EXAMINING THE DESIGNATION AND REGULATION OF BANK HOLDING COMPANY SIFIS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

JULY 8, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–38

U.S. GOVERNMENT PUBLISHING OFFICE

96–999 PDF WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. MCHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas
TOM EMMER, Minnesota

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California

SHANNON MCGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

RANDY NEUGEBAUER, Texas, *Chairman*

STEVAN PEARCE, New Mexico, *Vice Chairman*
FRANK D. LUCAS, Oklahoma
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
ROBERT PITTENGER, North Carolina
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
MIA LOVE, Utah
TOM EMMER, Minnesota

WM. LACY CLAY, Missouri, *Ranking Member*
GREGORY W. MEEKS, New York
RUBÉN HINOJOSA, Texas
DAVID SCOTT, Georgia
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
STEPHEN F. LYNCH, Massachusetts
MICHAEL E. CAPUANO, Massachusetts
JOHN K. DELANEY, Maryland
DENNY HECK, Washington
KYRSTEN SINEMA, Arizona
JUAN VARGAS, California

CONTENTS

WITNESSES

WEDNESDAY, JULY 8, 2015

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

EXAMINING THE DESIGNATION AND REGULATION OF BANK HOLDING COMPANY SIFIS

Wednesday, July 8, 2015

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Pearce, Lucas, Posey, Luetkemeyer, Stutzman, Mulvaney, Pittenger, Barr, Rothfus, Guinta, Tipton, Williams, Love, Emmer; Clay, Hinojosa, Scott, Maloney, Sherman, Lynch, Heck, and Vargas.

Ex officio present: Representative Waters.

Also present: Representative Royce.

Chairman Neugebauer. The Subcommittee on Financial Institutions and Consumer Credit will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Examining the Designation and Regulation of Bank Holding Company SIFIs."

Before we begin, I would like to thank the witnesses for traveling to Washington to testify today.

For situational awareness, we are expecting 4 votes sometime in the next 30 or 40 minutes. This first series of votes is expected to last possibly over an hour-and-a-half. Per an agreement with the Minority, Members' oral statements will be limited to 1 minute per side.

And without objection, the written opening statements of the chairman and the ranking member will be made a part of the record.

I now recognize myself for 1 minute.

Good afternoon.

Over the last several years, we have seen bipartisan and bicameral interest in reexamining Dodd-Frank's regulatory framework for bank holding companies with assets greater than $50 billion. Dodd-Frank's arbitrary asset threshold, set under Section 165, does not adequately consider the systemic risk profiles of bank holding companies.

Section 165's objective is to mitigate risk to the financial stability of the United States due to the distress and failure of the financial institutions. I am concerned that using a static asset threshold does not provide enough flexibility for regulators when designating systemic importance. Recent evidence shows vast differences in systemic importance between the smallest U.S. G-SIBs and the largest U.S. regional banks, yet they remain subject to the same Section 165 standards.

Even banking regulators have highlighted the flaws in the Section 165 threshold. So, for example, Comptroller of the Currency Thomas Curry recently testified that there are currently non-systemically important banks being regulated as systemically important due to the current threshold.

As policymakers, we must always strive to be precise when improving legislation and frameworks so as to minimize unintended consequences. I hope that this hearing will allow members to begin considering different ways of measuring systemic importance and the regulatory consequences of being designated as a SIFI.

I now recognize the ranking member of the subcommittee, Mr. Clay, for 1 minute.

Mr. CLAY. Thank you, Mr. Chairman.

And I want to thank each of our witnesses for coming here today and testifying.

I also would like to make clear to the subcommittee that I know that this is an abbreviated hearing, but if we are going to move forward with legislation, I look forward to having another hearing before that occurs.

The financial crisis was due in no small part to regulators' failure to use their existing authority to rein in banks' risky lending and trading activities. We responded in the Dodd-Frank Act by clearly identifying for regulators which financial institutions would be subject to minimum prudential standards, while also granting the Federal Reserve discretion in its application of these standards.

I welcome debate on regulators' efforts to tailor their approaches to the particular risk that individual banks present, but I remain skeptical of proposals that would eliminate Dodd-Frank's clear standard for a subjective activities-based designation process.

And I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

Today we have a very distinguished panel, and I appreciate their being here: Mr. Harris H. Simmons is the Chairman and CEO of Zions Bancorporation; Dr. James R. Barth is an Eminent Scholar in Finance at Auburn University, and a Senior Fellow at the Milken Institute; Dr. Paul H. Kupiec is a Resident Scholar at the American Enterprise Institute; Mr. Satish M. Kini is a Partner at Debevoise & Plimpton; and Dr. Simon Johnson is the Ronald Kurtz Professor of Entrepreneurship at the Massachusetts Institute of Technology, Sloan School of Management, and a Senior Fellow at the Peterson Institute for International Economics.

Per an agreement with the Minority, we will waive the oral presentation of your testimony. And without objection, your full written statements will be made a part of the record.

[The prepared statement of Mr. Simmons can be found on page 95 of the appendix.]

[The prepared statement of Dr. Barth can be found on page 42 of the appendix.]

[The prepared statement of Dr. Kupiec can be found on page 67 of the appendix.]

[The prepared statement of Mr. Kini can be found on page 55 of the appendix.]

[The prepared statement of Dr. Johnson can be found on page 49 of the appendix.]

Chairman NEUGEBAUER. The Chair now recognizes himself for 5 minutes for questioning.

Mr. Simmons, can you compare the systemic importance profile between Zions and a large money-center bank?

Mr. SIMMONS. I would be happy to maybe give a couple of examples.

If you look at asset size, we are $58 billion in total assets, and so, among the kind of traditional bank holding companies, we are the smallest of the SIFIs. We are one 45th the size of JPMorgan Chase.

But if you use other measures, it becomes even more pronounced. And so, for example, if you look at the data that we file on what is known as an FR Y–15 form every quarter showing systemic risk indicators, on one of the indicators for interconnectedness with the financial system, that measure being intra-financial-system assets, we are 1/264th of JPMorgan Chase's size. If you look at payments activity, they are 775 times larger than we are. If you look at assets under custody, they are about 5,900 times our size. And if you look at derivatives, over-the-counter derivatives activity, they are about 21,260 times our size.

So if you look at the things that we believe and that the Basel Committee has identified as being important in thinking about systemic risk, size is one factor, but when you take other things into account, there is even a greater disparity between a company like us and a company like JPMorgan Chase.

Chairman NEUGEBAUER. And one of the things—I believe that you just filed your stress-test documents recently, is that correct?

Mr. SIMMONS. Yes.

Chairman NEUGEBAUER. And can you tell us how many pages that presentation included?

Mr. SIMMONS. It was roughly 12,500.

Chairman NEUGEBAUER. And that is front and back, if I am not mistaken. Is that correct?

Mr. SIMMONS. Yes. It is a pretty good stack. It is 32 volumes of a lot of very high-level math, mostly.

Chairman NEUGEBAUER. Okay.

Dr. Barth, in your testimony, you note that under the Basel Committee framework for measuring systemic importance, the metric of size is only 20 percent of the calculation, but under Section 165 of the Dodd-Frank Act, it says asset size is 100 percent of the calculation.

Can you explain the significance of this distinction and how an asset-size-only calculation can mischaracterize systemic risk?

Mr. BARTH. Yes. I would be happy to.

As I indicate in my testimony, size per se is a totally inappropriate way to go about designating SIFIs. It turns out that—I know of no regulatory authority that would use just size. In fact, all the evidence that I present in my testimony indicates that size per se is inappropriate, that one should go well beyond size.

For designating G-SIBs, there are 4 factors used, and, as you point out, size only represents 20 percent of what goes into determining whether or not a G-SIB is significantly important.

So I think using just size, the $50 billion threshold is totally arbitrary and static, and one can come up with a much better way to go about designating SIFIs if one wishes to. And I indicate the way to go about doing that in my written testimony.

Chairman NEUGEBAUER. Thank you.

Dr. Kupiec, some commentators have recently argued that the meaning of "systemic importance" under Dodd-Frank implies that a bank holding company's failure could cause credit intermediation issues in particular region.

Do you consider this definition of "systemic importance" representative of Congress' original intent in Section 165?

Mr. KUPIEC. Congress' original bill designated everybody over $50 billion, which is a very broad-brush approach. I would not consider regional banks systemically important. Banks that are primarily engaged in deposit taking and lending in a certain region of the economy, even of significant size, I would not consider, if one of those institutions were in peril, that it would cause a systemic crisis.

Chairman NEUGEBAUER. Yes, I think my more direct question is, should that be one of the considerations for systemic risk, that one bank failure might have some adverse effect in that region?

My understanding originally was to make sure that one financial institution didn't bring down the whole system, not what the impact was on a local or regional basis.

Mr. KUPIEC. Honestly, I don't think "systemic risk" has ever been defined very finely, very accurately. If a bank fails—there is fairly robust literature that says bank failures cause some economic problems. The question is, how big does that problem have to be before you think you have to take extra measures to prevent it? And, in my opinion, even a sizable regional bank is certainly digestible in the financial system that we have.

Chairman NEUGEBAUER. Thank you.

I now recognize the gentleman from Missouri, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

Mr. Johnson, you note in your testimony that there is substantial differentiation in the Fed's application of heightened prudential standards, dependent in part on size but also varying according to factors such as business model, complexity, and opaqueness.

Could you provide examples of how regulators have differentiated their regulatory approaches toward financial institutions above the $50 billion threshold?

Mr. JOHNSON. Yes, Congressman.

So Dodd-Frank, as you have already stated, sets a threshold above which there has to be enhanced prudential supervision, but the exact nature of that supervision and the standards are very much at the discretion of the regulators.

And we know from statements made by Federal Reserve Governor Tarullo and by FDIC Chairman Gruenberg that they are tailoring the content of the stress test, for example. The nature of the living wills are absolutely differentiated between the largest banks and what we are calling here the regional banks. Capital standards are also differentiated. And the list goes on.

So for every single category of items that are overseen by regulators, to the extent that we can see this from the outside, there is substantial differentiation above the $50 billion threshold. And the regulators appear to be taking into consideration exactly the kind of criteria that make sense, which is partly size but also, as the other witnesses have already said, interconnection; the precise nature of your business; is there substitutability, so if you fail, can someone else step in and provide the same services? So that seems to be exactly in line with the intent of Dodd-Frank.

Mr. CLAY. Could you contrast the litigation exposure that an activities-based designation process would create compared to the current approach in Dodd-Frank that clearly establishes which financial institutions are subject to heightened minimum prudential standards?

Mr. JOHNSON. Yes, Congressman. I think this is a very important issue.

If there were to be a process for banks similar to what we actually have for non-banks, the the Financial Stability Oversight Council (FSOC) would be responsible for determining whether or not particular institutions were designated as systemic and were subject to, for example, Federal Reserve oversight, that would be absolutely a cause for litigation. In fact, MetLife is litigating against the FSOC, and there are indications from other large non-bank financial institutions such as Prudential that they may be considering similar litigation.

So the entire process of overseeing the financial system and preventing the kind of lapses that we saw apply to 2008, that will become tied up in all kinds of legal process. There is no way that would be helpful.

Unless you think the regulators are imposing undue, inappropriate burdens on these small, simple businesses—and I don't think there is any evidence of that whatsoever—then I think you have, roughly speaking, the right current arrangement.

Mr. CLAY. Are there any areas of regulatory oversight where regulators have had the ability to exercise their discretion to tailor their application of heightened prudential standards and they have failed to do so? Are there any examples where they failed to do that?

Mr. JOHNSON. They have certainly tailored. Now, there are complaints from the industry that the tailoring is not sufficient. There is a discussion around the stress-testing, which I think is an appropriate and sensible discussion. And there have been public news reports about Zions' stress test, for example. There seems to be a big difference of opinion between the Federal Reserve, on the one hand, and Zions with regard to the nature of those results and what is driving them.

So those are important and, I think, legitimate and sensible discussions. But the basic idea is that you should have a category of banks that are not the largest, not the ones that are without question too-big-to-fail, but ones that are on the way to that territory.

For example, if you look at total risk exposures of PNC, which is considered to be a regional bank, or U.S. Bancorp, these are total risk exposures; it is consolidated assets plus other credit exposures—these are in the categories of $460 billion to $500 billion. Bear Stearns, when it failed, was somewhat over $500 billion; Lehman was about $600 billion. Those regional banks are already in that space where we should have heightened concern at least.

And if we look at the rates of growth of regional banks on a total risk exposure basis over the past year, they have shown, with some exceptions, including present company, remarkably robust and resilient growth rates. So even the smaller ones are growing rapidly.

Again, I am not saying this is an immediate systemic red flag, but it is something that you want the regulator and the Federal Reserve, in the first instance for banks, to pay more attention to. And that is what Dodd-Frank requires.

Mr. CLAY. And so it really depends on the business model and what kind of risk these entities take?

Mr. JOHNSON. Yes, Congressman. It exactly depends on the business model and the risk they are taking.

Mr. CLAY. Thank you for your responses.

I yield back.

Chairman NEUGEBAUER. Thank you.

I now recognize the gentleman from New Mexico, the vice chairman of the subcommittee, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

I would just start with the statement that Bear Stearns and Lehman were not bank holding companies and would not have been subject to that particular provision.

Mr. Simmons, now, when I think about business—my wife and I had a small business. Certainly, we were not in the $50 billion category, but when we got up to 50 employees, then we came under different rules. So we just found ourselves staying below $50 billion because it was so much easier.

Do you think that banks will actually—or the financial institutions will decide to self-limit their size just to not have to hassle with it?

Mr. SIMMONS. I suspect some may, although because the current threshold is not indexed, at some point—we asked ourselves the question, should we try to shrink below that, but—

Mr. PEARCE. Yes, so the question is on the table.

Mr. SIMMONS. Yes, the question has been on the table. We—

Mr. PEARCE. And so, in the attempt to try to improve the economy, the Federal Government may, in fact, set the economy up to start limiting itself. That is a concern that I have, and it sounds like it is already a discussion. And I would just guarantee you, when people have to deal with one level of the government or a different level, then you do actually have to work that.

Now, this idea that there are going to be two sets of standards—you have been in the bank business for a while. When regulators have different tiers, do they set two standards? Do they come in and identify which size you are with respect to regulations? Or do they just go to the highest level of regulations?

Mr. SIMMONS. I think there are clearly some cases, for example in the liquidity coverage ratio, where they have created a modified ratio for banks under $250 billion, where they have differentiated. But it is hard for us to know, and, certainly, we don't feel like there has been the kind of tailoring that we hear about. I would like a new tailor, I guess, some days. It feels like the suit is still very large.

Mr. PEARCE. Yes. But, again, that is the comment I hear from banks in my district. It is New Mexico, so very few fall in a large category, but they all say that they get the same standards that are applied to the big institutions.

Mr. Johnson, I have a curiosity about these varying standards. Do you see some difficulty in agencies?

Agencies are composed of people, and they have to remember two different standards. I know flying airplanes, for instance, in the Air Force, they only want you flying one kind of an airplane at once because it is kind of difficult to remember all the different air speeds and the checkpoints and things. And airliners are pretty much the same way.

And so bank regulators, are they going to memorize multiple sets of standards? Are they going to be tailors for individual clothing for the banks, or are they going to actually start standardizing themselves?

Mr. JOHNSON. Congressman, there are already 4 categories above the $50 billion threshold—

Mr. PEARCE. No, I am not asking—I am asking, in practical application, a regulator sitting there trying to remember all these different standards, are they really going to do it, or do you think that they will probably end up ballparking something in their head and just doing the best they can?

Because I don't see where that kind of a tailored process can work from a regulatory point of view. It requires too much judgement. To me, it looks very awkward, and very difficult.

You don't think so? You think they will be able to divide themselves up into little squares and do one thing in one company and another thing in another company and not merge the two together in their head and their heart?

Mr. JOHNSON. Certainly, everything we can see in terms of how the regulators operate and how they organize themselves, they treat the very largest, globally systemically important banks differently than they do the regional ones.

Mr. PEARCE. Okay. Fair enough.

Now, on your item number five, you say that the regulators failed, more or less—they had a great deal of discretion, and they failed to protect consumers.

What should we do from this point of view when the regulators fail?

Mr. JOHNSON. I think, Congressman, you have to work to understand the cause of that regulatory failure, which will probably—

Mr. PEARCE. No, but should we do something?

Mr. JOHNSON. Absolutely. And Dodd-Frank was an attempt to address that, which obviously—

Mr. PEARCE. Yes. So I really wrestle with the fact that the regulators were sitting right in the room with MF Global and they let the guy—some of these things that banks are doing, they don't know the difference. That guy knew the difference. He moved $101.5 billion out of segregated accounts, and yet nothing has happened to the regulators and nothing has happened to him. It is against the law.

And so, I always worry that the regulators just kind of end up doing what they want to do when they are sitting in that room, and I wonder how you perceive that.

Mr. JOHNSON. I think the regulators have to be held accountable, Congressman. And they are held accountable by this committee, among other things—

Mr. PEARCE. Yes. Again, I have asked the questions multiple times; I have asked it straight to the supervisors. Nothing has ever happened to anybody. So I appreciate your opinion there, but I understand.

I yield back the balance of my time, Mr. Chairman. Thank you.

Chairman NEUGEBAUER. Thank you.

And now the gentleman from Texas, Mr. Hinojosa, is recognized for 5 minutes.

Mr. HINOJOSA. Thank you, Chairman Neugebauer and Ranking Member Clay, for holding this hearing.

As we examine the process for designating certain financial institutions as systemically important, SIFIs, under the Dodd-Frank Act, we would do well to remember that during the financial crisis of 2007 and 2008, the American financial system teetered on the brink of collapse. Every major American financial institution either failed or was taken over by a larger institution or required government assistance to weather the storm.

My first question is for Dr. Simon Johnson.

In your testimony, you indicated that it would be more sensible to measure banks by their total exposure, as defined in the systemic risk reports to include on- and off-balance-sheet items, rather than by their total consolidated assets as is currently done under Dodd-Frank.

Do you think the current measure of $50 billion consolidated assets is a good proxy for banks that pose a systemic risk to our financial system?

