October 1, 2018

Honorable Michael Crapo
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Re: Regulatory Implementation of the Economic Growth, Regulatory Relief and Consumer Protection Act

Dear Chairman Crapo and Ranking Member Brown:

Having participated in more than 200 rulemakings and related activities since our founding in 2010,[1] including the privilege of testifying before this Committee a number of times,[2] Better Markets[3] appreciates the invitation to comment on the October 2, 2018 Senate Banking Committee hearing on the regulatory implementation of the Economic Growth, Regulatory Relief and Consumer Protection Act, formerly S. 2155 (the "Act").

Given the recent 10th anniversary of the collapse of Lehman Brothers on September 15, 2018, many are reflecting on the 2008 financial crash and the onset of the worst financial crash since 1929, which caused the worst economy since the Great Depression of the 1930s.[4] As is

---

[1] *See, e.g.,* Annual Report, available at https://bettermarkets.com/sites/default/files/2016%20Annual%20Report%20%28Better%20Markets%29.pdf.

[2] *See, e.g.,* "FSOC Accountability: Nonbank Designations," March 25, 2015 hearing, Committee on Banking, Housing, and Urban Affairs, available at https://www.banking.senate.gov/hearings/fsoc-accountability-nonbank-designations.

[3] 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 that protects and promotes Americans' jobs, savings, retirements, and more.

[4] *See* Better Markets, "The Cost of Crisis, $20 Trillion and Counting", July, 2015, available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis-2.pdf and Federal Reserve Bank of San Francisco, "The Financial Crisis at 10: Will We Ever Recover," August 13, 2018, available at https://www.frbsf.org/economic-research/publications/economic-letter/2018/august/financial-crisis-at-10-years-will-we-ever-recover/.

too well known, much of that economic devastation is ongoing for tens of millions of Americans, and the economic, social and political upheavals it caused are continuing as well.[5]

However, too many are forgetting or ignoring some of the most important and basic lessons of that financial crisis. In particular, without vigilant and independent oversight and regulation, financial institutions of various sizes, activities and complexity, often deeply interconnected and highly leveraged, can build up so much risk, often unseen and poorly understood, that they eventually threaten the economic stability of the financial system and the entire country. That is what happened in the years before the last crash and, unfortunately, that is what is happening again as memories fade and as the private sector rebounds and pursues its narrow interests in maximizing profits, as is their right if not duty. That's why vigilant and independent oversight and regulation are so critically important to protect the public interest and avoid future crashes, taxpayer bailouts and economic catastrophes.

Importantly, none of this requires evil actors in or motives by the private sector. It's the nature of markets and financial firms, individually and, ultimately, collectively. That is the unsettling, but undeniable truth behind former Citigroup CEO Chuck Prince's infamous and much misunderstood quote in July 2007:[6]

> "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you're got to get up and dance. We're still dancing."[7]

Translation: when a financial institution and its peer group are making lots of money doing roughly the same thing and their stock is going up (i.e., the market "music" is playing), they have to keep doing the same thing ("dancing") or their revenues, profits, bonuses and stock will go down ***relative*** to their peer group. While doing otherwise may be tolerated by a board, the executives and stockholders for a short time, it won't last long as revenues, profits and stock drop relative to their peers, which is why Mr. Prince was right: "as long as the music is playing, you've got to get up and dance."

That is why regulators, supervisors and public officials must be vigilant and independent in their oversight, regulation and enforcement. Put differently, they have to step in and slow the tune if not change the song or stop the "music" altogether, regardless of how much "dancing" the private sector is doing or wants to do. Without taking such independent and, at

---

[5] *See, e.g.,* "Crashed: How a Decade of Financial Crises Changed the World," Adam Tooze (2018).

