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Proposal and Comment Information

Title: LFI -Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, OP-1868

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Submitter Information

Organization Name: Better Markets

Organization Type: Organization

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Comments attached.

BETTER
MARKETS

August 14, 2025

Ann E. Misback, Secretary
Attn: Docket No. OP-1868
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations; Docket No. OP-1868; Document Number: 2025-13223; 90 Fed. Reg. 31641 (July 15, 2025)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the proposed revisions to the rating framework ("Proposal") used for large financial institutions ("large banks").[2] Unfortunately, the Proposal is not in the best interest of the public, financial stability, or even the regulators, because it undermines and weakens the supervisory framework for large banks. Consequently, it should be stopped.

One of the most important components of bank supervision at the Federal Reserve ("Fed") is to regularly evaluate the condition of the largest, most complex banks in the country. This includes large banks and bank holding companies with more than \$100 billion in total assets and U.S. holding companies of foreign banking organizations with more than \$50 billion in total assets.[3] As with any process that seeks to mitigate detrimental outcomes, the success of the bank supervisory process is dependent on a direct relationship between supervisory findings of deficiencies for poorly run banks and the potential for consequential restrictions on certain actions, including expansionary plans. Congress recognized this and used both the Bank Holding Company Act[4] and the Dodd-Frank Wall Street Reform and Consumer Protection Act[5] to provide some

1 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.

2 Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations; Docket No. OP-1868; Document Number: 2025-13223; 90 Fed. Reg. 31641 (July 15, 2025); https://www.federalregister.gov/documents/2025/07/15/2025-13223/revisions-to-the-large-financial-institution-rating-system-and-framework-for-the-supervision-of.

3 *Id*. at 31641.

4 The Bank Holding Company Act, 12 U.S.C. 1841.

5 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

discipline for supervisors' use of this authority to promote a well-functioning, safe, and sound banking system.

The current large bank ratings framework requires that, to be considered "well managed," large banks must meet expectations in three core areas: capital, liquidity, and governance and controls, which the Fed recognized to be of critical importance for large banks that are financially resilient and well run."[6] If any of the three categories are found to be deficient, the bank is not considered to be "well managed," and consequently, it faces possible restrictions on expansion, and it is subject to formal (public) or informal (non-public) enforcement actions to correct the causes of the deficiency. In other words, significantly deficient practices in ***any*** of these three critically important categories do indicate a large bank is not being "well managed," and assertions otherwise ignore observed history.

Unlike the bank supervisory framework and rating system for smaller banks, which contains a composite rating for each bank along with six component ratings, the Fed considered and ***clearly stated its intent not to provide a composite rating for large banks***. The Fed explained that because each of the three areas that are evaluated for large banks is already composed of several factors and considerations, assigning an ***additional*** composite rating for the bank was unnecessary and would not add any new information. It also said that a composite score could "dilute the clarity and impact" of the three component ratings.[7] Moreover, a deficiency in any of these core areas directly threatens a large bank's safety and soundness and thus raises serious questions about the effectiveness of bank management and boards of directors. Such a deficiency should not be ignored or overlooked just because other core areas are not deficient.

This Proposal ***does not change the underlying criteria*** for rating each component area, continuing the recognition of the importance of each criterion. However, ***it does make two significant changes to the interpretation of the rating results that would dangerously undermine the effectiveness of the large bank rating framework***:

1. <u>Weakens the definition of "well managed:"</u> A large bank would only be required to earn "meets expectations" ratings in ***only two of the three*** broad categories being rated. In other words, the bank could be rated as ***deficient in one category and still be considered "well managed" overall.***

2. <u>Reduces the usage of meaningful enforcement actions stemming from supervisory assessments that promote more resilient and better-managed banks</u>: The presumption that a large bank with one or more deficient ratings likely would be subject to enforcement action or other form of possible restrictions until it corrects the deficiencies ***would be removed***.

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6 Large Financial Institution Rating System; Regulations K and LL; Document Number: 2018-25350; 83 Fed. Reg. 58724 (Nov. 21, 2018); https://www.federalregister.gov/documents/2018/11/21/2018-25350/large-financial-institution-rating-system-regulations-k-and-ll.

7 *Id.* at 58731.