Mr. JOHNSON. Congressman, I think that is a very fair question. I do think we should shift the discussion away from consolidated assets, which are just one measure of what is on your balance sheet, to include other exposures through derivatives, credit lines, credit cards, and so on. And I think, when you look at that, most of the banks that are in the category, say, between $50 billion and $100 billion consolidated assets, if we look at them in terms of total exposures, all of them except for two, Zions and Huntington, are above $100 billion in total exposures.

Now, once you get to any financial institution of any kind with a total risk exposure close to 1 percent of U.S. GDP, I think you need to pay attention to it as a potential systemic issue, either in isolation, perhaps, or as a cluster of similar firms with similar portfolios that could get into trouble.

So most of the firms that are in this category above $50 billion, I think, are already on this potential systemic interest list. Zions is an interesting, different, smaller entity. There is no question about that.

Mr. HINOJOSA. So with that response, would you keep a bright-line test, or would you suggest a qualitative discretionary approach with Congress outlining the factors for consideration?

Mr. JOHNSON. You absolutely need a bright-line test, for the reasons that Congressman Clay already mentioned. If it becomes something qualitative, something involving judgment, for example, by the FSOC or by the Federal Reserve, it is going to be litigated till the end of time.

Mr. HINOJOSA. Okay.

My next question is to Auburn University's Dr. James Barth.

Currently, the top 33 financial institutions control approximately 84 percent of industry assets. The remaining 6,400 banks control the remaining 16 percent of assets.

So do you think the concentration of such large amounts of banking assets in a relative handful of firms is itself a systemic concern?

Mr. BARTH. Yes, I do think the concentration of assets in a handful of institutions may indeed be a concern. But, as I point out in my testimony, the 6 largest bank holding companies, domestic bank holding companies, control 68 percent of all the bank-holding-company assets in the United States as of the end of March of this year. The top 11 bank holding companies, excluding the savings and loan holding companies, control approximately 80 percent of all the assets of bank holding companies as of, again, March of this year.

So that is a concentration, but I don't think one should include the regional banks as SIFIs. They do not, in my view, pose a systemic threat. And all the evidence that I indicate in my testimony concurs with the opinion that I just expressed.

Mr. HINOJOSA. Thank you.

My next question is for Mr. Satish Kini.

There is, at this time, a considerable amount of debate regarding whether the current process for designating a non-bank SIFI by the FSOC is as transparent as it should be. So do you believe that to be the case? Why or why not?

Mr. KINI. I think there is debate, Congressman, about the transparency of the FSOC process for non-bank SIFIs. That process does not necessarily need to be imported into a process for bank holding companies if Congress chooses a different threshold or a different metric by which to apply these enhanced prudential standards to bank holding companies.

Mr. HINOJOSA. My time has expired, and I yield back.

Chairman NEUGEBAUER. I recognize the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Housing and Insurance Subcommittee, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I would like to start out with—we have been talking about the intent of Congress here with regards to Dodd-Frank. And I think it was interesting that when we had the former author of the bill, Mr. Frank himself, in this committee a little over a year ago, he indicated that the SIFI situation has gone well beyond the intent of what he and his coauthor, Mr. Dodd, had intended. And I think, as we go through this process, we need to remember that this was supposed to be about the big guys, not talking about regional banks.

And it is kind of interesting that, as we are talking about this, I have in front of me here the Federal Reserve System order approving the merger of bank holding companies between BB&T and Susquehanna Bank. And in there, in the financial stability portion, it lists the metrics by which they determined that combining these 2 banks, which would be around $200 billion in assets now—they listed 5 separate things, which, coincidently, are almost exactly word-for-word what our criteria is in our bill that we are trying to talk about here, for designating a SIFI.

They list those criteria, and then they go on and talk about in the final closing discussion here that this transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the U.S. banking or financial system. That is the Fed talking about this, with a $200-billion-asset institution.

So what does that tell you? It tells you that—Mr. Simmons, you are in the business, you are in this category here we are talking about. What do you think about the comments I just made?

Mr. SIMMONS. I fundamentally believe you need to look not only at size but a lot of other activities. The interconnectedness, the complexity, the funding structure—there are a lot of things that contribute to, I think, a rational determination as to whether an institution is systemically risky to our economy. And I think an approach that takes all those things into account is probably a more useful approach than, certainly, the arbitrary—

Mr. LUETKEMEYER. It is interesting, we have had both Secretary Lew and Chair Yellen in the committee over the last year, and both of them have said that they agreed with our analysis that these regional and midsized banks are not systemically important.

I have a chart here that I actually dug up; it is actually for the end of 2013, but it shows the size differential and puts some perspective in a graph form. You have JPMorgan over here on my right that makes up the entire grid. And then you have the next 14, other than the top 4. You go down to 5 through 19, and it makes up all of JP Morgan. It gives you some idea of the size of the big guys and the size of the rest of the group that makes up this.

So I know there is a question and has been concern with regards to regional banks, if a regional bank went down, that it would perhaps cause the collapse of other banks and hurt the region. That is not the intent of what this bill, Dodd-Frank, was about. It was about a big bank going down and affecting the entire economy.

But, Mr. Simmons, can you address the issue of a couple of regional banks which would go down? Number one, are they tied together close enough, normally, for that to happen?

Mr. SIMMONS. In my experience, there is very little interconnectedness between regional banks—

Mr. LUETKEMEYER. So it would be very difficult for one to actually affect the other?

Mr. SIMMONS. I think that has proven to be the case even in experience.

And I also think it is difficult to determine, if you start down that path, where do you stop? A community bank failing in a small community is going to have a systemic impact on that community. I believe that the language in Dodd-Frank was intended to focus on the U.S. economy and not on any particular region in the first place.

Mr. LUETKEMEYER. I didn't want to blindside you here, Mr. Simmons, but you wrote a letter to me, I think last year. We had a meeting, and then you went from there to the Fed. And you wrote back to me with regards to your meeting that you had at the Fed. And in there you said that you spent some time with staff at the Federal Reserve Board, and they admitted that around the Fed no one considers regional banks, such as Zions Bancorporation, to be systemically important.

Is that—

Mr. SIMMONS. That is correct.

Mr. LUETKEMEYER. —an accurate reflection of what your conversation—

Mr. SIMMONS. It is. And I think it reflects public statements that have been made at the Board of Governors level, as well.

Mr. LUETKEMEYER. So basically what we are saying here is that the Fed, the Chair of the Fed, Secretary Lew, and the author of Dodd-Frank believe that what we are talking about here is a solution to an unintended consequence of their bill. And, hopefully, we can all agree that this is something we need to work on and support.

I thank the gentleman, and I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentlewoman from New York, Mrs. Maloney, is recognized for 5 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, for holding this important debate.

I believe, as many of you said in your testimony, that the $50 billion threshold doesn't accurately measure systemic importance. And a lot of you have said in your testimony and talked about the advantage of tailoring the enhanced prudential standards so that they are appropriate for the amount of systemic risk that each bank poses. And I personally think that is a more accurate standard. To the extent that a prudential standard is intended to mitigate systemic risk, it should be tailored to the bank's systemic risk.

And while the Fed absolutely has the discretion to tailor the enhanced prudential standards based on each SIFI's systemic risk, that is not what they have done, unfortunately. And to the extent that they have tailored at all, they have based it purely on asset size, which even the Fed agrees doesn't properly measure systemic risk.

In fact, in the Fed's proposed capital surcharge for the biggest eight banks, they propose to calculate each bank's systemic risk based on an indicator-based test that goes beyond mere asset size and then require higher capital surcharges for banks that pose more systemic risk and lower surcharges for banks that pose less systemic risk.

So one idea that I think is worth pursuing is extending that proposal to all 33 banks with over $50 billion in assets and calculating their domestic systemic importance and then requiring the Fed to tailor the prudential standards based on each bank's actual systemic risk.

So, Mr. Simmons, if your bank ended up with a very low systemic risk score, then the prudential standards would have to be tailored to reflect that lower risk. And because the Fed's indicator-based test is based on the same test, I believe, that Mr. Luetkemeyer's bill would require—and I believe there are four standards in it: size; interconnectedness; complexity; and substitutability—using them, I think this might be a good compromise.

So I would like to ask each of the witnesses whether they think it would be helpful to extend the Fed's indicator-based test for systemic risk to all 33 banks over $50 billion?

I would like to start with Mr. Kini and welcome him, because his firm is located in the district I am privileged to represent, and have each witness give your thoughts on this idea.

Thank you.

Mr. KINI. Thank you, Congresswoman.

I do think that if the goal here and the policy objective is to identify as accurately as possible those banking organizations that pose significant risk to financial stability, then it is very much worth considering a more nuanced alternative than just flat asset size. So I do think that would be a useful exercise.

Mrs. MALONEY. Okay. Thank you.

And Dr. Johnson?

Mr. JOHNSON. Congresswoman, I do agree that the Fed should and does use this multiple-indicator approach. And I think as a previous speaker mentioned, they use it when looking at potential mergers. But I am not in favor of modifying the bright-line approach of Dodd-Frank. I think what you are asking for there, or what Congress asked for, is official—

Mrs. MALONEY. We would keep the $50 billion, but then—

Mr. JOHNSON. If you wanted to move it to $100 billion total risk exposures, I would not complain about that. That would only change it for two financial institutions, two banks.

But the point of having the threshold set at a relatively low level is to ask the Federal Reserve precisely to look on a case-by-case basis, applying its multiple indicators—there is no complaint about that whatsoever that I have heard—and to decide who is systemic and who is not.

The problem of using Congress to place particular scores, Congresswoman—one problem would be, what exactly is the right score for systemic risk? I agree with Dr. Kupiec, who said we don't know exactly what is systemic risk. You can have many arguments for many, many hours about exactly how to weight those measures in there. Experts and people in the industry absolutely do not agree.

So I think you are better off keeping the bright line, $50 billion consolidated assets or $100 billion total risk exposures, and then pushing the Fed, as you are doing in what you said today, to be nuanced and sophisticated in how they look case by case.

Mrs. MALONEY. And Dr. Barth?

Mr. BARTH. Yes. I am in favor of a multifactor approach, as you mentioned. Four factors that have been mentioned earlier, I think that is an approach. I am opposed to identifying SIFIs or designating SIFIs solely on the basis of size.

In my testimony, I point out there is indeed evidence indicating that regional banks, for example, do not pose a systemic risk. And if the Fed can tailor its supervisory approach or regulatory approach to banks over $50 billion in size, it can do that for all banks, and therefore there is no need for that designation of SIFIs.

Mrs. MALONEY. And, Mr. Simmons, who is on the front lines?

Chairman NEUGEBAUER. I'm sorry. The time of the gentlewoman has expired.

Mrs. MALONEY. Okay. Thank you.

Chairman NEUGEBAUER. I now recognize the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman.

I am confused, so help me, because I wasn't here when we did Dodd-Frank. And I am hearing some things that sound inconsistent to my layman's ear. I hear talk of tailoring, and I hear talk of Fed nuance. I hear Dr. Johnson saying that is probably one way around the concerns that we have on this side of the aisle.

Yet, Dr. Johnson, in reading your opening testimony, you are critical of the Fed's lack of ability to apply the same nuance before the crisis. So I guess one of the questions I have—and we probably won't get a chance to get into it here today—is, why do you think the Fed is going to do a good job now, when you thought they did a lousy job before the crisis?

So I am not sure if—if you don't like the fact of Congress setting the nuance, you are okay now, I guess, with the Fed setting this nuance, but you were unhappy with the way the Fed did it before the crisis. So it seems like you are taking the exact opposite position after the crisis as you took before the crisis.

But let me start from scratch, and see if I can get a handle on one thing here.

Dr. Johnson, you just said you would be okay with changing the number, which makes me wonder, how did we get the number in the first place? Does anybody know? Did we just pick $50 billion? I wasn't here. Does anybody know why we have $50 billion? Is it defensible?

Dr. Kupiec?

Mr. KUPIEC. From talking to staffers at the time, apparently there was a proposal on the table before Dodd-Frank to do away with holding company supervision by the Federal Reserve for all banks under $50 billion and that the primary Federal banking regulator would become the holding company supervisor. And there was language drafted about that. And somehow that $50 billion cutout ended up in the final bill on the SIFI designation for the Fed.

So I wasn't in the hearings, but, from people who were in the discussion, that is the way I am told, that $50 billion sort of came out of the air as a historical artifact.

Mr. MULVANEY. I see a couple of people nodding their heads. So, unless somebody wants to disagree, I will take that for the sake of this discussion.

Dr. Barth said something I am going to come back to in a second about evidence regarding regional banks. Let me ask—that is a nice word to use. Is there any evidence that $50 billion is the right number?

Mr. JOHNSON. Well, Congressman—

Mr. MULVANEY. I will go down the line.

Very quickly, Dr. Johnson?

Mr. JOHNSON. I think you should look at total risk exposures. That is what we learned in the crisis matters. And if you look at the risk reports that they have to now provide because of Dodd-Frank, everyone, with the exception of Zions and Huntington, who is above $50 billion, has total risk exposures over $100 billion.

When you look at the history of financial crises in the United States and other places, financial institutions with total risk exposures close to 1 percent of GDP—

Mr. MULVANEY. Got it.

Mr. JOHNSON. —do amount to systemic risk.

Mr. MULVANEY. I have heard that, but I have also heard you say that it depends on the business model and the risks they take, not necessarily the size of the asset.

So I am asking again, is there any evidence, other than the fact that a staffer found it in a previous bill, that $50 billion is the right number?

Anybody else?

Dr. Barth?

Mr. BARTH. No. I know of no evidence indicating that a $50 billion threshold is the right number by which one would designate SIFIs, those institutions with greater than $50 billion in assets, or even if one shifted to exposure basis.

It is interesting—in my testimony, I refer to a study done by three New York University Business School professors, one of whom was a recipient of the Nobel Prize in economics, and they actually calculate systemic risk for banks. And when you look at the regional banks, their scores are less than 0.10 percent. The biggest money-center banks have hundreds-of-times-larger systemic risk scores.

So, again, the evidence that I cite—and it is not just that study but other studies—indicates that there is no basis for using simply size per se and certainly not using the $50 billion threshold.

Mr. MULVANEY. Dr. Barth, that is music to my ears.

Keep going, then. Tell me the evidence you had about the fact that the regional banks are not systemically important. Because you said the word "evidence," which is something I pay attention to.

Mr. BARTH. Yes. The study that I just mentioned by the three New York University Business School professors—also, there is a study by the Office of Financial Research using multiple criteria which indicates the same, that the biggest banks dominate with respect to systemic risk. It is not the regional banks.

There is also a Bank of Canada study indicating that no regulatory authorities, to their knowledge, would focus on just size per se.

I don't know of anybody who is going to do a serious study of systemic risk who would only look at asset size per se, whether it be consolidated assets or exposures. There are many other factors, including some of the factors that have been mentioned earlier, the ones used for identifying—

Mr. MULVANEY. Dr. Barth, I apologize. I have 10 seconds, and I want to ask one final question.

Does anybody disagree—we have Republican witnesses, Democrat witnesses. Does anybody disagree with the concept that we should be using evidence in writing our laws?

Okay. I will take that as a "no" on both sides of the aisle.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. So, $50 billion is a safe harbor. If you are not over $50 billion, they can't designate you a SIFI, they can't impose additional standards.

Everyone over $50 billion should not be treated the same way. And perhaps either the regulators or this committee needs to look at creating a process by which those who are over $50 billion provide information, but I think most of the regional banks would ultimately be determined to not be SIFIs. It would be nice to get a few forms filled out and be in a position to at least take a look.

The focus of Dodd-Frank is on asset size. I think that is wrong. I think Dr. Johnson focuses on total exposure. I have said before here we ought to be focusing on the size of the liabilities of an institution, not the size of the assets.

Lehman Brothers didn't do us any harm because they had too many assets. Their problem was they had too many liabilities, particularly contingent liabilities, particularly to U.S. persons. So when Lehman Brothers went under, it was clear that a lot of American institutions would not be paid. What is a liability on Lehman Brothers' balance sheet as an asset—or was listed as an asset on the balance sheet of so many U.S. institutions.

Dr. Johnson, does the law require that the FSOC impose significant additional standards on regional institutions that may just happen to be over $50 billion?

Mr. JOHNSON. No, Congressman. The situation is as you stated it in your opening sentences. There is a safe harbor below $50 billion, and above $50 billion there are enhanced prudential standards across a number of criteria. So they can't be weaker than what people have below $50 billion. But the extent to which they are stronger depends on the decision of the regulator, which, in this instance, is primarily the Board of Governors of the Federal Reserve System.

And I would just also emphasize, to put it in terminology relative to what you have said and what other members have said, which is this is not about designating anyone as systemically important. These regional banks are not designated as systemically important. They are subject to these enhanced prudential standards. There are systemically important institutions that have been so named by the Financial Stability Board, for example, and it is only a few very large institutions of the United States.

Mr. SHERMAN. So you are saying that if you are a regional bank and you are over $50 billion, you don't get the honor of being designated a systemically important financial institution, with all that honor entails.

Mr. JOHNSON. It is certainly not in Dodd-Frank anywhere I can see, and it is not a matter of regulatory practice. They are not putting a SIFI stamp next to these regional banks.

They are subjecting them to additional specific scrutiny—for example, around the capital stress test, the way they look at, do you have enough capital. Yes, that is different above $50 billion. And you can ask whether it has been applied in a fair and reasonable way across all these different sizes. And that is what Zions is—

Mr. SHERMAN. So the regulators could, under the law, simply gather some information about institutions $50 billion to $100 billion and decide you are a plain vanilla large institution, or largish institution, you don't face any additional scrutiny? Or do they have to impose some additional scrutiny on everybody over $50 billion?

Mr. JOHNSON. There is some, "scrutiny" is a good word, Congressman. There is some additional scrutiny. There is—

Mr. SHERMAN. But not necessarily any higher capital standards?

Mr. JOHNSON. The capital standards cannot be lower than what we have below $50 billion. However, the law also says that there shouldn't be discontinuity, to the previous important point made by the Vice Chair. If you have a big discontinuity, people sometimes will not want to grow below that size.

