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Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street, S.W.
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Federal Deposit Insurance Corporation
Robert E. Feldman, Secretary
Attention: Comments/Legal ESS
550 17th Street, N.W.
Washington, D.C. 20429

Re: Fed Docket Nos. R-1627/ 1628; OCC Docket ID OCC-2018-0037; and FDIC RIN 3064-AE96

Dear Officers,

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comment on two companion proposals regarding new risk-based categories and associated prudential standards for large U.S. banks. The proposals, jointly issued by the Federal Reserve Board (Board, Fed) the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), implement Section 401 of S. 2155, formally known as the "Economic Growth, Regulatory Relief, and Consumer Protection Act." The proposals also amend certain prudential standards outside S.2155's statutory mandate relating to liquidity, risk management, stress testing, single counterparty credit limits, and capital requirements.

Generally we are concerned that the proposal relaxes safeguards beyond what Congress mandated. Of special concern, the agencies propose to relax liquidity requirements.

Overview

Following the financial crisis of 2008, Congress approved the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. That law included Section 165, which called for greater prudential standards for those banks with more than $50 billion in assets. There are about 39 such banks, out of a total of more than 5,000 in the United States. Even as the agencies adopted rules for these large banks, they tailored these rules based on size. The largest banks face stricter rules than those near $50 billion.

In 2018, Congress approved S. 2155. That law raised the $50 billion threshold for enhanced supervision to $250 billion. Public Citizen opposed this law. We argued that the failure of one or several of the two dozen banks that would face less scrutiny under S. 2155 presented a danger to the economy. For example, the largest loss suffered by the Federal Deposit Insurance Fund during the crash was IndyMac, which actually held about $30 billion in assets. Ally Financial, which now escapes enhanced scrutiny under the new banking law changes, received more than $16 billion from taxpayers through the Troubled Asset Relief Program (TARP). Zions, which lobbied against stricter rules a year before the financial crisis, will also now escape enhanced scrutiny, and it also received bailout funds. Had regulators applied enhanced supervision of firms in this asset range in the early 2000s, it might have prevented the reckless mortgage-making of the likes of CountryWide, which held about $200 billion in assets.

Proponents of S. 2155 offered no substantial justification for these relaxed standards, including no evidence that removing these banks from enhanced supervision would contribute to economic growth, Public Citizen believes that in reducing supervision instead of bolstering the economy, it may imperil the banks along with taxpayers who might be called upon to bail them out again.

We are not alone; the American public supports stronger Wall Street regulation, not weaker. The financial crash cost millions of Americans their homes, their jobs and their savings so they understand what's at stake when financial institutions don't have proper oversight. The conservative Cato Institute issued a poll showing bipartisan support for strong regulation.[1] And, when the Public Policy Polling group surveyed views on S 2155, it found that sixty four percent of respondents opposed the bill, while only 25 percent supported it. Additionally, when the group asked whether reducing oversight of community banks was worth the price of also reducing oversight of banks with up to $250 billion in assets, 67 percent opposed, while only 17 percent supported this trade off.[2]

We understand that the agencies must oblige congressional mandate, despite the weight of American opinion. As we will discuss shortly, however, we believe the agencies have stepped beyond the statutory obligations of S. 2155 in their attempts to relax supervision, a further affront to American economic interests.

Overview of Proposed Rules

Under the proposed rule changes, the agencies seek to classify banks into four new risk categories. Category I banks would now be classified as U.S. GSIBs, or "global systemically important banks." This includes the very largest banks, namely JP Morgan, Citigroup, Bank of America, Wells Fargo, Morgan

[1] Wall Street vs. The Regulators: Public Attitudes on Banks, Financial Regulation, Consumer Finance, and the Federal Reserve, CATO INSTITUTE (September 19, 2017) https://www.cato.org/survey-reports/wall-street-vs-regulators-public-attitudes-banks-financial-regulation-consumer

[2] Memo, *Strong Majorities Support Regulating Wall Street*, PUBLIC POLICY POLLING, (February 27, 2018) https://www.publicpolicypolling.com/wp-content/uploads/2018/02/AFRNationalMemoPollFeb18.pdf