[6] It is telling that this statement was just a month after Bear Stearns had to bail out one of its hedge funds and just days before the collapse of two of its hedge funds, which had been unsuccessfully shopping their positions since the first quarter of 2007. That is to say, in July 2007 there were clear, strong and concrete indications of a coming crash visible to the major financial institutions on Wall Street, but the "music" continued to play. See "2 Bear Stearns funds Are Almost Worthless," Reuters, July 17, 2007, available at https://www.nytimes.com/2007/07/17/business/17cnd-bond.html.

[7] "Citigroup chief stays bullish on buy-outs," Michiyo Nakamoto and David Wighton, July 9, 2007, The Financial Times, available at https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac.

times, unpopular actions, the public interest is subordinated and exposed to the erratic and volatile dynamics of the marketplace, with devastating crashes the inevitable result.

Regulatory Implementation of the Act

It is with those baseline understandings in mind that we think about the implementation of the Act. No one disputes that the Act requires regulators to undertake certain, specific actions. However, it also appropriately and wisely provided regulators with ample discretion to use their best judgment and expertise to ensure the safety, soundness and stability of the financial system. Put differently, as you know, the legislation does not mandate unwise, mechanical or blind deregulation that would undermine financial stability, increase the likelihood of future bailouts, and once again harm hardworking Americans who are still paying the bill for the last crash that they did not cause.

The challenge and responsibility of getting this right cannot be understated. As former Senator Ted Kaufman said on the Senate floor during debate over the Dodd-Frank Act, wise regulators are critical bulwarks against the future crashes:

> The [Dodd-Frank] financial reform bill places enormous responsibilities and discretion into the hands of the regulators. Its ultimate success or failure will depend on the actions and follow-through of these regulators for many years to come. One of my main concerns is, if we elected another President who believed we should not have regulators and regulation, they would again have the ability to do what they did to cause a meltdown.[8]

Of course, no one wants that to happen or another crash, but those are the stakes as elected officials, policymakers and regulators make decisions regarding financial regulation, including how to best implement the Act.

First, that means that those financial institutions with assets of more than $100 billion but less than $250 billion must be ***considered*** for enhanced prudential regulation based on an individualized, multifactor risk analysis that includes sizes, activities, complexity, interconnectedness, leverage and other risk factors – as was the case previously for institutions with more than $50 billion in assets.[9] It is simply baseless to claim, as some have,[10] that financial firms with less than $250 billion in assets do not pose any systematic risk. One need

[8] Congressional Record Volume 156, Number 105 (Thursday, July 15, 2010) Available at https://www.gpo.gov/fdsys/pkg/CREC-2010-07-15/html/CREC-2010-07-15-pt1-PgS5870-2.htm.

[9] *See* Better Markets "Fact Sheet: Everything You Need to Know About the $50 Billion Threshold" (November 28, 2016), available at https://bettermarkets.com/sites/default/files/50b%20Fact%20Sheet%20Updated%20Long%20Version%2011.28.16_0.pdf

[10] *See, e.g.,* August 17, 2018 letter to Federal Reserve Board Vice Chairman Randal Quarles from several Senators, available at https://www.perdue.senate.gov/imo/media/doc/Letter%20to%20VC%20Quarles%20re%20401-%20Final.pdf.

only glance at the list of hundreds of banks receiving TARP money in 2008-2009[11] to quickly see that systemic risks are not limited to only the top dozen banks in the United States. Indeed, banks of all sizes also availed themselves of the Fed's many emergency rescue programs from 2007 through 2012, proving that systemic and contagion risk was significantly broader than those few banks with more than $250 billion in assets. Finally, regarding the 26 specific banks that will benefit the most from the Act, a Better Markets analysis reveals that they received more than $2.5 trillion in emergency bailouts during the financial crisis.[12]

Second, some proponents of weakening or eliminating the financial protection rules that were enacted after the financial crisis have urged the Fed to discontinue the use of Comprehensive Capital Analysis and Review (CCAR) stress tests. Such an action would be as unwarranted as it would be unwise. As has been detailed and well-recognized in the United States and around the world (including by the Fed[13]), stress tests are one of the Fed's most significant and successful post-crash actions. We will not burden you here with the mountain of proof of that other than to refer you to scholar Morris Goldstein's amply detailed book "Banking's Final Exam: Stress Testing and Bank-Capital Reform."[14]