The regional banks, Congressman, are growing fast. The average rate of growth of total exposures last year was 6.5 percent for the regional banks. So that doesn't seem to be an impediment to the growth at this stage.

Mr. SHERMAN. I just have 40 seconds.

What limits are there on bank holding companies in issuing credit default swaps? Because that is kind of how we got into this trouble to begin with.

Mr. JOHNSON. Congressman, there are a variety of restrictions on the amount of risk that they can take. And this would depend exactly on what they are doing with these credit default swaps, to what extent they are hedging, to what extent they are actually taking on risk. And there are plenty of micro prudential regulations about that, as well as systemic concerns.

And, of course, one of the issues that came out in the case of AIG was the way in which what appeared to be a small financial institution, in the sense that its banking activities were perceived to be small, actually was writing a lot of CDS and creating a huge amount of risk for that part of AIG and for the rest of the financial system.

So there are additional concerns and some scrutiny by the regulators now on exactly this, on who has what kind of open positions and what kind of exposures through derivatives such as CDS.

Mr. SHERMAN. And whether that is a bank holding—

Chairman NEUGEBAUER. The time of the gentleman has expired.

Mr. SHERMAN. —company or otherwise.

I yield back.

Chairman NEUGEBAUER. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Overall, do you believe that the SIFI designation has been a help or a hindrance? Has it impaired competitive markets? Has it given it an advantage?

And, also, I would like to know what recommendations you would provide for statutory reform of SIFI at this time.

Mr. Simmons, we will start with you.

Mr. SIMMONS. As to whether it has been a help or a hindrance, I take the view that fundamentally, stress-testing is one of the really major elements that has come out of this designation for us. And I fundamentally believe it is a useful tool in risk management, but I believe it is one among many tools. And it has become the central focus, and we spend so much time and money on it that I think it has clearly reached a point of diminishing returns.

The lack of transparency into the Federal Reserve's modeling process as compared to ours has been a source of great frustration that has led us to curtail some kinds of lending. And so, in that respect, it has been a hindrance to us.

And as far as a legislative fix to this, I am very much in favor of anything that moves beyond a strict size threshold and looks at other factors of systemic risk which we have talked about earlier today.

Mr. PITTENGER. Thank you.

Dr. Barth?

Mr. BARTH. Yes. I don't think that the SIFI designation has been worthwhile at all or beneficial. It seems to me that it misleads people about the actual systemic risk of institutions and categorizes too many institutions with the same catchall phrase as a SIFI.

As regards reform, I would agree with Mr. Simmons that one should go well beyond using just size in identifying whether or not an institution is a systemically important financial institution (SIFI).

Mr. PITTENGER. Thank you.

Mr. Kupiec?

Mr. KUPIEC. Thank you.

The idea of a SIFI is basically that an institution is too-big-to-fail in bankruptcy without causing a financial crisis. That is the whole idea behind a SIFI.

And what has happened is over time, we have tried to develop a resolution process for how regulators would deal with a failed SIFI. And if you look at all the papers and processes on that by the FDIC, the Financial Stability Board, and the Bank of England, what they will tell you is, if a systemically important financial institution gets into trouble, we are going to take over the parent and we are going to seize its assets, and the way we are going to keep markets from ending up in a crisis is we are going to recapitalize and liquify the operating subsidiaries. The operating subsidiaries of bank holding companies are bank depository institutions—basic banks.

And so, there is a huge disconnect between the idea of what causes a SIFI and what regulators are going to say they are going to do to fix the too-big-to-fail problem if a SIFI gets in trouble. It is not about the consolidated holding company or its size. It is about identifying the individual operations that need to continue if the SIFI gets in trouble. There is a total disconnect.

So this goes back to the whole question of what should they be looking at? They should be taking the bank holding companies and looking at the operations that they are going to maintain and keep running in a systemic resolution.

And that doesn't relate to the size of the SIFI; that relates to the specific subsidiary operations. So you could have JPMorgan Chase, which is a huge operation, but it may have only three or four subsidiaries that people would agree have to keep open and operating.

So you should look down to—not at the SIFI level. The designation should be aimed at the operations that make financial markets work, the ones that regulators say they have to protect if that institution gets in trouble. So there is a huge disconnect between this whole idea—

Mr. PITTENGER. Quickly, because I am running out of time, on statutory reform, do you have any ideas?

Mr. KUPIEC. Oh, this is a huge—it is very much a Congressman Luetkemeyer approach, with a 406, the—but aimed at the subsidiaries and not the consolidated group. It is the individual activities.

Mr. PITTENGER. All right.

Mr. Kini?

Mr. KINI. I think the one thing that I would say is that the current framework puts organizations—as soon as they cross $50 billion, it subjects them to mandatory enhanced standards. That means a $51 billion bank organization has to be treated differently than a $49 billion institution. And there is a real question in my mind as to whether that approach makes sense.

Mr. PITTENGER. Thank you all very much.

I yield back my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Massachusetts, Mr. Lynch, is recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

And I want to thank the ranking member.

And I thank the witnesses for your help today.

Dr. Johnson, I am not sure if you are familiar with Thomas Hoenig's proposal over at the FDIC. I know we are talking about regional banks that might or might not hit the tripwire of $50 billion, but he actually came out with a broader analysis in talking about risk, as you are talking about exposure as well, as being probably the most critical factor here.

He rolled out a proposal, and we are actually sponsoring legislation consistent with that. He talked about the fact that if you have a smaller community bank that is well-capitalized, it meets the liquidity coverage ratio, it holds effectively zero trading assets or liabilities, has no derivative exposure other than interest rates and foreign exchange derivatives, and even then has less than $3 billion in notional derivative exposure and maintains a ratio of GAAP equity to assets of at least 10 percent, and then meets the eligibility requirements for 4 straight quarters, he wants to propose some regulatory relief for those banks.

And he talks about eliminating the stress-testing requirement under Section 165 of Dodd-Frank; relaxing certain aspects of Basel capital standards and risk-weighted asset calculations; eliminating entire schedules on call reports, including schedules related to trading assets and liabilities and derivatives and certain other capital requirement calculations; and, also, lengthening the examination schedule from 12 months to 18 months so they are not getting examined so often, because that can be expensive as well.

What about that whole analysis? I can't ignore the similarity between your own comments and what Chair Hoenig is proposing. Is that something we could look at not only for the smaller community banks but also to some of these regional banks that might be operating prudently?

Mr. JOHNSON. Congressman, I think it is a very good idea to look at the community bank situation and to stipulate some fairly stringent criteria which they can opt into and that would get them some regulatory relief. I think that is a very good idea. I think Mr. Hoenig has many good ideas, and that is one of them.

Certainly, when a bank reaches the size, let's say, of Zions or Huntington, you might want to consider this similar sort of possibility. But I would caution everyone that once you get over $100 million, $150 billion in total assets, there should be a level of scrutiny and concern. It doesn't mean that you prevent them from growing, it doesn't mean you prevent them from running certain kinds of businesses, but you want the regulators to look at it.

And to the previous question that was put to me, what is the difference between now and before 2008? The primary difference is we had a crisis, we had Dodd-Frank. The regulators are very scared about anything similar happening in the future, so they got the point. And I think you are empowering them and you are requiring them not to forget as we go forward.

But, having said that, I think Mr. Hoenig's proposal is absolutely sound and should be taken very seriously.

Mr. LYNCH. Are there other steps that we could take with regional banks that would be incremental?

I know the derivatives issue that was brought up here, credit default swaps, I guess riskier activity that could be red-flagged, that if regional banks were not involved in that particular activity, we could take them down a notch in terms of the regulatory scrutiny that would otherwise apply.

Is there anything that we could do in—I know that it is a case-by-case analysis, and I am not sure if the regulatory framework allows for that.

Mr. JOHNSON. The regulatory framework absolutely allows for that on a case-by-case basis.

I think Mr. Simmons raised a good point about the stress test. To what extent are the stress tests fair? To what extent are they transparent? To what extent do people understand what the Fed is asking from them? And to what extent does it go beyond being what Mr. Simmons called a useful tool to being an onerous obligation?

I think that is a very fair question. And that is the question that you should be putting to the Fed and the Fed should be explaining to you and to others exactly what their approach is and why it makes sense to ask what they ask from Zions and to ask what they ask from JPMorgan Chase.

But I don't think you want to legislate that. I think if you start to legislate what should or should not be in stress tests, you will come up with some very strange criteria.

Mr. LYNCH. Right. I don't doubt that at all.

Thank you, Mr. Chairman. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

We are going to go to one more Member, and then we are going to recess for votes.

Members, I would ask you to, as soon as the last votes are over, come back, and we will finish up.

We now go to Mr. Tipton, the gentleman from Colorado, for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

As we are talking about soundness, which we can all certainly support, I think we need to be mindful that we are impacting businesses at home and people's jobs.

And, Mr. Simmons, in your written testimony, you establish that Zions has very conservative limits on some of your commercial lending.

Since Zions' primary business model does involve commercial lending and many of the aspects of your loans being under $5 million in size, has this regulatory regime impacted your ability to be able to actually make some of those loans in Zions' footprint?

Mr. SIMMONS. What has been a significant factor in our thinking about some loan types and categories—I think I noted specifically in my written testimony construction lending, commercial real estate lending generally.

We operate currently in construction lending—in 2006, regulators issued guidance that suggested that if you are operating a construction portfolio, maintaining it at under 100 percent of risk-based capital, that they were quite comfortable with that, and over that limit they would allow it but wanted to have stronger risk management around it.

We are at about, roughly, a little under a third of that level today and have basically put a cap on it. Because of the implications of that particular asset class and what we believe—the result we believe it is creating in the Federal Reserve stress test. Again, it gets back to concerns about transparency.

Mr. TIPTON. And so it is the unknown quantity sort of coming out of a regulatory regime.

I would like to be able to drill down. We had had testimony that came in from the regulators, and there seems to be empathy on this panel and from the regulators in regards to not the big banks but the smaller banks, some of the super-regionals that you would qualify in.

You had cited that you had 12,500 pages in terms of a stress test this year, double-sided, that the chairman had noted. How many pages did you have last year?

Mr. SIMMONS. It was similar.

Mr. TIPTON. Similar to that?

Mr. SIMMONS. Yes.

Mr. TIPTON. So are those costs impacting your ability to do what you are designed to do, which is to provide access to capital for businesses and for individuals?

Mr. SIMMONS. I would say certainly the cost is—it is costly. We spent over $20 million last year doing that, and for a company our size, that is a fair amount of money.

I think as important is the amount of internal time and effort and just the focus on this. I mentioned in my written testimony that we held 20 board meetings last year. Seventeen of them had as a significant item on the agenda focusing on stress tests.

And that is where I think that—I think it is a useful tool, but I think it has the potential to be overdone.

Mr. TIPTON. How many new people have you hired for compliance in Zions?

Mr. SIMMONS. I noted that we have hired over the last 4 or 5 years close to 500 in risk management, internal audit, and compliance.

Mr. TIPTON. Do any of those people make loans?

Mr. SIMMONS. None of those individuals make loans.

Mr. TIPTON. None of those people make a loan. So you aren't able to focus on your core business model if you want to be able to do it right.

Mr. Chairman, I think it is pretty frustrating. I never thought I would be quoting Barney Frank, but, effectively, he has come out and said we didn't intend for it to be able to go this far, in terms of a regulatory regime. And I think that it really speaks to an out-of-control regulatory process, to where a broad-based piece of legislation is being put forward and we are leaving the regulators to be able to fill in the blanks.

And now, arbitrarily, we are talking about $50 billion, and we are seeing the regulators and others step back and say, well, that may not be the right number. But I would certainly probably take issue in terms of some of Mr. Johnson's comments in terms of Congress actually getting involved—maybe smaller, prescriptive bills.

And Mr. Luetkemeyer, I will certainly associate myself—I co-sponsored that legislation. It is going to be an appropriate way for this to be able to address something that I think is impacting our ability to be able to grow our communities, to be able to grow jobs. We need that access to capital to be able to do that.

Dr. Barth, you cited concentration as a potential problem in terms of some of the regulatory regime that we are seeing. Are we actually incentivizing concentration of banks? We are seeing more small banks now shut down than there are new banks start up. Are we actually driving the ship into creating more significant banking businesses rather than spreading that risk through small communities?

Mr. BARTH. Yes, I am concerned about concentration, but I don't think we have a particularly serious problem now with respect to concentration. The regulatory authorities can deal adequately with the concentration that exists here in the United States. My point about concentration is simply that the money-center banks dominate the share of assets of bank holding companies here in the United States.

So, again, concentration is an issue, but I don't think it is the important issue. I think the important issue is the one that has been mentioned many times, which is that size per se doesn't tell us very much about systemic risk of financial institutions. We have to move well beyond size if we really want to take a serious attempt at trying to determine which institutions are indeed systemically important here in the United States.

Mr. TIPTON. Thank you.

I yield back, Mr. Chairman.

Chairman NEUGEBAUER. The time of the gentleman has expired. I thank the gentleman.

Without objection, this committee will stand in recess subject to the call of the Chair. I ask Members to return promptly after votes.

[recess]

Chairman NEUGEBAUER. The subcommittee will come back to order.

I now recognize the gentleman from Texas, Mr. Williams, for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And I thank all of you for being here today.

Before passage of Dodd-Frank, the term "systemically important" barely registered for the average American. Yet here we are, almost 5 years later to the day, and the term "SIFI" has become almost commonplace for most financial institutions.

As we have discussed today, Zions Bank, which operates one of their community banks, Amegy, in my home State of Texas, is the smallest SIFI that exists. The time, expense, and energy that it takes a bank of their size to comply with regulation after regulation, in my opinion, is simply not acceptable.

As an original cosponsor of Mr. Luetkemeyer's bill, I strongly support his effort to reform the SIFI designation. Setting arbitrary thresholds, whether that be $50 billion or $500 billion, to me, is counterproductive. Plain and simple, banks, whether they are big or small, need to be able to simply compete.

So my first question to you, Mr. Simmons, is this: You state in your testimony that your banking activities are very traditional in nature—deposits, making loans, and providing your customer with a high degree of service, with a focus on lending to small businesses.

As a small-business owner myself for 44 years—I am a car dealer, I am in the car business—I rely on banks for loans. And, in fact, there hasn't been a day—I don't know if I should say this braggingly or not, but there hasn't been a day in my business career I haven't been out of debt.

Now, can you explain to me how being designated as a SIFI impacts your bank's ability to make small-business loans?

Mr. SIMMONS. Sure.

As I indicated in my written testimony, one of the things that we have come to realize is that the Federal Reserve stress tests become really our binding constraint. There are various methods of measuring capital in a financial institution and capital requirements, but the stress test and the Comprehensive Capital Analysis and Review (CCAR) process has become, for us, the binding constraint. And it is the Federal Reserve's model, specifically, that we are trying to manage to.

And it is frustrating because we don't know really how those models work, but we can divine enough information from the results to determine that we believe that there are very high loss rates attributed, for example, to construction loans. So we find ourselves pulling back there.

One of the specific areas that we find ourselves really thinking about right now is that in the Federal Reserve's models, the templates they furnish to gather data do not allow you to provide the detail that is required to really evaluate a loan, to look at collateral values, at the customer's cash flow, et cetera, that would allow you to really determine how risky a loan is. And so we just provide the loan balance on a supplementary schedule for loans under a million dollars or loans that are credit-scored for owner-occupied commercial real estate.

As a consequence, we believe—we don't know, but we believe that there are probably high loss rates attributable to those loans because they have no other way of determining what the loss content is, and their own instruction suggests that missing data defaults to a high rate of loss.

So dealing with the uncertainty and the unknowns has us, I think, being more conservative than we would certainly be if we had the detail.

Mr. WILLIAMS. Another question, and we touched on this a little bit, but how has having this designation impacted your business model?

And $20 million in costs associated with these stress tests is certainly no small sum. In other words, does having this designation eventually impact the services that your can provide your customers like me?

Mr. SIMMONS. One of the ways that it is actually impacting our business model is we announced a month ago that we are—we have had seven subsidiary banks, each with its own charter, management team. We are consolidating those into a single charter to try to reduce some of the cost of—and to ensure that we have consistency in the way we are generating data for the regulators.

And so that is an example of how we are having to adjust to this new world of—

Mr. WILLIAMS. Yes. Usually overregulation affects the customer, is the way it works.

Mr. SIMMONS. At the end of the day, we are spending a lot of money.

Mr. WILLIAMS. Yes.

Mr. SIMMONS. There is a lot of regulatory cost, much more than I had ever seen certainly before the crisis.

Mr. WILLIAMS. We are running out of time. I have one more question for you. Would you support eliminating the concept of SIFIs altogether?

Mr. SIMMONS. I think there are some very large institutions that present systemic risk. I am not opposed to the notion that we ought to try and understand what that risk is and regulate accordingly. I think the line was simply drawn at a level very arbitrarily that catches a lot of fish in the net that didn't belong there.

Mr. WILLIAMS. Thank you for your answers.

And I yield back, Mr. Chairman. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Minnesota, Mr. Emmer, is recognized for 5 minutes.

Mr. EMMER. Thank you, Mr. Chairman.

And thanks to the panel for being here all afternoon.

Dr. Barth, before we took the break, you testified that the $50 billion threshold is "entirely inappropriate" for measuring whether an entity falls within the definition of a SIFI. You also testified that the $50 billion threshold is "totally arbitrary and static."

Just for the record, is it possible for you to expand on that last statement, the "totally arbitrary and static?"

Mr. BARTH. Yes. I would be happy to, sir.

It turns out there is no evidence supporting the notion that a $50 billion threshold distinguishes between bank holding companies that would be systemically important financial institutions and those that are not.

And as an economist, I typically turn to evidence, and as I point out in my testimony, there is ample evidence, indeed overwhelming evidence, that drawing a threshold at $50 billion for bank holding companies is totally inappropriate if one wishes to distinguish between systemically important financial institutions and those which are not. There is more than just size that would go into any calculation as to whether or not an institution would be a SIFI.

Mr. EMMER. Right.

And, Mr. Simmons, I understand that you are the chairman and CEO of a $58 billion bank holding company that operates 7 community banks in 11 States. These community banks are full-service banks, correct?

Mr. SIMMONS. They are.

