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The Honorable Mike Crapo
Chairman
U.S. Senate Committee on Banking, Housing, & Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing, & Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

The Center for American Progress ("CAP") is pleased to submit the below statement for today's hearing entitled, "Implementation of the *Economic Growth, Regulatory Relief, and Consumer Protection Act*" in the U.S. Senate Committee on Banking, Housing, & Urban Affairs.

In May, President Donald Trump signed S.2155, the *Economic Growth, Regulatory Relief, and Consumer Protection Act*, into law.[1] Among other provisions, the bill rolled back the Dodd-Frank Act's stronger financial safeguards for banks with between $50 billion and $250 billion in assets. These stronger safeguards, known as "enhanced prudential standards," include capital and liquidity requirements, living wills, risk management standards, and other rules. Under the law, the Federal Reserve Board ("Fed") has the authority, but not an obligation, to reapply enhanced standards to banks with between $100 billion and $250 billion in assets.

If the Fed does not act, however, these large banks will be deregulated to the detriment of U.S. financial stability. The banks deregulated by S.2155, roughly 25 of the largest 40 banks in the country, collectively hold about 16% of the assets in the entire U.S. banking sector and received $47 billion in TARP bailout funds during the 2007-2008 financial crisis.[2] They are not small, local community banks. For some context, Countrywide—a key player in the financial crisis—was a $200 billion bank. If one or several of these banks failed during a period of stress in the financial system, it could threaten U.S. financial stability and negatively impact the economy at a regional and national level.[3] The Fed should prevent this imprudent deregulation and use its authority to reapply these vital safeguards to each and every bank with between $100 billion and $250 billion in assets.

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[1] *Economic Growth, Regulatory Relief, and Consumer Protection Act*, S.2155, 155 Cong. 2 Sess. (Government Printing Office, 2017).
[2] Gregg Gelzinis and Joe Valenti, "Fact Sheet: The Senate's Bipartisan Dodd-Frank Rollback Bill," (Washington: Center for American Progress, 2018), available at https://www.americanprogress.org/issues/economy/reports/2018/02/28/447264/fact-sheet-senates-bipartisan-dodd-frank-rollback-bill/.
[3] Elizabeth Warren, "Don't Let Big Banks Escape the Fed's Scrutiny," *Bloomberg*, October 26, 2017, available at https://www.bloomberg.com/view/articles/2017-10-26/elizabeth-warren-don-t-let-big-banks-escape-the-fed-s-scrutiny.

The bill also changed the frequency of stress testing for firms with between $100 billion and $250 billion in assets from annual to periodic. The Fed's annual stress testing framework has been one of the most important prudential tools implemented following the financial crisis. The Fed should continue to subject these firms to robust annual stress testing—not a "stress testing-lite" regime conducted less frequently.

Comments and actions taken by the Fed, however, suggest it will not aggressively exercise its discretion under S.2155. The Fed joined the Office of the Comptroller of the Currency ("OCC") and proposed a rule that would lower the loss-absorbing capital requirements at the eight most systemically important banks in the country.[4] The Fed also joined four other financial regulators and proposed a rule that would significantly undermine the Volcker Rule.[5] Additionally, the Fed's recent stress testing proposal would loosen certain assumptions used in the stress tests, resulting in an aggregate decrease in capital for the banks subject to the tests.[6]

Beyond these concerning deregulatory actions, Fed Vice Chairman for Supervision Randal Quarles has suggested in speeches that the Fed may roll back additional post-crisis rules for banks with more than $250 billion in assets and a recent speech revealed that the Fed may not reapply crucial living will requirements to most banks with between $100 billion and $250 billion in assets.[7] The misguided regulatory rollbacks and recent public comments provide no confidence that the Fed will aggressively use its authority to reapply the Dodd-Frank Act's enhanced standards to the class of deregulated banks.

The *Economic Growth, Regulatory Relief, and Consumer Protection Act* contained another deeply troubling provision relevant to today's hearing on implementation. Section 402 of the bill loosened the calculation of the supplementary leverage ratio ("SLR") for banks predominantly

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[4] Board of Governors of the Federal Reserve System, "Rule proposed to tailor 'enhanced supplementary leverage ratio' requirements," Press Release, April 11, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm; Gregg Gelzinis, "This is not the time to loosen rules on bank capital," *MarketWatch*, May 2, 2018, available at https://www.marketwatch.com/story/this-is-not-the-time-to-loosen-rules-on-bank-capital-2018-05-02.

[5] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Commodity Futures Trading Commission, "Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (2018), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180530a1.pdf; Gregg Gelzinis, "Regulators' dangerous plan to carve up the Volcker Rule," American Banker, June 18, 2018, available at https://www.americanbanker.com/opinion/regulators-dangerous-plan-to-carve-up-the-volcker-rule.