In short, this Proposal would dangerously and fundamentally erode the meaning and value of large banks' supervisory ratings. This is like lowering the grading curve on a final exam to allow students with lower scores to pass; the students' numerical grades may be unchanged, but the interpretation, meaning, and effect of the grades would shift dramatically in favor of the banks. Importantly, this Proposal would also limit the actions that the Fed could take to correct large banks' deficiencies, which would protect consumers and financial stability. So, not only would banks be less frequently assessed as not being "well managed," but also the consequences of these less frequent supervisory assessments would be significantly weakened.

As detailed by the Fed in the Proposal, as of the fourth quarter of 2024, using the current large bank rating system, ***only 13 of the 36 large banks rated by the Fed were considered "well managed."***[8] The remaining 23 large banks were deficient in at least one of the three areas and, therefore, not considered "well managed." If the Proposal is adopted, the Fed's analysis shows that ***8 of the 23 large banks that are not considered "well managed" under the current framework would shift to be considered "well managed" without having addressed deficiencies that have already been identified***. This result should concern all Americans, and, frankly, the Fed itself. The current supervisory assessments clearly show that bank supervisors have identified serious problems at most of these large banks. Simply reducing the consequences of these problems at large banks makes the system less safe.

We urge the Fed to reconsider this Proposal. Not only does it not make sense, but it is also dangerous for the American people and financial stability, and it is adding to the many other deregulatory actions that are already underway, such as weakening stress testing and capital requirements at the largest banks. The way to address and correct weak practices at large banks is not to sweep them under the rug and pretend they are not important. The fact is that most large banks have serious risk management deficiencies that threaten the American people and financial stability. That is the assessment of the Fed's own supervisors. The Fed should be squarely focused on requiring these large banks to make changes to improve their risk management and operations so that costly and disruptive failures and bailouts are less likely to occur, rather than spending time and resources on deceptive sleight-of-hand tricks to incorrectly make the problems seem to disappear.

BACKGROUND

In the aftermath of the 2008 Financial Crisis ("2008 Crash"), as part of the Dodd-Frank Act, Congress recognized the need for and entrusted the Fed and other banking regulators with a supervisory program that was specifically designed to assess and respond to core areas of risk at large banks that threaten financial stability.[9] The most recent major revision to the large bank

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8 Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, *supra* note 2 at 31648.

9 *See* Board of Governors of the Federal Reserve System, Consolidated Supervision Framework for Large Financial Institutions, Supervisory Letter 12-17 (Dec. 17, 2012), https://www.federalreserve.gov/supervisionreg/srletters/sr1217.htm.

supervision program was made in 2018, when the Fed adopted the rule that established the large bank rating framework that exists today.[10] The rating framework was designed to:

- Reduce the probability of large banks failing or experiencing material distress; and reduce risks to U.S. financial stability and to consumers of bank products and services;

- Enhance the clarity and consistency of supervisory assessments and communications of supervisory findings and implications; and

- Provide transparency related to the supervisory consequences of a given rating.[11]

Within this framework, three components are rated for each large bank: capital planning and capital sufficiency; liquidity risk management and liquidity sufficiency; and governance and controls.[12] Each component is assigned a rating on a four-level scale.[13]

Large bank component ratings directly translate to supervisory consequences for banks that are deficient in one or more areas. Specifically, a large bank:

> [M]ust be rated ***'Broadly Meets Expectations' or 'Conditionally Meets Expectations' for each of the three component ratings*** (Capital, Liquidity, Governance and Controls) to be considered 'well managed.'[14]

In its final rule that established the current large bank rating framework,[15] which this Proposal would materially change, the Fed notes the importance of each supervisory component area, calling them "core areas" that are "necessary and critical to a firm's strength and resilience." Importantly, some of the public input related to the formation of the current rule insisted on the addition of a composite rating. In the final rule, the Fed directly and clearly rejected these commenters, saying that a composite rating that combined all three component ratings into a single assessment would not be informative and was not necessary. The Fed also noted that such a composite rating would "dilute the clarity and impact of the component ratings." Therefore, the consideration of including a composite rating in this Proposal effectively backtracks and contradicts the Fed's prior statements and negates the Fed's original intent for the large bank supervisory framework that is based on and built around these three "critical" components.

Furthermore, each of the components is important enough on its own to warrant a large bank to be assessed as not "well managed" when deficiencies are identified. The Bank Holding Company Act defines the term "well managed" to include the condition that "at least a satisfactory

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10 Large Financial Institution Rating System, *supra* note 6.