Mr. EMMER. They provide, among other things, business and consumer loans?

Mr. SIMMONS. Yes.

Mr. EMMER. Your company recently filed this—I think the testimony before the break was stress-test documents. Is that correct?

Mr. SIMMONS. Yes.

Mr. EMMER. I don't know if they are called something else, but that is what they were referred to earlier. These are some 32 volumes of over 12,000 pages?

Mr. SIMMONS. Yes.

Mr. EMMER. Do you know how many of your employees were dedicated to putting those 32 volumes and over 12,000 pages together?

Mr. SIMMONS. We have a staff of about 30 employees who work on it pretty much full-time throughout the year.

Mr. EMMER. How long did it take?

Mr. SIMMONS. Oh, it is a process that goes on all year long. And then we have scores of others who contribute in one way or another—auditors, frontline credit people. There are a lot of people who are touched by it.

Mr. EMMER. And have you put a cost to it? Are you able to give us an idea of how much and the hours that were put in and the effort?

Mr. SIMMONS. The one number I am quite confident of is that we spent a little over $20 million in direct cost, because I can go through and look at bills from law firms and consultants.

Mr. EMMER. Right.

Mr. SIMMONS. The internal costs, I haven't really tried to tabulate that.

Mr. EMMER. All right.

Just a general question, are certain elements of Dodd-Frank frustrating the ability of financial institutions like yours—and this follows in line with Representative Williams earlier. He was trying to get at the questions you just had, whether this was impacting your ability to service the consumer, the actual customers.

Are certain aspects of Dodd-Frank frustrating the ability of financial institutions like Zions to make loans and offer credit to job creators?

Mr. SIMMONS. Well, not specifically attributable to the SIFI issue, but I would tell you that trying to make a mortgage loan these days has become incredibly complicated. And that may be a topic for a different day, but the ability-to-repay rules, the documentation around it, and the ancillary rules around making a residential mortgage have become incredibly complicated and, I believe, are stifling the extension of credit to a number of creditworthy borrowers, in our firm at least.

Mr. EMMER. Wow. And I know the focus today has been on SIFIs and the threshold and how you measure it, but I am just interested because it seems to all be related.

And these are general questions, but can you tell us whether the law is having a disproportionately negative impact on Americans of modest means and business startups? I am interested in making sure that capital is available for the people on the lower end who are actually creating the new opportunities in their garage. And it is community banks, among others, that in the past have provided that capital. Are you seeing an impact on that?

Mr. SIMMONS. It is to the extent that, like I said earlier, in our case we are pulling back somewhat, being conservative in terms of how we make loans. It is hard to say. I am not sure I can generalize how it is affecting others, but that is primarily how it is affecting our ability to serve customers.

Mr. EMMER. Okay. Thank you. I see my time has expired.

Chairman NEUGEBAUER. The gentleman from New Hampshire, Mr. Guinta, is recognized for 5 minutes.

Mr. GUINTA. Thank you, Mr. Chairman.

Thank you all for coming here and indulging our first vote series, and we appreciate it.

As we know, Section 165 of Dodd-Frank requires the Federal Reserve Board to apply enhanced prudential standards to bank holding companies with total consolidated assets of $50 billion or more. Thirty-seven bank holdings currently have assets greater than $50 billion that are subject to enhanced supervision.

Under that same section, a bank holding company with total consolidated assets of $50 billion or more must comply with and hold capital equal to—or equal with the requirements of regulations adopted by the Federal Reserve.

Mr. Kini, in your testimony you stated that Section 165 does not allow the Federal Reserve to raise the $50 billion threshold or to avoid applying the mandatory enhanced prudential standards to any set of greater-than-$50-billion asset bank holding companies.

This provision only allows the Federal Reserve to vary application of enhanced prudential standards.

Does this give regulators enough flexibility to ensure that institutions above the $50 billion threshold are not overburdened by tougher rules?

Mr. KINI. Congressman, I think what Section 165 does, to your very good point, is it dictates that there is a mandatory level of enhanced standards that have to apply at $50 billion. So it is kind of like a toggle switch. At $50 billion, there has to be some sort of enhanced capital, enhanced liquidity, enhanced stress-testing, and other enhanced standards that have to apply at that level. So there has to be a distinction between $51 billion and $49 billion bank holding companies.

Now, the Federal Reserve has the authority to tailor and differentiate once it goes above the $50 billion. But, to your point, at $50 billion, that is an important threshold that the Dodd-Frank Act sets and that the Federal Reserve does not have the authority to vary with respect to these core elements.

Many people, including Federal Reserve Governor Tarullo, have questioned the value of applying all of these standards to $50 billion bank holding companies and, I think, have openly questioned and suggested whether this ought to be reexamined. The Federal Reserve does not have authority to change where that toggle switch fits. Only Congress can act to move that toggle switch.

Mr. GUINTA. Okay. So the FSOC doesn't, and the Federal Reserve doesn't, only Congress.

Mr. KINI. With respect to these core elements of capital, liquidity, stress-testing, the Federal Reserve does have authority to vary and differentiate, but it can't move that $50 billion threshold. It has to apply the $50 billion threshold because that is what the statute says.

There are other parts of Section 165 where the FSOC and the Federal Reserve could move things, but those are outside of these core elements, and that is statutorily set at $50 billion. There has to be a differentiation, according to the statute.

Mr. GUINTA. Okay. I thank you.

I yield back to the Chair.

Chairman NEUGEBAUER. I thank the gentleman.

The gentlewoman from Utah, Mrs. Love, is recognized for 5 minutes.

Mrs. LOVE. Thank you, Mr. Chairman.

First of all, I would like to thank all of you for being here today, especially Mr. Simmons from the great State of Utah. I really appreciate having some Utah testimony here today, so thank you so much for being here and answering questions for all of us.

I wanted to focus a little bit on the things that I have heard in terms of the 500 employees that have had to have been added. Most of those full-time employees are there for pretty much compliance, internal audits, credit administration, and enterprise risk management—there just to deal with risk management.

So, I am trying to figure out the amount of effort that has gone in just to comply with some of the regulations when it comes to Dodd-Frank. Where does that—paying those 500 additional employees, I just want to hear from you where the cost of that compliance ultimately ends up?

Mr. SIMMONS. It is like all costs in a company; at the end of the day, it gets divided somehow between customers and shareholders. And it is all a function of pricing in the marketplace, but it is a cost.

And one of my concerns, ultimately, is that all of this additional cost is making the entire regulated industry, financial institutions, or financial services industry, less competitive relative to the unregulated or the shadow industry.

Mrs. LOVE. Right.

Mr. SIMMONS. And we see evidence that business is leaving the regulated industry for other climes that are a little more hospitable in terms of the cost structure.

Mrs. LOVE. Okay.

The other question I have is—and I guess I can go down and ask everyone this question—when we are looking at the SIFI thresholds, whether they are raised or eliminated, would bank regulators still have the regulatory or supervisory tools necessary to make sure that all banking organizations are operated in a safe and sound manner?

If we were to bring that down, for instance, if we were to bring that threshold down, do you feel that the regulators would still have the tools they need to make sure that you are operating in a safe manner?

Mr. SIMMONS. I will start.

I believe they have always had the tools to do that, fundamentally.

Mr. BARTH. I would agree. If the threshold were eliminated, regulatory authorities do indeed have the tools to be sure that financial institutions operate in a safe and sound manner. They have always had the tools.

Mrs. LOVE. Okay.

Mr. KUPIEC. I would agree, too.

Mr. KINI. I would agree, as well. I think merely raising the threshold or eliminating it does not take away authority that the regulators have. The Federal Reserve, for example, in the Bank Holding Company Act has broad authority and has ample authority to take supervisory measures that it deems fit under that Act both as a regulatory matter and as a supervisory matter.

Mrs. LOVE. Okay.

Mr. JOHNSON. They have always had the tools, but they didn't use them. The massive inability or unwillingness to use those tools prior to 2008 was the motivation for Dodd-Frank in general, and the specific threshold issue we are talking about, which is to say: You must use those tools or talk about how to use those tools above this threshold.

Mrs. LOVE. That doesn't make any sense to me. So they have the tools and they wouldn't use them, but we have to add another piece of legislation in order for them to use the tools that they already had?

Mr. JOHNSON. Congresswoman, they didn't use the tools because they were asleep at the wheel. Chairman Greenspan thought it was an inappropriate use of Federal Reserve powers and so on. So Congress decided to address that.

If you think you want to go back to letting the Fed make up its own mind entirely about these issues, that is a pretty big step, and not one that I would advise.

Mrs. LOVE. No, I certainly wouldn't advise that, because I have found out that when we give too much control to any regulatory agency, it actually hurts those that it vows to protect, as we are seeing here.

If you think about it—my time is limited—there is a system that was put in place to make sure that we don't have, systematically, banks that are too-big-to-fail. And yet, this has actually created an environment where a lot of the smaller banks are being absorbed or are having to close their doors because they cannot deal with the cost of compliance.

And I want to again make sure that everyone knows that the cost of compliance always goes to the consumer, those people who are out there trying to get a loan for their home, for a loan to start their business, or to purchase a vehicle so that they can get to and from work.

I yield back.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now the gentlewoman from California, the ranking member of the full Financial Services Committee, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much.

I am very appreciative for this hearing for any number of reasons. First, I would like to say to Mr. Simmons over there, I visited your bank.

Mr. SIMMONS. Yes.

Ms. WATERS. And I know that during the time that I visited, there was a little bit of a problem with the stress-testing, and I had just begun to focus on the centralized risk management systems. But I want to tell you that your employees and all of the people there were extremely efficient. They were friendly. I was welcomed there. We had a good time there.

And so I just want you to know that, whatever it is we are looking at or we are questioning you about today, I know that the people who are employed in the bank really do care.

Mr. SIMMONS. We would always love to have you back. It was nice to have you there.

Ms. WATERS. We will come back to visit you sometime in the near future.

Let me just ask a little bit about this centralized risk management that we have been taking a look at. Your testimony states that the bank has incurred high costs due to stress-testing and resolution-planning requirements under the Dodd-Frank Act. But you also said that stress-testing is an important part of successfully running a bank, that you are not against stress tests, that they are important to have.

Now, in March, Moody's issued a report that stated, and I will quote, "We view Zions' relatively new centralized risk management system as its major rating constraint. This also includes the risk culture of the company, particularly as it relates to managing asset concentrations and adhering to the country's post-crisis risk limits."

The report adds that, "While this function is long established at most banks, Zions only began this process a few years ago. If it weren't for the Dodd-Frank Act, the question becomes, would Zions be investing in such robust centralized risk management systems?"

First of all, how are your risk management systems? Do you consider that the criticism that was levied has been corrected? What is going on there?

Mr. SIMMONS. The first thing I would say is I fundamentally disagree with that statement from Moody's. I think a fundamental measure of risk in a traditional bank, at the end of the day, is what do your loan losses look like.

And if you look at our average net charge-offs as a percentage of loans for the period of 2008 through 2011, which I would really consider to be the worst cycle we have had since the Great Depression, our average loan losses were 1.9 percent annually. That compares to a weighted average of 2.51 percent for all traditional bank holding companies, which excludes the big trust banks like Northern Trust and State Street. And it compares to a charge-off ratio of 2.05 percent for all commercial banks.

We actually came through the downturn, despite the fact that we had a lot of exposure in places like Nevada and Arizona, which really got hurt hard in the downturn, we came through it in better shape than average.

And so, yes, everyone in the industry has done a lot to continue to strengthen their risk management systems, ourselves included. I fundamentally don't believe that the $50 billion threshold, though, has played a particularly important role in getting to where we are today.

Ms. WATERS. Okay. All right. Thank you.

Mr. Johnson, I want to ask you—I have been in and out, and I apologize for that. But it seems as if there has been a lot of discussion about designating these regional banks as SIFIs if they are $50 billion or more. And you are saying that our regulators have flexibility, and this is not automatic.

Would you explain this again? I am sure you have said it several times today.

Mr. JOHNSON. Yes, I think there has been some confusion over terminology in the discussion.

The topic is not about systemic designational—designating any particular bank as systemically important, using the SIFI term. It is that there is a threshold in Dodd-Frank that says, above this threshold, there have to be standards that are—I am just quoting here—more stringent than the standard rate requirements that apply to the smaller banks. That is it.

And then it goes on to say immediately—and I am quoting—the Board of Governors may "differentiate among companies on an individual basis by category, taking into consideration capital structure, riskiness, complexity, financial activities, size, and other risk-related factors." That is a lot of discretion or tailoring, which exactly is intended to address the issues that have been raised today.

And I think Dodd-Frank anticipated this. They wanted there to be some minimum standards so you couldn't have the kind of massive lapses that we had before 2008. And, above those minimum standards, the way in which they are applied is substantially at the discretion of the regulators.

Ms. WATERS. Thank you.

Mr. Simmons, do you understand it that way?

Mr. SIMMONS. One of the things I said earlier today was that we don't see a lot of evidence of tailoring that is nearly proportionate to our size vis-a-vis the size of the largest institutions subject to some of these rules. And so I do believe that costs are falling disproportionately on smaller institutions which are subject to these enhanced prudential standards.

Chairman NEUGEBAUER. The time of the gentlewoman has expired.

Ms. WATERS. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Without objection, I am going to recognize Mr. Royce, who is a member of the full Financial Services Committee but not a member of the subcommittee. He has a bill coming up on the Floor. And without objection, he is recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. I appreciate it.

I am increasingly concerned about what Mr. Harris described as the diminishing returns of increased regulation. When a regional bank is spending $200 million on compliance projects, and hiring 500 additional non-loan-officer staff, it really makes you question who is benefiting. Certainly not the customer looking for a loan to build a home or start a business or pay for a child's education.

And a lot has already been said today by Members on both sides of the aisle about how the current $50 billion threshold for enhanced prudential standards is the wrong one. And I would like to ask Mr. Kini: You, in your testimony, describe how this is not the only place that the number has been applied. In fact, it has become what you termed a "systemic risk lodestar" for the Federal financial regulatory agencies.

Where else has this been applied, since you raised that issue? And under today's regulation, what is the difference between being a $49 billion bank and a $51 billion bank?

Mr. KINI. Thank you, Congressman.

I think you are exactly right. The $50 billion threshold is now used in a number of different contexts beyond what is dictated in Section 165.

So, to give one example, regulators have dictated that certain enhanced compliance requirements apply in the regulations under the Volcker Rule for $50 billion banking entities. There is no statutory directive to do that, but this $50 billion concept is embedded there. It is embedded in certain governance and risk management standards that the Comptroller of the Currency has adopted.

So it is kind of expanding and being used in a number of different areas that are not required by the statute. And I think that is because the regulators are looking at Section 165 and pointing to it and saying, well, Congress made a choice here on $50 billion, so we are going to adopt a $50 billion threshold, as well.

So the end result seems to be: one, kind of a continued proliferation of the $50 billion threshold; and two, the imposition of regulatory requirements that are beyond the set that we have been talking about up to now on bank holding companies once they cross that $50 billion mark.

Mr. ROYCE. So you are saying that regulators have used the flexibility given to them under current law to apply the $50 billion threshold on this elsewhere, even when not required, and they have not, as some have suggested, used the flexibility to tailor the regulation based on the risks posed by the bank?

Mr. KINI. I think that is a fair statement. I think they have, in various contexts, used $50 billion elsewhere where there is no requirement to do so, and they haven't done—in some of those cases, like in the Volcker Rule, there are harder standards at $50 billion than below.

Mr. ROYCE. Right.

So here is my question, could the Federal Reserve, on its own, raise the CCAR level to $100 billion or $250 billion? If, as Dr. Johnson suggested, the $50 billion threshold is not a systemic risk designation, then wouldn't a higher number make sense for stress-testing?

Mr. KINI. The Federal Reserve could vary different types of stress-testing above the $50 billion level, but it has to apply enhanced capital requirements at $50 billion, and it has to apply Dodd-Frank stress-testing, so DFAST stress-testing, at $50 billion. And, as a matter of fact, Governor Tarullo has really asked, well, does that make sense, to apply some of that level at $50 billion.

Mr. ROYCE. Okay.

My last question to you would be, have other countries around the world adopted the bright-line $50 billion asset-based threshold here?

And, also, did the Federal Reserve advocate for this approach when the Basel Committee was designing its methodology for determining systemic risk regulation?

Mr. KINI. I am not aware that the Federal Reserve advocated for the $50 billion. As a matter of fact, the Basel Committee uses a much more nuanced indicator-based approach when it looks at globally systemically important banks, number one.

And, number two, when the Federal Reserve has considered mergers under its bank holding company authority and has been directed by Dodd-Frank to look at systemic importance, it, too, uses a much richer and nuanced analysis, which suggests that when the Federal Reserve is not directed to use $50 billion, it, too, would use a much more nuanced approach and a much richer analysis for determining systemic importance.

Mr. ROYCE. Thank you, Mr. Kini. I appreciate it.

And thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Washington, Mr. Heck, is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

Dr. Johnson, for you, sir—and I apologize for not having been here earlier if some of my inquiries are a bit redundant. Please accept my apologies.

But I do understand you to have said in response to a question earlier today that you found much merit, or at least some considerable merit, in Mr. Hoenig's approach of making these determinations on the basis of the level of risk activity as opposed to just asset size. Is that correct?

Mr. JOHNSON. I think the specific Hoenig proposal we were discussing is to create a safe haven, primarily designed for community banks but also potentially expandable, where, if you meet certain very stringent criteria across a range of dimensions, including the riskiness of your portfolio, how much capital you have, how much leverage you have, and so on—but if you meet these stringent criteria, you will opt out of a lot of the other regulations that currently apply to community banks. Yes, that idea I do support.

Mr. HECK. And is there any point at which that size matters if the risk activity continues to be de minimis? And if so, what would you indicate as the appropriate size?

Mr. JOHNSON. As I discussed in my written testimony, if you look at the experience in the United States with financial crises, and the same thing is true in other countries—I used to be the chief economist at the International Monetary Fund, for example. When the systemic footprint of an institution or its total risk exposure reaches around 1 percent of GDP, you should open your eyes and you should look at it and you should try to understand what is it, how does it fit in the system, what would happen if it collapses, would it bring down other similar financial institutions, for example.