Third, after years of falsely claiming that Dodd-Frank and the Fed improperly regulate by size alone, supporters of the Act now often argue that financial firms with less than $250 billion in assets cannot possibly pose a systemic threat to the financial system. However, the notion that financial institutions with between $100 billion and $250 billion in assets are *by definition* incapable of posing a risk to the financial system is unsupported by evidence, and in fact is directly contradicted by the historical record, as discussed above.[15] Moreover, big banks in the $100 billion to $250 billion asset range provide critical credit to large parts of the economy and the failure of one or more of them would have devastating effects on their borrowers, which could well spill over into a larger crisis.

Indeed, an important lesson of the 2008 financial crisis is that the distress, failure or inability to satisfy the obligations of a mid-to-large size bank at an inopportune time can exacerbate a crisis, ignite contagion and plunge already troubled markets into chaos. Just one example is Countrywide Financial, which had approximately $117 billion in assets when acquired by Bank of America, but which generated $65.3 billion in losses, crippling the bank for years even after it received $45 billion in TARP funds.

---

[11] *See, e.g.,* "Tracking the $700 Billion Bailout," New York Times, available at http://archive.nytimes.com/www.nytimes.com/packages/html/national/200904_CREDITCRISIS/recipients.html?scp=5&sq=tarp&st=cse.

[12] https://bettermarkets.com/resources/who-does-s-2155-benefit-recidivist-giant-banks-received-trillions-taxpayer-bailouts

[13] *See infra* n. 19 and accompanying text.

[14] Bankings Final Exam, Columbia University Press (2017), available at https://cup.columbia.edu/book/bankings-final-exam/9780881327052.

[15] *See*, *supra*, n. 11 and accompanying text.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

As Stanford's Anat Admati, Paul Pfleiderer, and Amit Seru have noted, policymaking based on this flawed assumption "is potentially quite dangerous."[16] Firms with between $50 billion and $250 billion in assets, they note, "are not community banks. The failure of one or more of them will cause significant disruption and collateral harm, particularly in the context of overall market turmoil."[17] Whether or not they "will cause" deleterious consequences, they may and that alone requires the Fed to undertake an individualized risk assessment rather than blindly exempting all such banks due to an uninformative asset size number.

Indeed, history shows the speed with which turmoil among these sub-$250 billion banks can spread through the financial system: "The Savings and Loan crisis along with some other banking crises have also shown that even small institutions that all take similar risks and tend to fail at the same time can be dangerous and costly."[18]

Fourth, while we agree with Federal Reserve Chairman Jerome Powell's testimony before Congress in March that "supervisory stress-testing is probably the most successful regulatory innovation of the post-crisis era,"[19] it is also important to note that the results of the stress tests are only as valid as the assumptions upon which they were based and the rigor with which they are conducted. Financial institutions - including those with hundreds of billions of dollars in assets that were the focus of the Act - face risks that are interlinked and complex. By their very nature, these risks are difficult to predict. For that reason, reliance solely on stress tests can provide regulators with false assurances about the stability of the financial system as a whole, as well as the individual firms operating within it.

For this reason, the Dodd-Frank Act relies on a set of interconnected financial stability rules to help reduce risky behavior by banks, make banks more resilient to financial shocks, help regulators detect threats on the distant horizon, and give regulators tools to unwind failing firms quickly. But the interlocking system of financial stability rules will lose their effectiveness if they are dismantled piece by piece, in whole or in part, as could happen with the implementation of the Act.