Stanley and Goldman Sachs. Category II would be those large banks that are not GSIBs, but have at least $700 billion in assets (or consolidated assets of more than $100 billion and more than $75 billion in foreign-based assets). Category III would be those that have more than $250 billion in consolidated assets. And, Category IV would be those banks more than $100 billion and are not in the other categories. We do not object to these categories, although the agencies have provided no clear explanation of why these break points are relevant, or why there should be four categories instead of five—or for that matter ten. Thus, we ask the agencies provide such a justification before finalizing the rule.

We agree that size is the clearest indicator of systemic risk, and that enhanced prudential standards should apply as the size of the bank's assets increase. We note that the agencies have responded to congressional supporters of S. 2155 who complained about arbitrary size demarcations, namely the $50 billion level for enhanced supervision, by creating new arbitrary size demarcations.

In addition to the four new proposed risk categories, the agencies also propose to address specific financial institutions by creating an additional risk rubric. Characterization under this rubric would consist of an analysis of a firm's size, cross-jurisdictional (foreign) activity, its reliance on short-term wholesale funding, nonbank assets, and off-balance sheet exposures. Under this new rubric, size would be the first and most important indicator of risk, based on the premise that the failure or distress of larger institutions would harm the economy more than the failure of smaller ones. Cross-jurisdictional operations would be the second most important indicator given that a firm with sizeable foreign operations that fails means that more than one national regulatory or bankruptcy regime applies. This risk factor reflects that fact that interests of the United States may differ than those of another country with issues such as prioritization of payments to a financial firm's creditors. The third factor that would be analyzed is the financial firm's reliance on short-term, uninsured funding. The financial crisis revealed that many firms relied on overnight credit, such as repurchase agreements, as a daily source of credit. When these firms began to falter, that type of credit evaporated immediately. In addition, banking organizations that fund long-term assets with short-term liabilities from financial intermediaries may need to rapidly sell less liquid assets to meet withdrawals and maintain their operations in a time of stress. This can lead to fire sales, and depress prices not only at the faltering firm, but across the financial sector. Finally, the agencies propose to look to the preponderance of non-bank assets-- a proxy for a bank's complexity. Such activities interconnect the bank with other financial firms, and firms outside the agencies supervisory purview and therefore increase risk.

We welcome all of these additional categories for risk examination under the newly proposed rule. Ideally, banks seeking less oversight will be more judicious about their foreign operations, reliance on short-term funding, and complex investments, and thus are all important factors for regulators to analyze in determining systemic risk posed by a specific financial institution.

Reduced Liquidity Requirements

Our most serious concerns with the proposed rule regard the planned reduction in liquidity coverage ratios.

Liquidity refers to the ability sell assets quickly (without the need to discount the price) so as to cover immediate obligations, such as an increase in depositor withdrawals. The financial crisis of 2008 revealed that too many banks lacked both the capital (net worth) to remain solvent, and the liquidity to meet urgent demands from customers. Their subsequent failures led the Fed to provide emergency funding across a broad range of firms to shore up bankrupt institutions. The Dodd-Frank mandated strong liquidity buffers subsequently adopted by regulators were designed to prevent such a bailout in the future.

Under the proposed rule, firms that hold assets between $100 billion and $250 billion, which currently face modest, tailored liquidity requirements, would no longer be required to meet the liquidity coverage ratio[3] and the net stable funding ratio.[4] Where the liquidity ratio addresses ensuring a certain level of easily sellable assets are held by firms, the net stable funding ratio addresses the reliability of sources that lend to banks. The Fed estimates that this proposed change would reduce the liquidity buffers at these banks by $34 billion. While we do not support this change, we acknowledge that it reflects the congressional mandate in S. 2155.