So this is an argument for scrutiny. It doesn't say that you should apply exactly the same standards to everybody irrespective of their size above that level.

But if we take this 1 percent or .75 percent of U.S. GDP, a total risk exposure of about $100 billion would make sense. Now, that is not exactly the same as $50 billion consolidated assets. It would make a difference, for example, to Zions and also to Huntington. But, as I mention in my written testimony, those are the only two U.S. bank holding companies that would be affected by such a shift in emphasis.

Mr. HECK. The bottom line being, if I am hearing you correctly, that you and I would agree that some form of regulatory relief geared toward lower-risk-activity institutions of a certain size would be appropriate and a prudent thing to do.

Mr. JOHNSON. Look, absolutely. For community banks below $10 billion, below $1 billion, I have a lot of sympathy for the arguments that they have gotten caught up a little bit too much in the regulatory net. And what is nice about Mr. Hoenig's proposal is, let them opt out, let them choose a business model that is absolutely, clearly, beyond any doubt much safer, and then you can exempt them from a variety of other systemic regulatory-type requirements.

Mr. HECK. I am going to go off-topic a little bit here, but I cannot resist the impulse, given your professional background at the IMF.

Is the United States paying a price, directly or indirectly, for our failure to embrace the recommended reforms of, what now, 5 years ago? And if so, what do you think they are?

Mr. JOHNSON. In terms of financial-sector reforms?

Mr. HECK. To the IMF.

Mr. JOHNSON. Oh, at the IMF. Look, I think, yes, the lack of support in Congress for the quota reform at the IMF is a problem. I think the IMF can and in many instances does play a helpful role in terms of stabilizing the world economy, and that means stabilizing our trading partners, and we care a lot about the stability of our export markets. And from a national security perspective, we absolutely do not need more failed states around the world.

The IMF needs to modernize. It needs to change its governance. There are more proposals on the table. But you can't get there unless and until the U.S. Congress approves the quota reform that is currently on the table. It has been on the table for a long time.

Mr. HECK. Dr. Johnson, do you believe our failure to embrace those reforms, as are supported pretty much throughout the rest of the globe by the participants, cedes economic development leadership in the world to other countries? Are we giving up influence, gravitas, opportunity to make a positive impact to other countries by virtue of our unwillingness to adopt these—

Mr. JOHNSON. We are absolutely failing in our own leadership and disappointing many of our friends. Whether any other country can step forward and take up that leadership remains to be seen. I rather think that you get something more anarchic and something more chaotic, which is also not good.

I don't think it is over, also, Congressman. We can step up; we can take more responsibility. And the situation in Europe, for example, is, these days, an absolutely pointed reminder of what happens if you let other people sort out their own problems. It often doesn't happen.

Mr. HECK. All I can say is "hear, hear" on both points. Thank you very much, sir.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Pennsylvania, Mr. Rothfus, is recognized for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

And I would like to go back to the beginning, when the chairman asked a couple of questions. And, Dr. Kupiec, I want to address this to your attention.

Section 165 of Dodd-Frank provides that the Federal Reserve shall establish enhanced prudential standards for bank holding companies with consolidated assets of $50 billion or more "in order to prevent or mitigate risks to the financial stability of the United States."

I wonder if I have been hearing some revisionist history lately. With some defense of the $50 billion threshold, supporters have suggested that these institutions as low as $50 billion could pose a risk, not for the financial stability of the United States, but pose a risk for a region of the country, which is sufficient for a SIFI designation. Or, in the alternative, they would argue that two or more of these institutions could fail at the same time and could collectively pose a systemic risk.

I guess my question is, do SIFI designations that are ostensibly justified by regional risk or by the risk of multiple institutions all failing at the same time comport with the text and intent of the law, which talked about institutions affecting the financial stability of the United States?

Mr. KUPIEC. Congressman, I would say no. I would say the law is silent on the conditions that prevail.

I think if you want guidance on this, you need to go to the non-bank SIFI designation part, where it talks about designating non-bank SIFIs. And it does not ever say the context of the failure. So the law is silent about whether—because if a SIFI fails in a good time, there are plenty of institutions that would step up to the plate and buy it, and there would be no harm, no foul. Some people would lose money, but it wouldn't be a systemic event.

Mr. ROTHFUS. It wouldn't affect the financial stability—

Mr. KUPIEC. It would not affect financial stability.

Mr. ROTHFUS. And I think Mr. Simmons made a point about, when a community bank would go down in a small community, that region is going to be detrimentally impacted. And I can see somebody create a case where, regardless of a $50 billion threshold, maybe a $2 billion threshold or a $3 billion threshold, if you had a string of community banks that would encounter a difficulty, then you could make a similar argument to what I would consider some revisionism going on.

Mr. KUPIEC. It is creative. It is creative justification.

And I would take issue with Mr. Simmons' characterization. The $50 billion threshold really is a systemic risk threshold for banks, and it is treated that way. You are either above the $50 billion club and the Federal Reserve does a bunch of things to you that it doesn't do to other banks, or you are not. Now, they may be even tougher on the biggest banks. There is really no way to know since they don't tell us exactly what they do at different levels of bank size.

So I do think the $50 billion is a systemic threshold. And I do agree with you completely, that it is revisionist thinking to justify—

Mr. ROTHFUS. If I could, I have a quick question for Dr. Barth. I want to make sure I get this in.

Last July, CIT Group announced plans to purchase OneWest Bank. The deal would give CIT more than $70 billion in assets, making it the first company to voluntarily jump above the $50 billion threshold.

When questioned about the SIFI designation, CIT's CEO, John Thain, stated, "If you are going to go over $50 billion anyway, it is better to be $70 billion than $52 billion," so we could capture some economies of scale. In other words, if you are going to be a SIFI, go big or don't go at all.

Do you agree with Mr. Thain's analysis?

Mr. BARTH. Yes, I do. As Mr. Simmons pointed out earlier, for his bank—and I think it applies to other regional banks, as well—there are costs, but there are no offsetting benefits unless one gets much bigger to spread those costs over a larger asset base.

Mr. ROTHFUS. Wouldn't this present its own risks to the financial system? For example, isn't the idea of consolidating totally antithetical to the reasons used to ostensibly justify the SIFI designation process in the first place?

Mr. BARTH. Yes. I agree with you. It turns out it shouldn't be up to the government to force an institution to become bigger simply because it is imposing more cost on an institution—an institution being free to choose its own business plan. And I think Mr. Simmons nicely pointed out the additional costs that his bank is forced to comply with or incur solely because of an artificial threshold.

Mr. ROTHFUS. Thank you.

I yield back, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

And thank you to the witnesses.

We have heard repeatedly today from many of you all that the $50 billion asset threshold is arbitrary and unrealistically low.

If you take community banks in the aggregate and look at their assets combined and compare them, say, with Zion Bank's $58 billion size, and you look at the number of community banks that have been acquired or have failed since the enactment of the Dodd-Frank Act, the numbers are quite startling. By year-end 2010, there were 7,657 banks in the United States. By the first quarter of 2015, that number had declined to 6,419.

And if you look at small banks and de novo charters, newly formed banks, according to a March 2015 Federal Reserve Bank of Richmond study, there were only 4 de novo, newly formed banks total in the last several years, compared to a yearly average of more than 100 from 2002 to 2008.

If you add all of that up and you see the consolidation and you see that there are about 1,200 fewer banks today than there were when Dodd-Frank was enacted, you are talking about a pretty significant loss in assets or at least concentration of assets in larger, more systemically important institutions.

So what is the difference, from a financial stability standpoint, from a systemic risk standpoint, between the prospect that a failure of a $58 billion small regional bank would have on our economy versus the actual impact of the Dodd-Frank Act on community banks, which has been a dramatic consolidation and elimination of these small community banks?

Would anyone care to respond to that analysis?

Does the fact that there is consolidation in the industry and the fact that there are very few new charters and the fact that there are a lot of community banks going out of the business, when, in the aggregate, constitute a pretty significant asset size, maybe larger in the aggregate than a $58 million bank? Does that concern anyone?

Mr. KUPIEC. It certainly concerns me. It is not a good environment to want to be a banker in these days, and it is not getting any better.

I think it is always true—and there is lots of research to support it—that banks have a special place in the economy, and when a bank fails, of any size, bigger or small, it likely has negative impacts on the businesses that were being served by the bank. They have to spend money to go out and acquire a new bank relationship. It is not a good thing, but it is a matter of degree.

So the failure of 700 community banks in aggregate is a drag on the economy, but we don't treat that as a systemic event.

Mr. BARR. Let me explore the cost issue with the stress test with Mr. Simmons a little bit more.

You have testified, obviously, that as a consequence of the stress test you have added 500 compliance officers—and additional regulations—you have added 500 compliance officers, none of whom work in the core business of banking. None of them are in lending. They are in compliance.

Obviously, that is costly to the bank's profitability; it is costly to your shareholders. But my question is, what does it mean to your customer?

Mr. SIMMONS. The first thing I would say—these are great people. And risk management is certainly fundamental and core to the business of banking. I think the issue is that there are diminishing returns to all of this. And how much safer relative to how much more cost you spend is something that we are sensitive to. Our ability to attract capital and to grow is hampered by all of this.

And at the end of the day, the cumulative impact of not only Section 165 but of a lot of other new regulations—and I mentioned mortgage lending as a good example of one where we are spending a lot of time trying to figure out, how do we go about just doing what we used to do kind of naturally, which is make credit available to people who could pay it back, we kept it on our balance sheet, and serve our community?

Mr. BARR. Can I just interject? In talking to another regional bank CEO, what he told me was that $100 million in additional compliance costs is the equivalent to a billion dollars in capital not deployed in the community. Does that ratio square with your experience?

Mr. SIMMONS. Yes, given the leverage in the industry, that is probably about right.

Mr. BARR. So the compliance costs mean less credit available to customers. And that, I would argue, is in and of itself a risk to the financial system, that you have that much less capital deployed in the economy, compromising economic growth.

Mr. SIMMONS. And it compounds, because that is their annual costs, and so this compounds over time.

Mr. BARR. My time has expired. I yield back. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And I would like to thank our witnesses today.

Without objection, I would like to submit the following statements for the record: the opening statement of Chairman Randy Neugebauer; the opening statement of Representative Blaine Luetkemeyer; the opening statement of Ranking Member William Lacy Clay; and the written statement of the Regional Bank Coalition.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, we are adjourned.

[Whereupon, at 4:21 p.m., the hearing was adjourned.]

A P P E N D I X

July 8, 2015

Opening Statement
Chairman Blaine Luetkemeyer (MO-03)
"The Future of Housing in America: Oversight of"
Committee on Financial Services
July 8, 2015

Thank you, Mr. Chairman, for holding this important hearing.

An inefficient regulatory structure that does not reflect the reality of the U.S. banking system can have real economic consequences for both financial institutions and, more importantly, the American people. That's what our nation's credit unions and community, midsize and regional banks have experienced in the last five years. This is particularly true of many of the banks that have been deemed to be Systemically Important Financial Institutions not based on actual risk posed to the U.S. financial system, but based purely on arbitrary asset size.

In an effort to improve the manner in which systemic risk is identified, I introduced, along with five of my colleagues from this Committee, H.R. 1309, the *Systemic Risk Designation Improvement Act.* This bipartisan legislation would more closely tie the safeguards intended in the designation of SIFIs with real risk in the system.

This approach will free commercial banks to make loans to customers, supporting the recovery while allowing the federal financial regulators the ability to make determinations based on actual risk posed to the financial sector rather than asset size alone.

It is time to take a more pragmatic approach to the SIFI designation process and, more generally, the growing regulatory regime crippling our financial institutions and their customers.

I look forward to today's testimony and yield back.

Financial Institutions Subcommittee – Opening Statement- Chairman Randy Neugebauer
"Examining the Designation and Regulation of Bank Holding Company SIFIs"

- Good afternoon.

- Over the last several years, there has been growing bipartisan and bicameral interest in re-examining Dodd-Frank's regulatory framework for bank holding companies with assets greater than $50 billion.

- Dodd-Frank's arbitrary asset threshold test under Section 165 does not adequately consider the systemic risk profiles of bank holding companies.

- Section 165's objective is to mitigate risk to the financial stability of the United States due to the distress or failure of a financial institution.

- I am concerned that using a static asset threshold does not provide enough flexibility for regulators when designating systemic importance.

- Recent evidence shows vast differences in systemic importance between the smallest US G-SIBs and the largest US regional banks – yet they remain subject to the same 165 standards.

- Even banking regulators have highlighted the flaws in the Section 165 threshold.

- For example, Comptroller of the Currency Thomas Curry recently testified that there are currently non-systemically important banks being regulated as systemically important due to the current threshold.

- As policy makers, we must always strive to be precise when improving legislative frameworks as to minimize unintended consequences.

- I hope this hearing allows members to begin to consider different ways of measuring systemic importance and the regulatory consequences of being designated a SIFI.

STATEMENT

OF

JAMES R. BARTH

Eminent Scholar in Finance at Auburn University and Senior Fellow at Milken Institute

"Examining the Designation and Regulation of Bank Holding Company SIFIs"

Financial Institutions and Consumer Credit Subcommittee

House Financial Services Committee

U.S. House of Representatives

July 8, 2015

Chairman Neugebauer, Ranking Member Clay, and Members of the Committee, it is an honor to be here today to testify on the designation and regulation of Bank Holding Company systemically important financial institutions (SIFIs). My name is James R. Barth and I am an Eminent Scholar in Finance at Auburn University and a Senior Fellow at the Milken Institute. My research focuses on financial institutions and capital markets, both domestic and global, with special emphasis on regulatory issues. I was an appointee of Presidents Ronald Reagan and George H.W. Bush as chief economist of the Office of Thrift Supervision and previously the Federal Home Loan Bank Board. I have also been a visiting scholar at the U.S. Congressional Budget Office, Federal Reserve Bank of Atlanta, Office of the Comptroller of the Currency, and the World Bank. A current resume summarizing somewhat more fully my education, experience, and affiliations pertinent to subject matter of the hearing is provided at the end of my statement.

The United States recently suffered a severe financial crisis and the worst recession since the Great Depression. In response the U.S. Congress enacted and President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) in July 2010. An important objective of the DFA is to mitigate the threat to financial stability posed by SIFIs. A new group, the Financial Stability Oversight Council (FSOC), has been established to identify the SIFIs, which are then subject to enhanced prudential supervision by the Federal Reserve Board. Section 165 of DFA specifically requires that Bank Holding Companies (BHCs) with $50 billion or more in total consolidated assets automatically be designated as SIFIs.

Table 1 provides a list of BHCs that by law are automatically currently designated as SIFIs. As of March 2015, the biggest SIFI is JPMorgan Chase with $2,577 billion in assets, while the smallest one is Zions with $58 billion in assets. (See Figure 1 for a visualization of the striking differences in asset size among the SIFIs.) Clearly, these two institutions do not pose the same degree of systemic risk when one institution is more than 40 times the size of the other institution. This significant disparity in asset size indicates the total arbitrariness of designating SIFIs solely on the basis of whether a BHC has $50 billion or more in assets.

New York Community Bancorp, moreover, has total assets of $48 billion, which places it just below the $50 billion threshold for the SIFI designation. Clearly, the degree of systemic risk between Zions and New York Community Bancorp is not sufficiently different based on simply the $10 billion difference in asset size so that one bank should be designated as a SIFI and the other not so designated.

In short, there is no evidence to support the use of a $50 billion threshold set by law to distinguish between BHCs that are SIFIs and those that are not. Such a static and arbitrary threshold provides an incentive to those institutions just below the threshold to curtail their growth to remain below $50 billion, while those just above the threshold have an incentive to take actions to increase their size to spread the additional costs incurred due to being subjected to enhanced potential supervision over a bigger asset base. Surely, this was not the intent of the law.

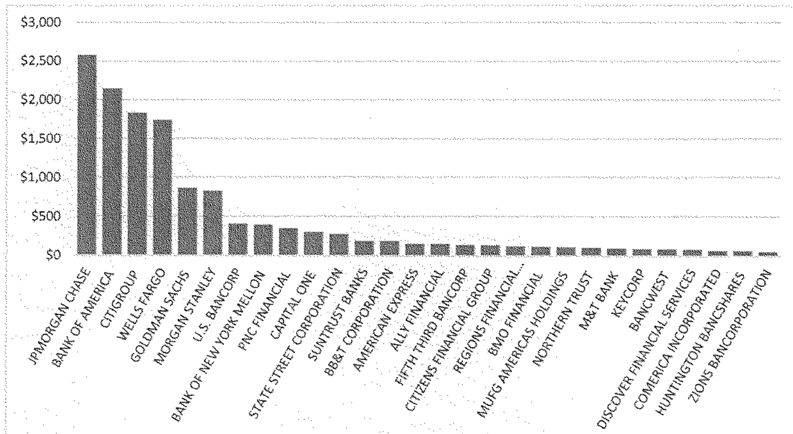
Table 1. U.S. bank holding companies with total consolidated assets greater than $50 billion

X denotes institutions that participated in DFA stress test and/or designated as G-SIBs by Financial Stability Board (As of March 31, 2015)

Rank	Institution Name	Location	Total Assets ($ billions)	Participated in stress test (March 2015)	G-SIBs (November 2014)
1	JPMORGAN CHASE & CO.	NEW YORK, NY	$2,577	X	X
2	BANK OF AMERICA CORPORATION	CHARLOTTE, NC	$2,145	X	X
3	CITIGROUP INC.	NEW YORK, NY	$1,832	X	X
4	WELLS FARGO & COMPANY	SAN FRANCISCO, CA	$1,738	X	X
5	GOLDMAN SACHS GROUP, INC.	NEW YORK, NY	$866	X	X
6	MORGAN STANLEY	NEW YORK, NY	$829	X	X
7	U.S. BANCORP	MINNEAPOLIS, MN	$410	X	
8	BANK OF NEW YORK MELLON CORPORATION	NEW YORK, NY	$399	X	X
9	PNC FINANCIAL SERVICES GROUP, INC.	PITTSBURGH, PA	$351	X	
10	CAPITAL ONE FINANCIAL CORPORATION	MCLEAN, VA	$307	X	
11	STATE STREET CORPORATION	BOSTON, MA	$279	X	X
12	SUNTRUST BANKS, INC.	ATLANTA, GA	$190	X	
13	BB&T CORPORATION	WINSTON SALEM, NC	$189	X	
14	AMERICAN EXPRESS COMPANY	NEW YORK, NY	$155	X	
15	ALLY FINANCIAL INC.	DETROIT, MI	$154	X	
16	FIFTH THIRD BANCORP	CINCINNATI, OH	$140	X	
17	CITIZENS FINANCIAL GROUP, INC.	PROVIDENCE, RI	$137	X	
18	REGIONS FINANCIAL CORPORATION	BIRMINGHAM, AL	$123	X	
19	BMO FINANCIAL CORP.	WILMINGTON, DE	$118	X	
20	MUFG AMERICAS HOLDINGS CORPORATION	NEW YORK, NY	$114	X	
21	NORTHERN TRUST CORPORATION	CHICAGO, IL	$107	X	
22	M&T BANK CORPORATION	BUFFALO, NY	$98	X	
23	KEYCORP	CLEVELAND, OH	$94	X	
24	BANCWEST CORPORATION	HONOLULU, HI	$90		
25	DISCOVER FINANCIAL SERVICES	RIVERWOODS, IL	$84	X	
26	COMERICA INCORPORATED	DALLAS, TX	$69	X	
27	HUNTINGTON BANCSHARES INCORPORATED	COLUMBUS, OH	$68	X	
28	ZIONS BANCORPORATION	SALT LAKE CITY, UT	$58	X	

Note: Savings & Loan Holding Companies and Foreign Bank Holding Companies are excluded. Also, BancWest Corporation will be subject to Dodd-Frank Act stress testing beginning January 1, 2016.
Source: National Information Center, http://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx; Board of Governors of the Federal Reserve System, http://www.federalreserve.gov/bankinforeg/dfa-stress-tests.htm; Financial Stability Board, http://www.financialstabilityboard.org/wp-content/uploads/r_141106b.pdf.