Fifth, a particularly dangerous suggestion is that implementing the Act should automatically include a number of foreign banks operating in the US, many of which received very significant bailouts during the financial crisis. As most recently detailed by Adam Tooze in his book "Crashed,"

> [T]he Fed, without public consultation of any kind, made itself into a lender of last resort for the world….providing a stopgap of liquidity that, all told, ran into the trillions of

[16] Letter to Chairman Crapo, March 6, 2018, available at https://www.gsb.stanford.edu/sites/gsb/files/admati-pfleiderer-seru-letter-s.2155-final.pdf
[17] *Id.*
[18] *Id.*
[19] https://www.bloomberg.com/news/articles/2018-03-20/fed-still-reigns-supreme-over-banks-despite-dodd-frank-rewrite

> dollars and was tailored to the needs of banks in the US, Europe and Asia. It was historically unprecedented, spectacular in scale and almost entirely unheralded.[20]

It is unfortunate that the many Fed facilities and actions, particularly regarding its assistance to foreign banks, have received so little substantive attention and review. This is undoubtedly due, in part, to "the Fed label[ing] its liquidity facilities in a bamboozling array of acronyms,"[21] which appear to have been a created complexity intended to prevent transparency, oversight and accountability.[22]

Nevertheless, the known facts starkly illustrate the risks posed to the US and US taxpayers from the operation of foreign banks, including most tellingly that nine of the top twenty largest users of the Fed's emergency lending facilities during the crisis were foreign banks.[23] This included Fed's "gigantic"[24] Term Auction Facility (TAF), which was one of the many programs created to bail out the asset backed commercial paper markets: "if TAF loans of varying duration are converted to a common twenty-eight day basis, the total sum loaned came to a staggering $6.18 trillion in twenty-eight day loans."[25] Remarkably, foreign banks were "over 50 percent of the borrowers"[26] of TAF. Another example was the Fed's $2 trillion Term Security Lending Facility (TSLF) where "51 percent was lent to non-American banks."[27] About 40 percent of its $737 billion Commercial Paper Funding Facility (CPFF) went to European banks.[28] Most of these programs were dwarfed by the staggering size of the swap lines, which, by September of 2011, amounted to $10 trillion.[29]

Deutsche Bank's U.S. subsidiary Taunus is a good illustration of the US bailouts not just of foreign banks, but of foreign banks' US operations. Leaving aside the bailout of the parent company Deutsche Bank, Taunus itself was bailed out with at least 354 billion American dollars, which prevented it from going bankrupt and requiring the emergency assistance of German

---

[20] *Supra* n. 5 at p. 202.
[21] *Id*. at p. 206.
[22] The inevitable result is, of course, "the scale of the Fed's liquidity actions was so large and varied that it poses problems of accounting," as Adam Tooze noted. *Id*. at p. 207. He asked the right questions, but also provided the answers: "How should one measure the Fed's huge programs? As a stock at a point of maximum exposure? As a rate of flow over a given period during the crisis? Or should one simply compile the sum total of all lending from the beginning to the end of the crisis? The first measure will tend to minimize the image of intervention. The last measure will yield the largest figure. Each measure has its uses. Thanks to records extracted from the Fed by legal action, we can compile all three numbers." *Ibid*. (citations omitted)
[23] https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again; *see also*, Tooze, *supra* n. 2 at p. 217 and accompanying text.
[24] *Supra* n. 5 at p. 207.
[25] *Ibid.*
[26] *Id*. at p. 208.
[27] *Ibid.*
[28] *Id.* at p. 209.
[29] *Id.* at p. 213.

taxpayers.[30] Put differently, the U.S. government substituted US taxpayers for German taxpayers to bail out a German bank and prevent it from failing: because Deutsche Bank itself was in such financial distress and on the verge of failure, it simply did not have the ability to bail out its US operations and, therefore, the German government would have had to first bail out Deutsche Bank so that it could bail out its US subsidiary.[31]