11 *Id*. at 58734.

12 *Id*. at 58734-35.

13 *Id*. at 58735.

14 *Id.* at 58735 (emphasis added).

15 *Id*. at 58731.

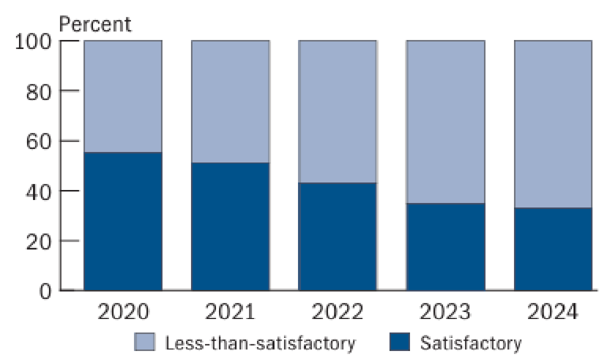
rating for management" is given.[16] Management is the foundation of the component of governance and controls. And, if a bank has material deficiencies in its management of either capital or liquidity, then it necessarily is not safe or sound, as these are the two critical financial factors that underlie a bank's safety and soundness, and deficiencies in either put a bank at serious risk of failure, as seen many times historically. Therefore, it must be the case that deficiencies in any of the three components of the framework individually result in the removal of the "well managed" assessment.

Banks that are "well managed" are allowed to do certain things because of their proven ability to exercise good judgment and not threaten their own safety and soundness or the broader financial stability. In the same way, certain activities, such as expanding operations at large banks that are not considered "well managed," are constrained using tools such as 4(m) agreements.[17]

Supervisory assessments and rating data from the Fed show that there has been a clear trend of large bank rating deterioration in recent years (see Chart 1).[18]

Chart 1

Figure 12. Ratings for large financial institutions



Note: Large financial institutions are rated according to three components: Capital Planning and Positions; Liquidity Risk Management and Positions; and Governance and Controls. Bars show the percentage of satisfactory and less-than-satisfactory ratings across all components. The 2024 value is as of the end of 2024:Q2. Key identifies bars in order from top to bottom. Data are revised since the publication of the May 2024 Supervision and Regulation Report.
Source: Internal Federal Reserve supervisory databases.

16 12 U.S.C. 1841(o)(9).

17 *See, e.g.,* Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, *supra* note 2 at 31642; BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, LARGE INSTITUTION SUPERVISION COORDINATING COMMITTEE PROGRAM MANUAL 17-18 (Feb. 2023), https://www.federalreserve.gov/publications/files/liscc-program-manual-202302.pdf.

18 Board of Governors of the Federal Reserve System, SUPERVISION AND REGULATION REPORT 17 (Nov. 2024), https://www.federalreserve.gov/publications/2024-november-supervision-and-regulation-report-supervisory-developments.htm.

In 2020 and 2021, even with the COVID-19 pandemic, more than half of all large bank ratings were satisfactory.[19] While this still represented a large number of deficient ratings, the trend has only worsened since. By 2024, only 33% of ratings were satisfactory.[20] In other words, most large bank ratings are now deficient. It is most common for large banks to have deficiencies in governance and controls, but there are also deficient ratings for some large banks' capital and liquidity.[21] Simply put, it is vital that the Fed remain steadfast in its supervisory work to keep the banking system safe and sound. This Proposal undermines the Fed's capacity in this regard.

COMMENTS

We strongly oppose the Proposal because weakening the large bank rating system is not in the public interest. Indeed, the Proposal simply weakens the Fed's ability to protect the public interest without offering any meaningful improvements to the current system.

The banks that are rated under this framework are large and can cause significant harm to consumers, businesses, and the financial system. As was proven in 2023, the failure of a large bank can cause a banking crisis and cost billions of dollars to resolve. Postmortem reports on the 2023 bank failures[22] detail the toxic combination of insufficient risk management, ineffective oversight of boards of directors, and a focus on growth as a panacea at the bank, along with bank supervisors who did not have the tools, experience, and management support to do their job. These findings are remarkably similar to the Financial Crisis Inquiry Commission's ("FCIC") conclusions about the causes and contributors to the 2008 Crash.[23] The FCIC documented the dangerous combination of blindness to risk, deference to bank management's judgment, deregulation, and faith in self-correcting markets and discipline on banks ostensibly provided by market participants. Implementing this Proposal would ignore these lessons from past banking crises and exacerbate problems like these moving forward.

