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Statement on Tailoring Rule, Resolution Plan Rule, and Assessment Proposal for Large Banking Organizations
by Governor Lael Brainard

I have supported changes to relieve burden on community banks, and I have voted for changes that are mandated by S.2155. Today's actions go beyond what is required by law and weaken the safeguards at the core of the system before they have been tested through a full cycle. At a time when the large banks are profitable and providing ample credit, I see little benefit to the banks or the system from the proposed reduction in core resilience that would justify the increased risk to financial stability in the future.

For the large domestic banks above the range in the statute, with assets of $250 billion to $700 billion, today's actions would reduce the liquidity coverage ratio (LCR) by 15 percent and remove an important requirement to ensure that regulatory capital is credibly loss absorbing. It is premature to reduce core capital and liquidity requirements for large banking institutions, since they have not yet been tested through a full cycle. At this point late in the cycle, we should not give the green light to large banking organizations to reduce the buffers they worked so hard to build post-crisis. This is especially important in light of reductions in capital as planned payouts exceed expected earnings at many of the largest banks.

**Liquidity at Domestic Banks**

The crisis demonstrated clearly that the distress of even noncomplex large banking organizations generally manifests first in liquidity stress and quickly transmits contagion through the financial system. The disruption associated with liquidity stress at two large domestic banking institutions in the $100 to $250 billion size range necessitated distress acquisitions.

Similarly, the failure of a large banking organization with roughly $300 billion in assets due to insufficient liquid resources triggered substantial spillovers.

The liquidity insolvency of a large banking institution with $250 to $700 billion in assets—or even $100 to $250 billion—would pose substantial risk of loss to the deposit insurance fund, especially since a distressed acquisition of a large banking institution by one of the largest domestic banking institutions is a less plausible option today than previously.

To address this vulnerability, we voted to finalize the LCR five years ago. The LCR was designed as a baseline requirement appropriate for all large banking firms that is already tailored to bank size and business model, and the compliance burden is relatively low. Although S.2155 does not require us to weaken this critical post-crisis safeguard for large banks, for domestic banks in the $250 to $700 billion size range, who account for $1.5 trillion in assets overall, today's rule will reduce the LCR requirement by 15 percent or $34 billion. For domestic banks in the $100 to $250 billion size range, who account for $1.9 trillion in assets overall, today's rule would eliminate entirely their current modified LCR requirement, a reduction of the LCR requirement by $167 billion.[1]

**Liquidity at Foreign Banking Organizations (FBOs)**

The crisis demonstrated clearly that the combined U.S. operations of foreign banks can pose important risks to U.S. financial stability in part because of the reliance on dollar-denominated short-term wholesale funding from the United States to fund the banks' global activities. In recognition of those risks, the Board stated its intention to implement an LCR standard for the combined U.S. operations of FBOs when it finalized the LCR for domestic banking organizations in 2014. Today's rule does not apply to the combined U.S. operations of

[1] Although these firms will hold buffers against their internal liquidity stress tests, these do not provide the same clarity and verifiability to market participants as the LCR.

foreign banks and does not address the important liquidity risks associated with the U.S. branch and agency networks of these firms.

The U.S. branches of foreign banks, which often serve as important sources of dollar funding for activities at their parent banks, can face important run risk during periods of stress because they rely heavily on runnable short-term wholesale funding. During the crisis, some foreign branches were among the most active users of discount window borrowing when wholesale funding markets were stressed. This risk is relatively unique to our financial markets due to the special role of the dollar in the global financial system. For years, the Board has discussed addressing this risk by proposing the application of standardized liquidity requirements to the branches and agencies of foreign banks, which would reduce the incentive to shift assets to branches from intermediate holding companies (IHCs). In fact, branch assets have grown as a percentage of foreign bank activities in the United States since the IHC requirements were put in place, and the U.S. branches and agencies of foreign banks rely roughly twice as much on short-term wholesale funding as the U.S. IHCs. I am disappointed today's rule does nothing to address this important outstanding risk.

**Capital**

For domestic and foreign banking organizations with between $250 billion and $700 billion in assets, which collectively account for $2.7 trillion in total assets, today's rule would also lower capital requirements by $9 billion.

The rule allows institutions between $250 and $700 billion in assets to opt out of the requirement to include unrealized gains and losses through accumulated other comprehensive income in the calculation of regulatory capital. This requirement ensures regulatory capital accurately reflects the amount that is fully available to absorb both realized and unrealized losses. It addresses an important vulnerability in the crisis, when market participants lost confidence in the regulatory capital measure as a reflection of solvency because it did not accurately reflect unrealized gains and losses on securities that directly reduce the retained earnings component of common equity.

In addition, today's rule will enable firms between $250 billion and $700 billion in assets to take advantage of the capital simplification rule that was originally aimed at reducing burden for smaller banks. Advanced approaches banks were scoped out of that rule because their capital structure warrants a more risk sensitive approach. Under today's rule, many of these banks will be able to take advantage of these changes to capital requirements, without any material change to their sizes or risk profiles.

**Resolution Planning**

Turning to resolution, we saw clearly in the crisis that the failure of one or more large banking organizations may lead to severe stress in the financial system as fire sales and run dynamics spread contagion. The Dodd-Frank Act requires firms to develop resolution plans that provide a credible path to orderly resolution in bankruptcy to ensure taxpayers will not again be on the hook.

I support some reduction in the frequency of plan submissions to temper the substantial work entailed. However, today's rule goes beyond the requirements of S.2155 in ways that may weaken the resolution planning process for very large banking firms and leave the system less safe. For banks above the statutory range, with $250 billion to $700 billion in assets, the proposal would require a full resolution plan only once every six years. Banking organizations in the range of $100 to $250 billion in assets will no longer be required to file a resolution plan at all.

In combination with other changes underway, I am concerned the rules we are voting on today go beyond the requirements of S.2155 and weaken core safeguards against the vulnerabilities that caused so much damage in the crisis.