Making matters worse, notwithstanding the lifesaving generosity of the US bailouts, Deutsche Bank (along with another foreign bank with significant operations in the US) then reorganized its US operations in 2010 to avoid US capital requirements (applicable to all bank holding companies in the US), which resulted in its US operations having a Tier 1 risk-based capital of -6.37 percent.[32] This action, among others, necessitated the enactment of the FBO rule and the requirement of intermediate holding companies ("IHCs") for foreign banks in the US.[33]

This history is often omitted from the debate about how to implement the Act, even while the law's supporters call on the Fed to ensure that that IHCs of foreign banks are treated comparably to U.S. bank holding companies of similar size and risk profile.[34] However, such an action would make the U.S. financial system less resilient, and more susceptible to the importation of risk from foreign banks, as detailed in our letter to the Federal Reserve on the subject of enhanced prudential standards and early remediation requirements for foreign banking organizations and foreign nonbank financial companies. In that letter, we noted:

> Foreign banking organizations play an important role in the U.S. financial system. Their U.S. regulated subsidiaries, and their lightly regulated branch and agency networks, issue large amounts of short-term dollar liabilities, and use the proceeds to lend to U.S. and foreign firms and to buy dollar denominated assets. When these organizations are distressed and there are runs on their financing, as was witnessed in 2008-2009, the effects on U.S. financial markets can be significant.[35]

Proponents of an aggressive implementation of the Act fail to recognize the unique threat to the American financial system posed by IHCs that are tied to their foreign parent

---

[30] https://bettermarkets.com/newsroom/senate-bank-deregulation-bill-will-put-us-taxpayers-hook-bailing-out-foreign-banks-again

[31] Adding insult to injury, Deutsche Bank bragged about not needing a bailout from the German government while never mentioning its lifesaving bailouts from the US government. As Adam Tooze put it, the "bullish" Deutsche Bank's CEOs "claimed exceptional status because they avoided taking aid from their national government[]. What the Fed data reveal is the hollowness of those boasts." *Supra* n. 5 at p. 218.

[32] See Better Markets comment letter on FBOs, April 15, 2013, available at https://bettermarkets.com/sites/default/files/documents/125-%20FRS-%20CL-%20Enhanced%20Prudential%20Standards-%204-15-13.pdf

[33] *See* "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies," December 12, 2012, available at https://www.gpo.gov/fdsys/pkg/FR-2012-12-28/pdf/2012-30734.pdf.

[34] *See, e.g., supra* n. 10.

[35] *See*, *supra*, n. 32; see also Crashed, supra n. 5 (detailing foreign distress, dollar demands and swap lines).

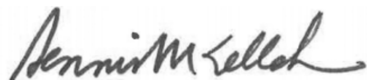
company, which may have a risk profile and contractual commitments to counterparties that are opaque to U.S. regulators. Consequently, "foreign institutions operating in the U.S.," write Admati, Pfleiderer and Seru, must be "regulated according to the risk they pose to the U.S. economy and citizens. The financial entanglement of foreign subsidiaries with their often very large parent institutions must be taken into account in determining the rules, and this means that regulations should be based on the size and systemic risk of the worldwide entity."[36]

Therefore, as with US institutions with $100 billion to $250 billion in assets, the Fed must do an individualized assessment of the unique risks each IHC poses to the US before making any determination to apply any of the provisions of the Act to any of them.

In conclusion, as your hearing reviews regulators' implementation of the Act, we urge you to carefully consider the importance of subjecting banks of all sizes and risk profiles to sensible and prudent financial protection measures, such as stress testing. And we urge you to encourage regulators to reject calls from some quarters to eliminate these measures, a step which may benefit the balance sheets of the banks involved, but also expose the U.S. taxpayer and our financial system to unnecessary risk.

Thank you for your consideration of this letter.

Sincerely,



Dennis M. Kelleher
President and CEO

CC: Members of the Senate Committee on Banking, Housing, and Urban Affairs
The Honorable Joseph M. Otting
The Honorable Randal K. Quarles
The Honorable Jelena McWilliams
The Honorable J. Mark McWatters

[36] *See supra* n. 16.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com