[6] Board of Governors of the Federal Reserve System, "Federal Reserve Board seeks comment on proposal to simplify its capital rules for large banks while preserving strong capital levels that would maintain their ability to lend under stressful conditions," Press Release, April 10, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.

[7] Randal K. Quarles, "Speech: Early Observations on Improving the Effectiveness of Post-Crisis Regulation," Board of Governors of the Federal Reserve System, January 19, 2018, available at https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm; Randal K. Quarles, "Getting It Right: Factors for Tailoring Supervision and Regulation of Large Financial Institutions," Board of Governors of the Federal Reserve System, July 18, 2018, available at https://www.federalreserve.gov/newsevents/speech/quarles20180718a.htm.

engaged in custody banking by excluding central bank deposits from the denominator of the SLR. This change violates the principle of the risk-neutral leverage ratio and lowers the capital requirements at the three largest custody banks in the U.S.—banks that collectively hold $70+ trillion in assets under custody and administration. The Fed should not magnify the harm of this misguided policy by applying the change to other banks with sizeable custody businesses or by finalizing proposed changes to the enhanced supplementary leverage ratio ("eSLR").

During consideration of S.2155, Section 402 was altered from a clear quantitative threshold to a qualitative description. The qualitative description creates the possibility that regulators will apply the weaker requirement to other Wall Street banks with significant custody banking operations. The Congressional Budget Office assigned this outcome a 50% probability in its analysis of the bill.[8] If the Fed extends this rollback to additional Wall Street firms, it will severely increase the potential harm of this policy. Decreasing capital increases the likelihood of bank failure, and in turn, the likelihood of another devastating crash.

Separately, the joint eSLR proposed rule from the Fed and OCC would have a particularly large impact on custody bank capital. The two custody banks that qualify as G-SIBs would see their leverage requirements drop from 5% to 3.75% at their holding companies and drop from 6% to 3.75% at their insured depository institutions. With Section 402 and the eSLR proposal, not only would custody banks have a lower numerical capital requirement, they will use a weaker calculation to meet that lower requirement. The combination could effectively drop G-SIB custody bank leverage requirements below 3%, using today's SLR calculation method. Custody banks are vital to the plumbing of the financial sector. The combination of Section 402 and the proposed eSLR rule would leave their capital requirements dangerously low. Regulators must consider the drastic consequences of a potential custody bank failure and withdraw the eSLR proposal given, among other considerations, its interaction with Section 402 of S.2155.

Bank profits are at all-time highs.[9] Lending has grown at a healthy rate and has supported economic growth following the depths of the financial crisis.[10] Market liquidity is well-within historical norms and in some cases is healthier than pre-crisis levels.[11] All the while, in the 9th year of the post-crisis economic expansion, risks are starting to build in the financial system. Valuations across asset classes are stretched, nonfinancial sector leverage is elevated, and the credit quality of firms taking on significant leverage has deteriorated.[12] Moreover, a large body of research from academia and regulators alike demonstrates that bank capital requirements,

[8] Jeff Stein, "Senate banking bill likely to boost chances of bank bailouts, CBO says," *The Washington Post*, March 5, 2018, available at https://www.washingtonpost.com/news/wonk/wp/2018/03/05/senate-banking-bill-would-boost-the-chances-of-more-bank-bailouts-cbo-report-says/?utm_term=.ef520f1a6464.
[9] Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Second Quarter 2018" (2018), available at https://www.fdic.gov/bank/analytical/qbp/2018jun/qbp.pdf.
[10] Federal Reserve Bank of St. Louis, "Loans and Leases in Bank Credit, All Commercial Banks," available at https://fred.stlouisfed.org/series/TOTLL (last accessed September 2018).
[11] Division of Economic and Risk Analysis, "Access to Capital and Market Liquidity" (Washington: Securities and Exchange Commission, 2017), available at https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.
[12] Jeff Spross, "Corporate debt is a ticking time bomb," *The Week*, August 17, 2018, available at http://theweek.com/articles/790578/corporate-debt-ticking-time-bomb.

while improved, are still too low.[13] Policymakers should be strengthening financial safeguards, not rolling them back.

Just 10 years after the financial crisis, memories in Washington, D.C. have clearly faded. Millions of American lost their jobs, homes, and savings due to unchecked risk-taking on Wall Street. Many Americans across the country still carry the economic scars from the crisis. They have not forgotten the feeling of having a house foreclosed on or getting a pink slip at work—not knowing how their family will make ends meet. Wall Street CEOs who pushed the U.S. economy to the brink of collapse were bailed out, faced no discipline, and many are wealthier today than they were in 2008. It is inexplicable that policymakers care more about the complaints of bankers—currently making record profits—than the potential harm that rolling back these reforms will do to workers and families across the country.

Sincerely,

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[13] Gregg Gelzinis, Andy Green, and Marc Jarsulic, "Resisting Financial Deregulation" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/12/04/443611/resisting-financial-deregulation/.