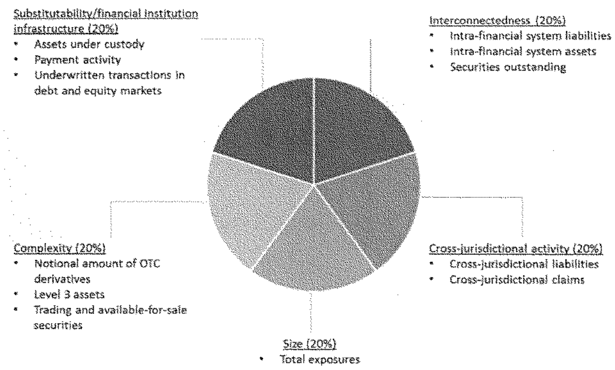
Figure 1. U.S. bank holding companies with total consolidated assets greater than $50 billion
($ billions)



If such a static threshold is to be used, it should certainly be much higher. A $500 billion threshold would include only the top 7 BHCs in Table 1, which accounted for 68 percent of the total assets of all BHCs as of March 2015. Alternatively, a threshold of $250 billion would include only the top 11 BHCs, which accounted for 80 percent of the total assets of all BHCs as of the same date. These two figures, moreover, do not have the same problem as the much lower $50 billion threshold in the sense that there are far bigger differences in assets for the nearest institutions below and above a $250 billion or $500 billion threshold. Of course, if either of these two figures were used to designate SIFIs, it would make sense to allow the figures to change over time, such as by linking them to the growth in GDP.

Table 1 also shows those BHCs that have been designated as G-SIBs by the Financial Stability Board. There are 8 institutions so designated and all of them have total assets greater than $250 billion. More importantly, the designation of G-SIBs is based on not just asset size. Instead, as Figure 2 shows, there are 5 factors used in the designation process. Certainly, the use of all these factors is a far more appropriate basis for designating a BHC as a SIFI than simply relying on asset size alone. Indeed, the size factor only accounts for 20 percent in calculating the final score that captures the global systemic risk of an institution. It should also be noted that the list of G-SIBs is not static but can change over time depending on the extent to which the business model of an institution evolves. For example, Banco Bilbao Vizcaya Argentaria was added to the list in 2012, the Industrial and Commercial Bank of China

Figure 2. Factors for designating G-SIBs



Source: Basel Committee on Banking Supervision (BCBS), "The G-SIB assessment methodology – score calculation", November 2014.

Limited was added in 2013, and Agricultural Bank of China was added in 2014. Importantly, an institution's score relating to global systemic risk may even be adjusted based on supervisory judgment. In a similar manner, if the threshold for designating a SIFI were increased to $250 billion or $500 billion, the Federal Reserve Board could use its judgement to determine if a BHC with less than this amount of assets should nevertheless be so designated.

It is important to point out that the Office of Financial Research (OFR) recently issued a report evaluating the systemic importance of the largest BHCs based on size, interconnectedness, complexity, global activity, and substitutability[1]. These are the same factors used to designate G-SIBs (see Figure 2). The report found that the eight BHCs designated as G-SIBs had the highest systemic importance scores, ranging from a low of 1.72 percent for Wells Fargo to a high of 5.05 percent for JPMorgan Chase. In sharp contrast, however, the other 25 BHCs had an average score of just 0.14 percent. On the basis of their findings, it was concluded that "... the largest banks tend to dominate all indicators of systemic importance."

The use of more than just a size measure by the authors to evaluate the systemic importance of BHCs is consistent with another report issued by the Bank of Canada[2]. The report concluded with the statement that "While regulators take different approaches in assessing systemic importance, all of them look beyond size to evaluate the importance of each institution for the financial system."

[1] Meraj Allahrakha, Paul Glasserman, and H. Peyton Young, "Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data", Office of Financial Research *Brief Series*, February 12, 2015.

[2] Éric Chouinard and Erik Ens, "Assessing the Systemic Importance of Financial Institutions", Bank of Canada, *Financial System Review*, December 2013.

It is also interesting to note that a recently published paper[3] by three economists -- one of whom received the Nobel Prize for Economics -- at the New York University Stern School of Business reached a similar conclusion as the authors of the OFR report. The authors implemented a model based on publicly available data so as to compute SRISK, which is defined as the capital that an institution is expected to need if there is another financial crisis. The results of their analysis for most of the BHCs listed in Table 1 are reported in Table 2. Bank of America has a highest score at 18.25 percent, while all of the BHCs with fewer than $500 billion have scores equal to or less than 0.10 percent, with the exception of State Street Corporation, which is designated a G-SIB and has a score of 1.33 percent.

Table 2. U.S. bank holding companies with total consolidated assets greater than $50 billion

Rank	Institution Name	Total Assets ($ billions)	SRISK% (June 26, 2015)
1	JPMORGAN CHASE & CO.	$2,577	13.66
2	BANK OF AMERICA CORPORATION	$2,145	18.25
3	CITIGROUP INC.	$1,832	12.12
4	WELLS FARGO & COMPANY	$1,738	≤ 0.10
5	GOLDMAN SACHS GROUP, INC.	$866	4.85
6	MORGAN STANLEY	$829	8.18
7	U.S. BANCORP	$410	≤ 0.10
8	BANK OF NEW YORK MELLON CORPORATION	$399	≤ 0.10
9	PNC FINANCIAL SERVICES GROUP, INC.	$351	≤ 0.10
10	CAPITAL ONE FINANCIAL CORPORATION	$307	≤ 0.10
11	STATE STREET CORPORATION	$279	1.33
12	SUNTRUST BANKS, INC.	$190	≤ 0.10
13	BB&T CORPORATION	$189	≤ 0.10
14	AMERICAN EXPRESS COMPANY	$155	≤ 0.10
15	ALLY FINANCIAL INC.	$154	N/A
16	FIFTH THIRD BANCORP	$140	≤ 0.10
17	CITIZENS FINANCIAL GROUP, INC.	$137	N/A
18	REGIONS FINANCIAL CORPORATION	$123	≤ 0.10
19	BMO FINANCIAL CORP.	$118	N/A
20	MUFG AMERICAS HOLDINGS CORPORATION	$114	N/A
21	NORTHERN TRUST CORPORATION	$107	≤ 0.10
22	M&T BANK CORPORATION	$98	≤ 0.10
23	KEYCORP	$94	≤ 0.10
24	BANCWEST CORPORATION	$90	N/A
25	DISCOVER FINANCIAL SERVICES	$84	N/A
26	COMERICA INCORPORATED	$69	≤ 0.10
27	HUNTINGTON BANCSHARES INCORPORATED	$68	≤ 0.10
28	ZIONS BANCORPORATION	$58	≤ 0.10

Source: http://vlab.stern.nyu.edu/analysis/RISK.USFIN-MR.MES#risk-graph.

[3] Viral Acharya, Robert Engle, and Matthew Richardson, "Capital Shortfall: A New Approach to Ranking and Regulating Systemic Risks", *American Economic Review: Papers & Proceedings*, 2012.

Once again, there are substantial differences in the evaluation of the systemic risk posed by the BHCs with $50 billion or more in assets, with the evidence indicating the number of SIFIs is quite limited. In a study examining individual bank risk, moreover, it is found that "... among large banks only (over US$50 billion in assets), size per se ceases to be an independent risk factor"[4]. These studies only further emphasize the need to base the designation of SIFIs on more factors than just asset size or at the very least to raise the threshold substantially above $50 billion. Even with a much higher threshold, the DFA specifies that "When differentiating among companies for purposes of applying standards established under section 165, the Board may consider the companies' size, capital structure, riskiness, complexity, financial activities, and any other risk-related factors the Board deems appropriate" [5]. The Federal Reserve Board could exercise this same discretion to identify BHCs falling below a new and higher threshold as SIFIs, if it so desired.

An important point to be made is that some may argue that the $50 billion threshold is fine because it is better to err on the side of caution when designating a BHC as a SIFI. However, this view ignores the fact that a BHC that is incorrectly designated as a SIFI is subjected to unnecessary costs without any offsetting benefits. Some of these costs are associated with the following supervisory and regulatory requirements. SIFIs are subject to higher capital, greater liquidity, and lower leverage requirements. They are also subject to annual stress tests conducted by the Federal Reserve as well as required to conduct their own semi-annual stress tests. The Federal Reserve, moreover, conducts an annual Comprehensive Capital Analysis and Review (CCAR) to assess whether SIFIs have sufficient capital to continue operations throughout times of economic and financial stress and that they have robust, forward-looking capital planning processes that account for their unique risks. Furthermore, SIFIs are subject to an enhanced supervision framework and fees may be assessed on them to finance the costs of supervision as well as the budget of OFR. The costs imposed on BHCs due to being inappropriately designated as SIFIs result in fewer and more costly services to the communities serviced by such BHCs. The regulatory authorities are also forced to spend more time dealing with these BHCs. The bottom line is that economic resources are being misallocated based on the current arbitrary and static $50 billion legal threshold.

---

[4] Luc Laeven, Lev Ratnovski, and Hui Tong, "Bank Size and Systemic Risk", *IMF Staff Discussion Note*, May 2014.

[5] Federal Register, Vol. 79, No. 84, May 1, 2014, p. 24529

Testimony submitted to the Financial Institutions and Consumer Credit Subcommittee of the House Financial Services Committee, hearing on "Examining the Designation and Regulation of Bank Holding Company SIFIs," Wednesday, July 8, 2015, 1pm (embargoed until the hearing begins).

Submitted by Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management; Senior Fellow, Peterson Institute for International Economics; and co-founder of http://BaselineScenario.com.[1]

A. Main Points

1) Section 165 of the 2010 Dodd-Frank Act authorizes the Board of Governors of the Federal Reserve System to establish "more stringent" standards and requirements for bank holding companies with assets over $50 billion compared with smaller bank holding companies. At the same time, the Fed is granted considerable discretion to determine exactly how to apply these standards, including what requirements are imposed on different size banks (Section 165(a)(2)(A)). (The precise wording of the Act is discussed further in Section C below.)
2) As a matter of practice since 2010, the Fed has not applied one set of standards to all banks with assets over $50 billion. There is substantial differentiation, depending in part on size, but also varying according to factors such business model, complexity, and opaqueness.
3) This differentiation, to date, seems sensible and reasonably robust – subject to the points below. It also appears completely consistent with Congressional intent, expressed through Dodd-Frank and earlier legislation that is still in effect.
4) The Federal Reserve has long had responsibility for the safety and soundness of the American financial system. This role can be traced back to the panic of 1907, which led to the founding of the Fed in 1913. The bank runs and broader economic problems of the 1930s led to a re-founding of the Federal Reserve System, with a clear mandate to prevent the financial system from getting out of control.[2]
5) In the run-up to 2007-08, the Federal Reserve had a great deal of discretion with regard to financial regulation and supervision but failed: to protect consumers, to understand the build-up of risk around derivatives, to supervise appropriately some large financial institutions then

[1] Also a member of the Federal Deposit Insurance Corporation's Systemic Resolution Advisory Committee, the Office of Financial Research's Research Advisory Committee, and the Systemic Risk Council (created and chaired by Sheila Bair). All the views expressed here are mine alone. Underlined text indicates links to supplementary material; to see this, please access an electronic version of this document, e.g., at http://BaselineScenario.com. For important disclosures, see http://baselinescenario.com/about/.

[2] On this and broader Fed history, see Peter Conti-Brown, "The Twelve Federal Reserve Banks: Governance and Accountability in the 21st Century," Working Paper #10, Hutchins Center on Fiscal & Monetary Policy at Brookings, March 2, 2015. For the Fed's extensive supervisory mandate in the 2000s, see Heidi Mandanis Schooner, "Central Banks' Role in Bank Supervision in the United States and United Kingdom," Brooklyn International Law Journal, 2003, available at ssrn.com.

under its jurisdiction, and to keep the system from imploding.[3] These failures were not due to lack of resources or an unawareness of the changes happening within the financial system. Rather there was a deliberate strategy of noninterference, along with many instances of actually encouraging various forms of deregulation that, in retrospect, are clearly understood – including by Fed staff and governors – as having increased levels of systemic risk.[4]

6) At the time of the discussions and debates that led to Dodd-Frank, Congress had to face the facts: almost all the banking and financial sector regulators had failed in their tasks – some even more spectacularly than had the Fed. (The exception was the Federal Deposit Insurance Corporation, but a decision was taken not to promote the FDIC to the role of system regulator.)

7) With regard to bank holding companies, Congress did not create a new authority for the Fed in Dodd-Frank. Rather Congress re-affirmed the existing broad authority and set some minimum bars – specifying bright lines to define for the Fed which kinds of bank holding companies require more attention, while allowing the Fed to retain a considerable degree of discretion regarding what exactly that attention will involve.[5]

8) At the threshold of $50 billion in total assets, bank holding companies are now required to prepare resolution plans. They must also file an integrated Systemic Risk Report (FR Y-15).

9) Bank holding companies with more than $10 billion in total assets must conduct annual company-run stress tests. Bank holding companies with more than $50 billion in total assets must conduct semiannual company run stress tests and also participate in stress tests run by the Federal Reserve.[6]

10) The Fed already had authority to establish regulatory capital requirements, liquidity standards, risk-management standards, and concentration limits (including single-counterparty credit limits). All of these can be and have been tailored as the Fed deems appropriate.[7]

11) There are, of course, costs with running any sensible risk management program. Many of these so-called "compliance costs" are very much in the interests of shareholders – it was deficiencies in or the complete lack of such programs that resulted in heavy losses and significant financial firm failures in the crisis. For example, the Dodd-Frank requirement

---

[3] The Federal Reserve System's own mission statement has four bullet points. The Fed disappointed along almost every dimension of these stated goals in 2007-08, with the exception that it kept the payments system functioning.

[4] For the history of deregulation and the role of the Fed, see Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, Pantheon 2010, particularly chapter 4. Fed chairman Alan Greenspan was a leader in this push for deregulation in the 1980s, 1990s, and into the 2000s but, to be fair, there was a considerable degree of bipartisan consensus on this policy direction.

[5] Dodd-Frank did create a new authority for the Fed vis-à-vis nonbank financial companies that are designated as systemic by the Financial Stability Oversight Council (FSOC).

[6] Section 165(i)(2) of Dodd-Frank is quite specific on these requirements. However, as applied by the regulators, there is a "substantially abbreviated data reporting template" for the smaller banks; see Thomas J. Curry, written testimony submitted to the Senate Banking committee, March 19, 2015.

[7] *Better Markets*, a pro-financial reform group, has produced a very useful fact sheet that shows the main thresholds and how the Fed has chosen to apply them.

(Section 165(h)) of risk committees for bank holding companies with more than $10 billion in assets seems entirely consistent with the best interests of shareholders.

12) Shareholders could, in principle, speak for themselves regarding how much risk management they want and how they would like this to be organized. But we must recognize the limits imposed on shareholder influence over bank holding company management, including through the extensive rules on ownership of banks. These restrictions are, ironically, administered by the Federal Reserve itself.[8]

13) Some recent legislative proposals could increase our deference to the Financial Stability Board (FSB), with regard to either criteria or actual designation of banks (or nonbanks) as systemically important. This would be unwise. The FSB plays an important role in facilitating communication between regulators, but not all major countries share our concern for or general approach to limiting systemic risk. Relying too much on the FSB would excessively cede US sovereignty to a body with limited accountability. It could also create the possibility of a "race to the bottom", as happened with capital requirements before 2007.

14) Other proposals suggest that the Financial Stability Oversight Council (FSOC) should have to designate banks as systemic in order for them to receive heightened scrutiny from the Fed. This would be a strange arrangement, as FSOC by design includes nonbank regulators, such as the chairs of the Securities and Exchange Commission and the Commodity Futures Trading Commission. Allowing or requiring nonbank regulators to tell a bank regulator which banks to regulate (and potentially how to regulate them) does not seem wise.

15) It would be helpful to require bank holding companies with at least $10 billion in total assets to file a Systemic Risk Report (FR Y-15). This report is concise and provides data on the systemic footprint of a financial institution. Hopefully, bank holding companies put together such data for their own management and investors in any case. Publishing such reports provides a clearer perspective, for regulators and for market participants, on differences in activities and risks across bank holding companies just below and just above $50 billion in assets.

