting the financial system. For example, well-capitalized banks are, by definition, less risky and, therefore their cost of capital should be lower than less well-capitalized competitors. Importantly, capital requirements also promote lending to support the economy and job creation, as the data clearly show. As we have discussed, scholar Morris Goldstein’s definitive study in his recent work, *Banking’s Final Exam*, demonstrates this conclusively:

Better capitalized banks lend more, not less, than weakly capitalized ones. One recent impressive study...finds that after holding other factors constant, a 1%-point increase in the equity to total assets ratio (i.e., the leverage ratio) is associated with a 0.6% increase in total lending growth. With this empirical finding, a key pillar of the case against much higher capital requirements is taken away.<sup>7</sup>

This needs to be a foremost consideration as the current record-breaking business cycle continues. When the inevitable downturn comes, we need banks that are sources of strength for the economy, not pro-cyclical drains on the economy as they pull-back on lending to repair their balance sheets and conserve capital as their write-downs mount.

Moreover, as announced yet again this week,<sup>8</sup> U.S. banks’ record or near-record levels of revenues, profits and bonuses over the last several years attest to the strength of those financial institutions and prove that the current capital and other regulations are not in any way hurting them competitively, internationally or otherwise.

Finally, any consideration of changing capital requirements as requested by the members of Congress or others must be considered in light of the perilous and unprecedented economic and financial circumstances facing the country today. Namely:

- the country is deep into the business cycle, the second-longest recovery since the end of World War II;
- the S&P 500 just reached the longest-ever bull market;
- more than \$2 trillion in stimulus has been injected into the economy via tax cuts and spending increases;
- the Federal Reserve is unwinding its unprecedented 2008-2009 emergency monetary policy measures, including reducing its balance sheet and moving away from its zero interest rate policy;
- the Federal Reserve is also in the midst of responding to, at best, ambiguous economic conditions by raising interest rates for the first time in ten years;

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<sup>7</sup> Morris Goldstein, *Banking’s Final Exam: Stress Testing and Bank-Capital Reform* (2017).

<sup>8</sup> The second quarter net income of US banks for 2018 rose 25 percent from the same period in 2017 for a \$12.1 billion increase, according to the Federal Deposit Insurance Corporation (FDIC). See. [FDIC Quarterly Bank Profile](#), FDIC.

- multiple significant legislative and regulatory steps have been taken to eliminate financial protection rules that were enacted after the 2008 financial crisis;
- the financial system is once again significantly leveraged, to historical levels by many measures;<sup>9</sup> and
- banks are once again beginning to lower their standards for underwriting and lending.<sup>10</sup>

The conclusion we draw from this data is that the last thing prudential regulators should do at this point in time under these circumstances – many unprecedented -- is reduce capital requirements on the largest banks in the world. In fact, in light of the facts and circumstances summarized above, the Fed and other regulators should consider imposing counter-cyclical measures, including building up banks' capital buffers to protect the financial system, to mitigate the next downturn, to facilitate lending through the cycle, and to prevent future taxpayer bailouts.

Therefore, we urge you to reject any importuning to reduce capital, which would reduce what has proven to be an effective and sensible bulwark for our financial system and the American taxpayer, particularly because the country needs to be prepared for the downturn.

Thank you for your consideration of this letter.

Sincerely,



Dennis M. Kelleher  
President and CEO

CC: Governor Lael Brainard

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<sup>9</sup> See, e.g., "[Household Borrowings Reaches Record \\$13.3 Trillion Rising as Rates Have Yet to Bite](#)," Josh Zumbrun, August 24, 2018, The Wall Street Journal, and "[Debt for US corporations tops \\$6 trillion](#)," Thomas Frank, June 27, 2018, CNBC.

<sup>10</sup> As the Fed staff knows all too well, there are numerous examples of this. For the latest, see, e.g., Frank, *supra* note 9, and "[Lenders Shunned Risky Personal Loans. Now They're Competing for Them](#)," AnnaMaria Andriotis and Peter Rudegeair, August 25, 2018, The Wall Street Journal.