However, the agencies do not stop at the boundary of that law. Currently, firms with more than $250 billion in assets must maintain liquid assets to cover 30 days of projected cash needs. The agencies propose to reduce the liquidity coverage ratio to between 70 and 85 percent of the current standard for banks between $250 and $700 billion. This group of banks holds $1.5 trillion in assets. This would reduce liquidity by $43 billion among this class of banks. [5] This rulemaking improperly expands changes beyond the congressional mandate, which only addressed banks with less than $250 billion in assets. The agencies claim that they are providing flexibility by tailoring the requirements. But these requirements are already tailored for size, complexity and risk profile of institutions. The current liquidity ratio was devised after careful analysis. Moreover, the proposed relaxation of requirements for this range of firms includes no economic justification.

There are, in fact, much more serious risks posed by this proposed relaxation for firms above $250 billion asset level. The institutions in this class suffered significant liquidity stress during the financial crisis. The FDIC and Fed provided funding support along with bailout funds from TARP. From the FDIC alone, this class received more than $125 billion in liquidity support from the FDIC's Temporary Liquidity Guarantee Program alone.[6]

Washington Mutual (WaMu), generally considered a more conservatively managed lender, failed for a number of reasons, but the proximate cause involved liquidity. Its mortgages were largely significantly underwritten; fewer than 20 percent covered houses where the outstanding balance of the mortgage was more than 80 percent of the value of the house. When the secondary market for mortgages collapsed, WaMu was unable to generate needed cash by selling its mortgages. After Lehman Brothers declared bankruptcy on September 15, 2008, WaMu depositors panicked and began to demand their deposits.[7] With insufficient funds to meet these depositor demands, the firm faced the threat of closure. The FDIC calculated that it would need to advance from its deposit fund $42 billion to meet these customer demands, greater than the balance of the fund itself.[8] In the end, JP Morgan acquired the firm—with

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[3] *Federal Banking Regulators Finalize Liquidity Coverage Ratio,* FEDERAL RESERVE BOARD (Sept. 3, 2014) https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140903a.htm

[4] *Agencies Proposed Net Stable funding Ratio Rule,* FEDERAL RESERVE BOARD, (May 3, 2016) https://www.federalreserve.gov/newsevents/pressreleases/bcreg20160503a.htm

[5] *Proposed Changes to Thresholds for Regulatory Capital and Liquidity Requirements*, FEDERAL REGISTER (Dec. 21, 2018) https://www.govinfo.gov/content/pkg/FR-2018-12-21/pdf/2018-27177.pdf

[6] *Statement by Martin Gruenberg, Meeting of FDIC Board of Directors*, FDIC (Nov. 20, 2018) https://www.fdic.gov/news/news/speeches/spnov2018a.pdf

[7] Kimberly Amadeo, *Washington Mutual and How it Went Bankrupt,* THE BALANCE (Dec. 4, 2018) https://www.thebalance.com/washington-mutual-how-wamu-went-bankrupt-3305620

[8] *Proposed Changes to Thresholds for Regulatory Capital and Liquidity Requirements*, see footnote 27, FEDERAL REGISTER (Dec. 21, 2018) https://www.govinfo.gov/content/pkg/FR-2018-12-21/pdf/2018-27177.pdf

government support— concreting the precedent that banks that pose such a widespread risk to our economy will end up being characterized as "too large to fail:" but also exacerbating another apparent problem—these firms are also too large to supervise.

This proposed rule is also problematic in that the agencies fail to identify the benefit of reducing the liquidity rules. Though the Fed notes that the reduction in the liquidity requirement will allow the banks to increase its investments in less liquid assets, it only states that it may generate a "modest" increase in revenue. We believe that the unspecified potential benefit in the face of a concrete increased risk to our economy does not justify this change. Moreover, bank investment in liquid assets contributes positively to the economy, such as the purchase of US Treasuries used to finance infrastructure, or corporate bonds that help fund the private sector. The banking sector has not suffered because the existing liquidity rules. On the contrary, the banking sector has enjoyed escalating and record earnings. In the latest FDIC Quarterly Banking Profile, the sector earned $62 billion, $14 billion or 30 percent more than for the same period in the previous year.[9] Some of this reflected the new corporate tax cut. As Fed Gov. Lael Brainard summarized, this reduction "comes at a time when large banks have comfortably achieved the required buffers and are providing ample credit to the economy and enjoying robust profitability. . . . [There is] little benefit to the institutions or the system from the proposed reduction in core resilience that could justify the increased risk to financial stability and the taxpayer."[10]

Commented [SH1]: I'm not sure this language gels with our usual messaging on cost/benefit analysis.