16) Should some bank holding companies with less than $50 billion in total assets be subject to heightened scrutiny, for example due to various off-balance sheet activities, such as derivatives? Without seeing Systemic Risk Reports for those firms, it is hard to know.

17) The available Systemic Risk Reports also suggest that, at all size levels, it would be sensible to think of bank holding company size more in terms of total exposure (on-balance sheet plus off-balance sheet) as defined in those reports, rather than the more narrow measure of total consolidated assets. (More on this in Section B below.)

---

[8] See for example, the Fed's 2008 "Policy statement on equity investment in banks and bank holding companies". On the "many activity restrictions and regulatory intrusions" involved with becoming a bank holding company – owning or controlling a bank – see Saule T. Omarova and Margaret E. Tahyar, "That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulation in the United States," *Review of Banking and Financial Law*, Vol. 31, 2011-2012, available at ssrn.com.

B. The Critical Threshold Issue

What if the threshold for enhanced prudential standards were lifted, for example, to $100 billion?

At the end of 2014, there were 9 bank holding companies that had consolidated assets between $50 billion and $100 billion: Deutsche Bank Trust Corporation ($56 billion), Zions Bancorporation ($57 billion), Huntington Bancshares Incorporated ($66 billion), Comerica Incorporated ($70 billion), Discover Financial Services ($83 billion), BBVA Compass Bancshares ($83 billion), Bancwest Corporation ($90 billion), KeyCorp ($94 billion), M&T Bank Corporation ($97 billion).[9] However, a better measure of potential significance in the financial system as a whole is "total exposures" of a bank holding company, as defined in the Banking Organization Systemic Risk Report form (FR Y-15, Schedule A, line 4).[10] This requires a bank to report both its on-balance sheet and off-balance sheet activities, including derivatives exposures and credit card commitments, in a comparable way.[11] As we learned in 2007 and 2008, off-balance sheet activities are important and can – particularly at a time of stress – have major impact on solvency of financial institutions and on the spillover effects from potential failures.

In the latest available Systemic Risk Reports, from the end of 2014, six of these 9 bank holding companies actually had "total exposure" (on- and off-balance sheet) over $100 billion.[12] It is hard to argue that the fate of a bank holding company with a total exposure threshold of over $100 billion is definitely inconsequential to the system as a whole.[13]

Of the three bank holding companies that had under $100 billion in total exposure, one is a subsidiary of a large non-US bank that recently failed the stress tests conducted by the Fed.[14] It

---

[9] This section uses information from the Systemic Risk Reports required by the Fed of all bank holding companies with over $50 billion in total assets. The form is here: http://www.federalreserve.gov/reportforms/formsreview/FRY15_20120822_f_draft.pdf. The publicly data on consolidated assets can be accessed, by bank, from this webpage (after selecting the desired reporting period): http://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx.

[10] These reports are available, by bank, from http://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx.

[11] The instructions regarding the content of this form are here: http://www.federalreserve.gov/reportforms/forms/FR_Y-1520131231_i.pdf.

[12] KeyCorp had $140 billion in total exposure, while M&T Bank ($120 billion), BBVA ($108 billion), Bancwest ($112 billion), Comerica ($103 billion), and Discover Financial Services ($100 billion) had over $100 billion in total exposure at the end of 2014. Total exposures were: $80 billion at Huntington; $74 billion at Zions, and $53 billion at Deutsche. These total exposures grew at annual rates of between 5 percent (at KeyCorp) to over 23 percent (at Huntington) from the end of 2013 to the end of 2014. Total exposures shrank only at Deutsche Bank, where there have been major issues both in the US and globally.

[13] Long-Term Capital Management (LTCM), when it was on the brink of failure in 1998, had on-balance sheet assets of around $125 billion, with capital of $4 billion. "But that leverage was increased tenfold by LTCM's off balance sheet business whose notional principal ran to around $1 trillion"; David Shirreff, Lessons from the Collapse of Hedge Fund, Long-Term Capital Management.

[14] Deutsche Bank (in the US) had total exposure of over $60 billion at the end of 2013; this fell to $53 billion at the end of 2014. Another subsidiary of a major global bank, Santander USA, had total exposures of $98 billion at the end of 2013, rising to $146 billion at the end of 2014. The assets of Santander USA increased from around $77 billion at the end of 2013 to over $113 billion at the end of the third quarter of 2014 and $118 billion at the end of the fourth quarter of 2014 – an example of how quickly a large global bank can shift business into its US subsidiary. *Too Big to Fail: The Hazards of*

would seem unwise to suddenly regard those firms as no longer needing more stringent standards than required for smaller and much simpler banks.

This leaves Huntington Bancshares Incorporated and Zions Bancorporation below $100 billion in total exposure.[15]

While some regional banks have relatively simple business models, others are at least partially more complex. For example, five of the 9 bank holding companies with under $100 billion in total assets are (i.e., own) registered swaps dealers or have a significant exposure to derivatives.[16]

Regional banks, including those in the $50 billion to $100 billion total asset range, were reportedly involved in lobbying for the repeal of Section 716 of Dodd-Frank, which would have "pushed out" some swaps from their insured bank subsidiaries. The repeal of Section 716 at the end of 2014 is a further reason for the Fed and other regulators to pay close attention to regional banks.

If the discussion turns to considering lifting the scrutiny and reporting requirements for banks having over $100 billion in total assets, then looking at total exposures remains important. In the Systemic Risk Reports for the end of 2013, all of the bank holding companies with over $100 billion in assets actually had total exposure of at least $140 billion.[17]

C. Regulatory Interpretation of Dodd-Frank

Some recent prominent discussion of the Dodd-Frank Act suggests that bank holding companies with over $50 billion are "designated" as "systemic". But this is not what the legislation actually says and this is not how the law has been interpreted by regulators.

Section 165(a)(1) of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act reads,

> "In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to

---

Bank Bailouts, by Gary H. Stern and Ron J. Feldman (Brookings, 2004) highlights, among other points, the potential dangers posed by foreign banks operating in the United States.

[15] Zions has had repeated problems with the Fed-run stress tests, barely passing in 2015. Part of the issue appears to be its large portfolio of Collateralized Debt Obligations. See Julie Steinberg, "Zions, Regulators Still at Loggerheads," *Wall Street Journal*, March 22, 2015.

[16] This CFTC list was checked on July 6, 2015: http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer. The OCC latest derivative report shows activities by bank in the third quarter of 2014, http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq314.pdf.

[17] It is hard to know what will or will not be regarded as systemic as the next crisis develops. IndyMac Bancorp, which failed in 2008, had assets of just over $30 billion; in retrospect, its problems should have been seen at least as an early warning for the rest of the system. Continental Illinois, which failed in 1984, was one of the top ten banks in the US, but its assets were only around $40 billion. US Gross Domestic Product in 1984, in current prices, was around $4 trillion, so Continental Illinois's balance sheet assets had a book value of about one percent of the size of the US economy. In modern terms, with U.S. GDP now over $17 trillion, this further confirms the notion that we should pay close attention as a bank's size (i.e., total exposures) reaches $150 billion.

recommendations by the Council under section 115, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000 that—

(A) are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3)."

Section 165(a)(2) stipulates that the Board of Governors may "differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate." And the threshold for applying some standards may be set above $50 billion.

The Federal Reserve appears to have interpreted this and related sections of Dodd-Frank exactly as intended, i.e., as requiring additional scrutiny for bank holding companies over $50 billion, compared with smaller bank holding companies, but not as requiring that all bank holding companies over $50 billion be treated the same way.[18]

Martin J. Gruenberg, chairman of the FDIC, confirms that this is how regulators have interpreted the law.[19]

> "In implementing the requirement for resolution plans, the FDIC and the Federal Reserve instituted a staggered schedule for plan submissions to reflect differing risk profiles".

And,

> "The FDIC's stress testing rules, like those of other agencies, are tailored to the size of the institutions consistent with the expectations under section 165 for progressive application of the requirements."

Overall, the Dodd-Frank financial reforms told the Fed to be more careful in its regulation of bank holding companies with more than $50 billion in total assets, but there was definitely no one-size-fits-all requirement. The Fed and other regulators seem to have followed both the letter and spirit of this instruction.

[18] Governor Daniel K. Tarullo discussed the Fed's "tiered approach to prudential oversight" most recently in his testimony before the Senate Banking Committee on March 19, 2015: http://www.federalreserve.gov/newsevents/testimony/tarullo20150319a.pdf.

[19] These quotes are from his recent testimony to the Senate Banking Committee, March 19, 2015.

STATEMENT OF

SATISH M. KINI

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARINGS ON:

"EXAMINING THE DESIGNATION AND REGULATION OF

BANK HOLDING COMPANY SIFIS"

JULY 8, 2015

Chairman Neugebauer, Ranking Member Clay and other distinguished members of the Subcommittee, I am honored to be here with you today. My name is Satish Kini. I am a partner in the Washington, D.C. office of Debevoise & Plimpton LLP and chair of the firm's Banking Group. In my remarks today, I draw on my over two decades of experience counseling financial services firms and banking organizations, including bank holding companies that today are subject to enhanced prudential standards under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

From the experience of the financial crisis was born the idea of tiered regulation and supervision, with more stringent standards applying to those financial institutions the potential stress or failure of which could present risks to the financial system or economy as a whole. The two key questions presented by this graduated approach are: first, how to identify those organizations that are systemically important and that, thus, should be subject to enhanced regulation and supervision, and, second, what enhanced requirements ought to apply to these firms.

In my remarks today, I will first discuss the Dodd-Frank Act's $50 billion asset threshold for imposing enhanced prudential standards on bank holding companies and contrast this approach with the indicator-based methodology adopted by the Basel Committee on Banking Supervision ("Basel Committee"), an international standard-setting body. Next, I will review the enhanced prudential standards applied to bank holding companies at the $50 billion level under the Dodd-Frank Act and examine how that $50 billion asset threshold has been exported for use in an array of other contexts. Finally, I will offer some thoughts on alternative approaches to the $50 billion threshold that Congress could consider.

I. The Dodd-Frank Act's $50 Billion Asset Threshold and the Basel Committee's Methodology for Identifying Systemically Important Banks

In the wake of the financial crisis, global leaders and financial regulators determined that enhanced prudential standards should apply to those financial companies that potentially pose the greatest risks to financial stability.[1] In the United States, Congress adopted Section 165 of the Dodd-Frank Act, which imposes enhanced prudential standards "[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions."[2] On the global level, the Financial Stability Board and Basel Committee endeavored to develop policy measures designed to mitigate spillover and contagion effects across jurisdictions that could arise from the failure of globally active banks. In each case, relevant authorities first required a process for determining which institutions should be subject to these enhanced prudential standards.

The Dodd-Frank Act's Asset-Based Approach. The Dodd-Frank Act uses a simple asset-based approach. In particular, Section 165 directs the Federal Reserve to apply enhanced prudential standards to all bank holding companies with total consolidated assets equal to or greater than $50 billion.[3]

---

1 *See, e.g.*, G20, The Seoul Summit Document ¶ 30 (Nov. 12, 2010) (endorsing "the policy framework, work processes, and timelines proposed by the [Financial Stability Board] to reduce the . . . risks posed by systemically important financial institutions (SIFIs)").

2 Dodd-Frank Act § 165(a). $50 billion threshold also appears elsewhere in the Dodd-Frank Act, including in Section 155(d) (assessments to fund the operations of the Office of Financial Research and Financial Stability Oversight Council ("FSOC")); Section 163 (certain special acquisition approval requirements); Section 210 (assessments that the Federal Deposit Insurance Corporation ("FDIC") may levy in respect of the Orderly Liquidation Authority); and Section 318 (Federal Reserve assessments).

3 The Federal Reserve also is directed to apply such enhanced standards to non-bank financial companies designated as systemically important by the FSOC.

Neither the statutory text nor its legislative history offers a clear explanation for why Congress chose a bright-line $50 billion asset threshold for application of enhanced standards. To the best of my knowledge, no economic studies or other data were cited by Congress in establishing this threshold. Some commentators have suggested that Congress deliberately chose an artificially low (and, thereby, over-inclusive) threshold not because it believed that $50 billion necessarily signaled systemic importance, but because it wished to avoid creating a de facto list of "too big to fail" banking institutions.[4]

The flaws in choosing this simple asset-based threshold for application of enhanced prudential standards seem relatively clear. By focusing exclusively on a bank holding company's asset size, this approach ignores other factors apt to be relevant to determining whether a banking institution should be subject to enhanced prudential standards. Moreover, there is no inherent characteristic measured by an asset-based approach that ensures the bank holding companies captured by the threshold do, in fact, pose the types of risks that the enhanced prudential standards are designed to mitigate. Put differently, no evidence suggests that a bank holding company with $49 billion in assets suddenly becomes systemically important, and thus deserving of application of Section 165's enhanced prudential standards, when it grows to $51 billion in assets. The $50 billion figure also is static – it does not increase over time, as the economy grows.

The Basel Committee's Indicator Approach. The Basel Committee has adopted a different approach in its efforts to identify global systemically important banks (the so-

---

[4] *See, e.g.*, Statement by Mark Olson, Co-Chair, Bipartisan Policy Center Financial Regulatory Reform Initiative's Regulatory Architecture Task Force, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 24, 2015); Federal Reserve Governor Daniel K. Tarullo, "Regulating Systemically Important Financial Firms," at the Peter G. Peterson Institute for International Economics, Washington, D.C. (June 3, 2011); *see also* S. Rep. No. 111-176, at 2 (Apr. 30, 2010) (applying heightened prudential standards for bank holding companies with $50 billion or more in assets, with a graduated approach to the application of such standards "intended to avoid identification of any bank holding company as systemically significant").

called "G-SIBs"). Specifically, the Basel Committee first identified the aspects and activities of global banking institutions whose failure would be most likely to generate risks to global financial stability. The Basel Committee then developed appropriate metrics, or "indicators," to measure these aspects and activities on both an individual institutional and a comparative level for the largest global banking institutions.

The specific metrics ultimately adopted by the Basel Committee measure global (or cross-jurisdictional) activity, size, interconnectedness, substitutability, and complexity. The methodology gives equal weight to each of the five categories of systemic importance; with the exception of the size category, the Basel Committee identified multiple indicators within each category. For the size category, the Basel Committee did not measure total consolidated assets but, instead, total exposures. The Basel Committee approach also allows supervisory judgment, within certain limits, to play a role.

Thus, the Basel Committee's methodology was designed to encompass more dimensions in determining a banking institution's systemic importance than simply its size (in contrast to the bright line $50 billion asset-based threshold used in the Dodd-Frank Act). The approach also is designed to be transparent and dynamic, with periodic reviews of the G-SIB list. In developing this approach, the Basel Committee's stated objective is to give banks "incentives to change their risk profile and business model in ways to reduce their systemic spillover effects."[5]

II. Enhanced Prudential Measures Applicable to Bank Holding Companies Subject to Section 165 and Broader Uses of the $50 Billion Threshold

As noted above, Section 165 of the Dodd-Frank Act directs the Federal Reserve to establish "more stringent" standards for bank holding companies that meet the $50 billion

5 Basel Committee, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement" 10 (July 2013).

asset threshold than applicable to "bank holding companies that do not present similar risks to the financial stability of the United States." Section 165's \$50 billion asset threshold also has been exported to other contexts, without the direction of Congress.

Application of Enhanced Prudential Standards Under Section 165. Section 165 identifies a set of mandatory enhanced prudential standards that apply to bank holding companies that hit the \$50 billion asset threshold. These standards include: risk-based and leverage capital requirements; liquidity standards; risk management requirements; supervisory and company-run stress testing; resolution planning and counterparty exposure reporting requirements; and single counterparty credit exposure limits.[6] In addition to these mandatory standards, Section 165 grants the Federal Reserve authority to adopt certain additional discretionary standards, including: a contingent capital requirement; enhanced public disclosures; short-term debt limits; and any other standards the Federal Reserve deems appropriate. To date, the Federal Reserve has not adopted any of the enumerated discretionary standards.

Section 165 allows regulators to alter the application of these standards in two ways. First, Section 165 grants the Federal Reserve express authority – either on its own or pursuant to a recommendation from the FSOC – to "differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors." Section 165(a)(2)(A).

This is important, but cabined, authority. In particular, it does not allow the Federal Reserve to raise the \$50 billion threshold or to avoid applying the mandatory

6 The Federal Reserve is given discretionary authority, in consultation with the FSOC, to determine that risk-based capital and liquidity requirements are not appropriate given the activities or structure of a particular company, in which case, the Federal Reserve is instructed to "apply other standards that result in similarly stringent risk controls." Section 165(b)(1)(A)(i). This exception appears designed to address the activities of non-banking organizations, rather than bank holding companies.

enhanced prudential standards to any set of greater-than-$50 billion asset bank holding companies.[7] This provision only allows the Federal Reserve to vary application of enhanced prudential standards. Put differently, Section 165 dictates that some level of mandatory enhanced prudential standards must apply to all greater-than-$50 billion asset bank holding companies, but standards of even further "increase[d] … stringency" can be fashioned for some subset of these bank holding companies. Section 165(a)(1)(B).

Section 165 contains a separate mechanism by which the $50 billion threshold can be raised, but this mechanism applies only to a discrete subset of the enhanced prudential standards set forth in the statutory provision. In particular, after receiving a recommendation from the FSOC, the Federal Reserve "may" raise the asset threshold that triggers application of the following requirements: resolution planning and credit exposure reporting; single counterparty credit exposure limits; contingent capital; enhanced public disclosures; and short-term debt limits.[8] Notably, of these standards, only the resolution-planning requirement is a mandatory enhanced prudential standard that has been made applicable to bank holding companies crossing the $50 billion threshold through a final rule adopted by the Federal Reserve.[9]

The authority to raise the $50 billion threshold does not apply to the core capital, liquidity, stress-testing, and other elements of Section 165; for these requirements, no regulatory authority to revise the statutory $50 billion asset threshold exists. Many

---

7 As Federal Reserve Governor Tarullo noted, "all firms" within the universe of banking organizations with $50 billion or more in assets "are subject to … enhanced standards." Statement by Federal Reserve Governor Daniel K. Tarullo before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 19, 2015) [*hereinafter* Gov. Tarullo Senate Banking Committee Statement].