If this Proposal is adopted, a large, complex, and potentially systemically important bank could have two areas rated as "Conditionally meets expectations," which indicates that the bank is at risk of not remaining safe and sound if certain material financial or operational weaknesses are not resolved in a timely manner. At the same time, it could be at the Deficient-1 level for the third area, with known and significant risks that need to be fixed with actions that are outside the bank's

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19 *Id.*

20 *Id.*

21 *Id.* at 18.

22 *See, e.g.*, OFFICE OF INSPECTOR GENERAL BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, MATERIAL LOSS REVIEW OF SILICON VALLEY BANK (Sept. 25, 2023), https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf; BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REVIEW OF THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF SILICON VALLEY BANK (Apr. 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

23 FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT (Jan. 2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

normal course of business. With this set of ratings, the bank would still be considered "well managed." Thus, it would be allowed to expand and enrich its shareholders, all while potentially endangering its customers, the financial system, and society at large, ***despite known deficiencies.***

The Fed erroneously justifies the Proposal by saying that it is more efficient for the Fed to focus on only the most severe problems at large banks and fewer enforcement actions will enable large banks to focus on "innovation and growth" and free up capacity to "develop new products, services, or technologies that benefit consumers and the broader economy."[24] The Fed provides data showing how large bank asset growth and loan growth slow when the bank is downgraded and is no longer considered to be "well managed."[25] This is a dangerous and inappropriate lens through which large bank deficiencies and costs or incentives to remedy them would be viewed as a result of the Proposal.

It is vital to not lose sight of the fact that, first and foremost, the mission of the Fed's Division of Supervision and Regulation ("Division") is to supervise and regulate banks (and certain other financial institutions) for the ***sole purpose*** of promoting their safety and soundness, not "innovation and growth" or the development of "new products, services or technologies." The justification provided by the Fed is not valid and is not in accordance with the stated mission of the Division. Second, the Proposal directly goes against the sole mission of the Division because it clearly and undeniably undermines safety and soundness. Material deficiencies in any of the three components of the current supervisory framework for large banks unquestionably mean a large bank is not "well managed" and it has unsafe and unsound risk management practices.

Third, nearly all "severe" problems begin with deficiencies that are not appropriately addressed by management or regulators early on. The Fed is essentially conceding that it will allow problems to metastasize before it deems it appropriate to take action. A bank that is unable to manage critical aspects of its operations should certainly face some potential restrictions. It should be forced to correct its problems before it is allowed to grow larger and potentially harm more consumers or the economy. The Fed does acknowledge that the Proposal will increase risk but fails to make the connection or quantify the cost to consumers, taxpayers, or other banks if these problems are ignored. If the Proposal is adopted, the only possible "winner" is Wall Street, but even that may be short-lived. Today, large banks face myriad risks, ranging from governance and controls issues such as cybersecurity management, anti-money laundering and terrorist financing, consumer compliance, and even the emerging threat of cryptocurrency activities, as well as capital and liquidity management. If this Proposal is adopted and more of these risks are ignored or not corrected, it is only a matter of time before there are more bank failures and bank crises than there otherwise would be.

The bottom line is that the Proposal should be rejected, and work on it should be stopped. Rather than weakening rules and helping large banks evade regulation, the Fed, and specifically the Division, should focus its time and resources on its sole mission of strengthening the banking

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[24] Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, *supra* note 2 at 31649.

[25] *Id.* at 31650.

system, which will benefit all Americans. Our comments in support of this course of action are as follows:

- It is misleading and wrong to regard a large bank with known significant deficiencies in a major part of its operations as "well managed." As detailed earlier in this letter, the Fed has clearly said that each of the three components that are rated for a large bank is important enough on its own to warrant the bank not being considered "well managed" when deficiencies are identified. Worse, to allow large banks with known deficiencies to continue to expand and endanger more consumers or the financial system is unacceptable.