We oppose the reduction in liquidity coverage ratio requirements.

Lowered Capital Requirements

In its proposed rule, the Fed also proposes to permit banks with between $250 billion and $700 billion in assets to ignore rules that require their capital levels to reflect the unrealized losses and gains of certain securities. Capital refers to the value of the firm's assets less the value of its liabilities. Assets may include investments whose values may change, such as from the time they were acquired. In some cases, the current value may be higher than the purchase price, in some cases, it may be lower. Leading to the financial crisis, firms claimed to hold assets valued well beyond their true value on the market. When some were forced to sell those assets to meet urgent funding obligations, the reduced sale price revealed a banking sector woefully undercapitalized. This undermined confidence in the banking sector's funders, such as its bondholders and other creditors.

To address this problem, the banking agencies finalized a rule in 2013 to make the nature of capital more transparent. This required inclusion of unrealized gains and losses in an accounting called "accumulated other comprehensive income" (AOCI). This serves as an early alert for problems with a firm's capitalization. Eliminating this rule would end this early alert. Not only would this mean that failures could be even more precipitous, but creditors may be more concerned about lending to banks, and charge higher interest.

We oppose elimination of the AOCI accounting for this class of banks.

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9 *Quarterly Banking Profile*, FDIC (Third Quarter, 2018) https://www.fdic.gov/bank/analytical/qbp/2018sep/qbp.pdf

10 *Statement of Governor Lael Brainard,* FEDERAL RESERVE BOARD (Oct. 31, 2018) https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20181031.htm

Less Frequent Stress Tests

The agencies also propose to reduce the frequency of stress testing for financial institutions that pose significant risk. Regulators use "stress" tests to examine how a bank would perform under certain adverse conditions, such as a decline in employment. Ideally, a bank should remain solvent and liquid in periods of stress, and remain a robust lender to the economy. Without frequent stress tests, the public and market will not have a current outlook of the bank's stability. With infrequent stress tests, banks may take unnecessary risks during the gaps between tests, exacerbating their problems. As history has shown, good times may lead to overconfidence. In the years before the financial crisis, few market observers predicted a precipitous decline. The stress tests represents a discipline to prepare for such declines.[11]

Congress left the frequency of stress tests to the discretion of the agencies in S. 2155. We believe the agencies should maintain frequent stress tests and oppose the proposal to reduce them.

Conclusion

In addition to specific concerns about liquidity, capital and stress tests, we are concerned with the general deregulatory tenor of this rule, a disturbing trend that has developed over the last two years.

While the two proposed rules at issue here may not collapse the regulatory architecture that currently covers a profitable and productive financial sector, the agencies are in danger of toppling our economy since the removal of one of the building blocks of our existing financial safeguards may lead to a serious domino effect. It is instructive that many of these proposed rule changes do not enjoy the support of key officers, such as FDIC member Martin Gruenberg and Fed Gov. Brainard. Were the agencies simply responding to sober data analysis and congressional mandate, we believe adjustments would have won unanimous support.

There will be another financial crisis. The timing may unpredictable. But when investigators look back at the source of that crisis, they will inevitably find that financial firms exploited deregulation. We urge the agencies to maintain strong rules. At a time when the economy is growing, that unemployment is low, that bank profits are setting records, regulators should be looking at strengthening, not weakening Wall Street rules.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org.

Sincerely,

Public Citizen

[11] Nellie Laing, *Well Designed Stress Test Scenarios are Important for Financial Stability*, BROOKINGS INSTITUTE, https://www.brookings.edu/research/well-designed-stress-test-scenarios-are-important-for-financial-stability/