- Reducing enforcement actions for banks that are not "well managed" weakens the incentives for banks to correct their problems. Enforcement actions are an important driver to motivate banks to correct their deficiencies. While it may be true that having fewer enforcement actions would save time for the regulators, a dubious goal for regulators in any event, those savings are ***not worth the cost of allowing large banks' unsafe or unfair behavior to continue.***

  Better Markets has tracked and detailed enforcement actions against the nation's six largest banks for many years and published its findings.[26] The most recent report shows that despite nearly 500 actions and more than $200 billion in fines and settlements, the largest banks continue to engage in unlawful and unethical activities.[27] It only stands to reason that if enforcement actions were reduced and large banks did not face a penalty for wrongdoing, such activity would only increase, harming more consumers and bringing more risk to the financial system.

- The year-long trend of increasing deficiencies at large banks indicates a clear and unmistakable increase in risk to the banking system and the public, not a flaw in the rating system or a problem with supervisory judgment. The Fed's data show a clear upward trend in deficiencies at large banks, particularly in the governance and controls area.[28]

  Research shows that these types of deficiencies can snowball, growing more serious in larger banks when they are not corrected. For example, one Fed study showed that between 2000 and 2017, more than 300,000 events totaling more than $230 billion in operational losses were reported by just 38 bank holding companies.[29] Researchers from the Federal

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26 *See, e.g.*, BETTER MARKETS, RAP SHEET REPORT (Oct. 12, 2023), https://bettermarkets.org/wp-content/uploads/2023/10/BetterMarkets_Wall_Street_RAP_Sheet_Report_10-2023.pdf.

27 *Id*. at 2.

28 Board of Governors of the Federal Reserve System, *supra* note 18 at 18.

29 Filippo Curti & Marco Migueis, *The Information Value of Past Losses in Operational Risk*, Board of Governors of the Federal Reserve System: Finance and Economics Discussion Series 2023-003 (2023), https://doi.org/10.17016/FEDS.2023.003.

Reserve Bank of Dallas also studied the data and found that operational risk at large banks was attributed to greater amounts of institutional complexity and moral hazard.[30]

- The Fed's justification for weakening the large bank rating system—the fact that large banks have proven to be stable through an economic cycle—does not hold water. In the nearly two decades since the 2008 Crisis, the economy has only had two months of contraction, at the onset of the COVID-19 pandemic.[31] During that period, the Fed and other parts of the government safety net spent trillions to shore up the economy and shield banks from the negative effects of recession. This does not represent a true business cycle, so the claim that large banks have shown that they can withstand a full economic cycle is simply false. Not only is it nonsensical, but it is a serious mistake to use this as proof that the large bank rating framework should be weakened.

- The Fed's reasoning that more large banks being considered "well managed" as a result of the Proposal would reduce compliance costs, propel more growth and investment, and enable the realization of economies of scale is wrong and dangerous. Growth is not a panacea for banks. A poorly managed bank growing larger only becomes more dangerous and more likely to harm more consumers or be more costly to resolve at failure. Research studies and data prove this point. For example, in a study of drivers of bank failures from 1863 to 2024, the New York Fed found that rapid growth was a catalyst, not a deterrent, for failure.[32] Another study comes to a similar conclusion, documenting the fact that banks are often overly optimistic and unrealistic about the benefits of growth and their ability to manage it.[33]

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30 Filippo Curti, W. Scott Frame & Atanas Mihov, *Are the Largest Banking Organizations Operationally More Risky?* Federal Reserve Bank of Dallas Working Paper 2016 (Mar. 3, 2020), https://doi.org/10.24149/wp2016.

31 NATIONAL BUREAU OF ECONOMIC RESEARCH, US BUSINESS CYCLE EXPANSIONS AND CONTRACTIONS, https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions (last accessed July 29, 2025).

32 Sergio Correia, Stephan Luck, & Emil Verner, *Failing Banks* 53, FEDERAL RESERVE BANK OF NEW YORK STAFF REPORTS (June 2025), https://www.newyorkfed.org/research/staff_reports/sr1117.

33 Rüdiger Fahlenbrach, Robert Prilmeier & René M. Stulz, *Why Does Fast Loan Growth Predict Poor Performance for Banks?*, National Bureau of Economic Research Working Paper 22089 (Mar. 2016), https://www.nber.org/papers/w22089.

CONCLUSION

We hope these comments are helpful as the Fed considers ways to strengthen its large bank supervision program.

Sincerely,

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