8 Section 165(a)(2)(B). As noted, raising the $50 billion threshold requires a two-step process – first, the FSOC must recommend a threshold be raised and, second, the Federal Reserve must determine to act on the recommendation. Neither the Federal Reserve nor the FSOC may act alone in this regard.

9 No regulatory attempt has been made to raise the $50 billion asset threshold for any Section 165 standard.

commentators, including Federal Reserve Governor Tarullo, have openly questioned the value of applying all of these requirements to $50 billion bank holding companies and have suggested that the threshold for application of these elements of Section 165 ought to be re-examined.[10] For this, Congress would need to act.

To date, the Federal Reserve has used its tailoring authority to increase the stringency of certain enhanced prudential standards. In recent testimony before the Senate Committee on Banking, Housing and Urban Affairs, Federal Reserve Governor Tarullo explained that the Federal Reserve has adopted "what are, in effect, three categories within the universe of banking organizations with $50 billion or more in assets."[11] At the base level, all banking institutions at or above the $50 billion asset threshold are subject to enhanced standards. In the second category, the Federal Reserve applies a higher level of prudential standards to bank holding companies with at least $250 billion in assets or $10 billion in on-balance-sheet foreign assets (so-called "advanced approaches" banking organizations). Finally, the eight largest bank holding companies are subject to the most stringent set of standards.

The Federal Reserve arguably could do more to tailor the standards that apply to bank holding companies that cross the $50 billion threshold; as noted, Section 165 gives the Federal Reserve authority to provide meaningful differentiation between and among bank holding companies beyond, and in addition to, the three asset-based buckets it has used. Particularly in the $50 billion to $250 billion range, there is no reason under the statute for the same set of enhanced prudential standards to apply, as it largely does

---

10 *See, e.g.*, Gov. Tarullo Senate Banking Committee Statement, *supra* note 7 (noting, in particular, the limited benefit of applying stress testing requirements at the $50 billion asset level); Federal Reserve Governor Daniel K. Tarullo, "Rethinking the Aims of Prudential Regulation," at the Federal Reserve Bank of Chicago Bank Structure Conference (May 8, 2014) (asking whether "$50 billion is the right line to have drawn" and questioning the value of resolution planning and stress testing at the $50 billion asset level).

11 Gov. Tarullo Senate Banking Committee Statement, *supra* note 7.

today, to a $51 billion bank holding company and to a $249 billion bank holding company, even though the two may have materially different businesses and risk profiles.

The Federal Reserve could take into account the statutorily enumerated risk-related factors ("capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size"), which largely mirror the systemic indicators used by the Basel Committee, to distinguish among $50 billion-plus bank holding companies. By such means, the Federal Reserve could tailor the enhanced prudential standards applicable to bank holding companies that operate a traditional banking business model of deposit taking and lending. For example, the Federal Reserve could apply qualitative liquidity standards to these bank holding companies, instead of the quantitative liquidity coverage ratio (which I understand requires disproportionate resources for smaller bank holding companies). As another example, the Federal Reserve could reduce the frequency with which resolution plans (or "livings wills") must be submitted by bank holding companies that operate under a traditional banking model.

The Expanding Use of the $50 Billion Threshold. Beyond Section 165's mandate to apply enhanced prudential standards to $50 billion-plus bank holding companies, that threshold appears to have become a systemic risk lodestar for the federal financial regulatory agencies. The threshold has thus has come to be used in contexts not expressly required by the Dodd-Frank Act.

To give a few examples:

- The $50 billion asset threshold has been used as a proxy for complexity and the need for enhanced compliance obligations under the final regulations implementing the Volcker Rule. Under those final rules, banking entities with $50 billion or greater in assets are subject to additional compliance requirements, including a CEO attestation obligation. 12 CFR Part 248, App. B.

- The Federal Reserve has determined to apply its Comprehensive Capital Analysis and Review ("CCAR") – its annual capital planning and capital assessment exercise – to bank holding companies at the $50 billion level. 12 CFR 225.8.[12]

- The Comptroller of the Currency has adopted heightened risk-management and corporate governance standards for all insured national banks and federal savings associations with consolidated assets of $50 billion or greater. 12 CFR Part 30.

- The FDIC has required all insured depository institutions with greater than $50 billion in assets to submit resolution plans to the FDIC for orderly resolution under the Federal Deposit Insurance Act.

The end result appears to be (a) a continued proliferation of the $50 billion asset threshold in a range of contexts, and (b) the imposition of a broad range of regulatory requirements – beyond Section 165's enumerated enhanced prudential standards – on bank holding companies (and their subsidiaries) once they cross the $50 billion mark. The impact of these requirements is magnified because various of the enhanced prudential standards are coupled with extensive reporting requirements, which place disproportionate strains on the resources of smaller banks (and arguably are not necessary to mitigate risks to financial stability).[13] The imposition of these various requirements on $50 billion asset bank holding companies results in real regulatory costs that – because the $50 billion threshold does not appear to have a firmly grounded and well-articulated relationship to systemic risk – do not generate commensurate systemic risk mitigation benefits.

The expanding use of the $50 billion threshold highlights the merits of re-examining whether this threshold is appropriately set and whether a different threshold is

[12] It is worth noting that the CCAR is used by the Federal Reserve as the risk-based capital enhanced prudential standard applicable to $50 billion to $250 billion bank holding companies. *See* 79 Fed. Reg. 17240, 17246 (Mar. 27, 2014) (the Federal Reserve's final rule implementing enhanced prudential standards under Section 165).

[13] *See, e.g.*, FR Y-14A (annual reporting on certain balance sheet, income, and capital projections); FR Y-14M (monthly reporting on loan and portfolio-level data); FR Y-15 (annual reporting of consolidated systemic risk data).

warranted. Of course, a revision of Section 165's threshold would not automatically alter these other uses of the $50 billion test, but it may cause regulators to rethink their reliance on this standard both for existing regulatory requirements and for future rules.

III. Potential Alternatives to the $50 Billion Asset Threshold in Section 165

The policy goals of a framework for enhanced prudential standards should be: first, to identify as accurately as possible those banking organizations most likely to pose significant risks to financial stability and, second, to apply appropriately calibrated prudential standards to the risks posed by these organizations.

From the perspective of these policy goals, bank holding companies ideally should be designated for application of enhanced prudential standards based on the risks they present to the financial stability of the United States, with only those that present truly systemic risks subject to appropriately enhanced measures. To achieve this goal, it may be useful for the systemic risk designation process to be informed by additional criteria of systemic importance beyond mere asset size.

Of course, there may be multiple paths to achieving this goal. For example, the asset-based threshold could be completely scrapped in favor of an entirely indicator-based approach, as deployed by the Basel Committee. Alternatively, some elements of the asset-based threshold could be usefully retained, such as where an asset-based threshold triggers a nuanced indicator-based review but does not automatically result in the application of enhanced prudential standards to a bank holding company or where some minimum asset-based threshold serves as a floor and removes institutions below this threshold from systemic consideration and regulation.

Both House Bill H.R. 1309, the Systemic Risk Designation Improvement Act of 2015, sponsored by Representative Luetkemeyer, and the Senate bill, the Financial Regulatory Improvement Act of 2015, sponsored by Senator Shelby, move away from the exclusively asset-based approach of the Dodd-Frank Act and incorporate the Basel

Committee's indicator-based approach for determining which bank holding companies should be subjected to enhanced prudential standards. In both cases, the apparent aim of these proposed provisions is to enact a designation process that incorporates a more thoughtful assessment of the specific risks posed by individual bank holding companies than the $50 billion asset threshold currently employed by Section 165. In my view, such efforts to revise the current enhanced prudential standards framework and to ensure enhanced prudential measures are applied in a more tailored fashion to bank holding companies that could potentially pose real risks to the U.S. financial system deserve serious consideration.

* * *

I am happy to respond to any questions. Thank you.

American Enterprise Institute
for Public Policy Research

Statement for the United States House of Representatives, Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

Examining the Designation and Regulation of Bank Holding Company SIFIs

Paul H. Kupiec

Resident Scholar

American Enterprise Institute

July 8, 2015

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Examining the Designation and Regulation of Bank Holding Company SIFIs

Chairman Neugebauer, Ranking Member Clay, and distinguished members of the Subcommittee, thank you for convening today's hearing and for inviting me to testify.

I am a resident scholar at the American Enterprise Institute, but this testimony represents my personal views. My research is focused on banking, regulation, and financial stability. I have included my full resume as an appendix to my testimony, but to summarize my background, I have extensive experience working on banking and financial market policies at the Federal Reserve Board (FRB), the International Monetary Fund, the Federal Deposit Insurance Corporation (FDIC), and the Bank for International Settlements. It is an honor for me to be able to testify before the subcommittee today.

I will begin by summarizing the main points of my testimony:

- The Dodd-Frank Act (DFA) has imposed massive regulatory compliance costs on many bank holding companies (BHCs) and yet failed to achieve its stated goals of ending too-big-to-fail (TBTF) and removing the threat of a systemic financial system disruption in the next financial crisis.
- The $50 billion consolidated asset threshold for automatic designation of BHCs as systemically important financial institutions (SIFI) is completely arbitrary and unrealistically low. It imposes unnecessarily intrusive regulation on a large number of BHCs that pose no threat to U.S. financial stability.
- The DFA criterion for identifying BHC and non-bank SIFIs are not aligned with international recognized 'best practices' for resolving a distressed SIFI or the FDIC's goals for its 'single point of entry' strategy for DFA orderly resolution.
- My testimony proposes replacing the $50 billion threshold with a requirement that the FSOC identify BHC subsidiaries that provide systemically important financial sector services that must be maintained to prevent financial market disruption should their parent BHC become financially distressed.
- Along with the new approach for designating systemically important BHC subsidiaries, I propose new enhanced prudential regulatory standards for systemically important operating subsidiaries to ensure that they can remain open, solvent and fully operational should their parent BHC seek bankruptcy reorganization. This approach removes the need for Title II Orderly Liquidation Authority and enhanced prudential standards on parent BHC holding companies.
- My proposal to re-orient the SIFI designation process and replace enhanced prudential standards on parent BHCs with enhanced prudential standards for critical operating subsidiaries is fully

consistent with the goal of ending TBTF without taxpayer bailouts, of removing implicit government subsidies that accrue to TBTF institutions, and achieving orderly resolution using judicial bankruptcy without the need for a government directed resolution process. The recommendations are fully compliant with international best practice recommendations for global SIFI resolution regimes and the Financial Stability Board's proposed requirements for minimum loss absorbing capacity.

- The new approach for BHC designation will replace costly and speculative regulatory analysis that has unproven financial stability benefits with stronger more objective capital regulations. The new approach would remove the need for Section 165 Board of Governors stress tests and redirect the goals of the annual orderly resolution planning process.

1. Dodd-Frank and the Too-Big-to-Fail Problem

One of the primary goals of the Dodd-Frank Act was to solve the TBTF problem. Many argue that the TBTF problem arises because SIFI financial institutions are so large and important that they are incapable of being reorganized in a judicial bankruptcy process without causing widespread financial market distress and disrupting economic growth. The financial crisis that reached a crescendo after the September 2008 Lehman Brothers bankruptcy is often cited as evidence that supports the TBTF hypothesis, but such "proof" ignores the possibility that the Lehman Brothers bankruptcy *was caused by* an advanced financial crisis already in progress—and the failure *was not the cause of* the financial crisis that peaked in the fall of 2008.[1]

The DFA assumes the TBTF hypothesis is true, and it creates a 4-layered approach to solve the problem: (1) it designates some BHCs *de facto* as SIFIs; (2) it specifies specific criterion and instructs a newly formed group of government regulators—the financial stability oversight council (FSOC)–to examine all non-BHC financial institutions and identify those that are SIFIs; (3) it specifies that the Federal Reserve Board (FRB) must impose new heighted prudential rules and undertake supervisory efforts to make sure that all SIFIs are highly unlikely to suffer financial distress; and, (4) should a SIFI become distressed, it creates a new resolution framework in which the FDIC acts as receiver and "liquidates" the SIFI outside of judicial bankruptcy in an administrative resolution process.

[1] When Lehman Brothers failed without a government rescue in September 2008—the failure did not directly drag down any other significant financial firm, even though Lehman was one of the largest nonbank financial institutions in the US. The chaos following Lehman's bankruptcy reflected the government reversal on its policy of rescuing large financial firms (the Bear Stearns rescue in March 2008 and Fannie Mae and Freddie Mac rescue earlier in September). This reversal shattered investor expectations who responded by hoarding cash, shunning financial institution exposure, and draining liquidity from the financial system.

Figure 1 shows the size and identities of the 38 institutions that meet the DFA *de facto* definition of a BHC SIFI. While each institution has consolidated assets that exceed $50 billion, the largest BHC SIFI has more than $2.5 trillion in consolidated assets, or more than 50 times the assets of the smallest BHC that meets the DFA SIFI threshold.

The thirty-eight institutions in Figure 1 are not only very different in size, they have very different business specializations. Some specialize in specific services such as securities underwriting, full-service derivatives, global payments systems, and trust and custodial services while others focus primarily on deposit taking and commercial and consumer lending. These institutions are in no way homogenous, and it is silly to argue that the U.S. financial markets and the U.S. regulatory and judicial infrastructure would be incapable of digesting the failure of any of these 38 institutions.

2. Regulatory Views on the "Best Practice" for Resolution of a Distressed SIFI

Before discussing specific criteria that might be used to designate BHC SIFIs, it is instructive to first understand how the FDIC plans to approach the resolution of a BHC SIFI should it be called on to administer a DFA orderly resolution. The FDIC has issued a Federal Register Notice in which it has outlined a "Single Point of Entry" (or SPOE) strategy for conducting an orderly resolution.[2] The overriding goal of the SPOE is to keep the failing SIFI's operating subsidiaries open and operating with adequate capital and liquidity to keep them out of bankruptcy or administrative resolution processes, and to avoid the need for asset "fire sales. In a joint paper on SIFI resolution policy, the Bank of England concurs with the FDIC that the key to achieving the orderly resolution of a SIFI without disrupting financial markets is to recapitalize SIFI operating subsidiaries to keep them open, liquid, operating and out of competing insolvency proceedings.[3]

In a SPOE liquidation, the FDIC would be appointed receiver of the top holding company in a BHC corporate group. The FDIC then charters a bridge financial company (bridge) and transfers all holding company assets and secured liabilities to the bridge, including the company's equity position in all subsidiaries.[4] The bridge then functions as the new BHC and the FDIC appoints new management to operate the new BHC and its subsidiaries.

---

[2] Federal Deposit Insurance Corporation SPOE NPR, (2013). *Federal Register*, Vol. 78, No. 243, Wednesday, December 18, 2013, pp. 76614-76624.

[3] Federal Deposit Insurance Corporation and Bank of England (2012). "Resolving Globally Active, Systemically Important, Financial Institutions," December 10.

[4] FDIC SPOE NPR p. 76617.

The FDIC leaves the shareholders of the failed BHC parent and most of the failed parent BHC's unsecured liabilities in the receivership. These claims will be converted into receivership certificates, so the bridge will have little debt when it is first formed. Using the DFA Orderly Liquidation Fund if necessary,[5] the bridge institution will issue new debt instruments and downstream the proceeds to recapitalize and liquefy distressed subsidiaries [primarily banks] to keep them out of bankruptcy or receivership, to relieve them of the need to engage in "fire sales" of assets in order to meet investor redemption demands, and to provide them with the liquidity for continuing operations.

To help ensure that the parent BHC will have sufficient resources to recapitalize its critical operating subsidiaries in an OLA resolution, the FDIC and Federal Reserve will soon issue new regulations to require BHC SIFIs to meet minimum "total loss absorbing capacity" or TLAC requirements. TLAC includes instruments such as common and preferred equity and subordinated debt that qualify as Basel III regulatory capital as well as additional debt instruments that do not qualify as Basel III capital.

The U.S. regulators have not yet released a notice of proposed rulemaking that outlines U.S. TLAC regulation, but the Financial Stability Board (FSB), an international organization of central banks and bank regulators empowered by the G-20 leaders to reform the international financial system,[6] has released a consultative document titled that provides an outline for U.S. TLAC rules.[7] The FSB document proposes a new international standard that would require large systemically important banking institutions to issue a minimum amount of long-term unsecured debt at the parent level that can be used to recapitalize critical operations throughout the institution should the SIFI require resolution. Large global bank SIFIs will be required to maintain TLAC at the parent BHC—comprised of the institution's Basel III compliant capital and long-term unsecured subordinated debt—in a range between 16 and 25 percent of the institution's Basel III risk-weighted assets.[8]

The FSB TLAC proposal also suggests that regulations may require TLAC to be distributed throughout the BHC's subsidiaries so that critical subsidiaries themselves satisfy minimum TLAC requirements. In a holding company structure, the parent company would issue TLAC-qualified debt and on-lend the funds

---

[5] The bridge could borrow from Treasury using the Orderly Liquidation Fund (OLF) or it could use the OLF to guarantee bridge liabilities that will sold to the market.
[6] "Financial Stability Board Charter," Financial Stability Board (2009).
[7] Financial Stability Board (2014), "Adequacy of loss-absorbing capacity of global systemically important banks in resolution."
[8] Federal Reserve officials have suggested that future U.S. TLAC requirements will be stricter than the FSB proposal. See, for example, Joe Adler, "Ending Too Big to Fail at the Push of a Button," *American Banker*, October 30, 2014.

to critical subsidiaries. These "prepositioned" loans could then be converted into equity if a subsidiary requires recapitalization.[9]

To summarize, DFA Title II Orderly Resolution Authority was never intended to protect bank creditors, and yet the bank regulators are planning on using their OLA authorities to shield bank creditors from loss and to keep critical operating subsidiaries [primarily bank subsidiaries] of the largest banking institutions open and operating should the SIFI BHC suffer a crippling loss that threatens its solvency. The 'catch' to regulators' solution to the TBTF problem is that the government's ability to impose a SPOE resolution is far from a sure bet. Kupiec and Wallison (2015) discuss a number of legal issues that may prevent the FDIC from using SPOE to recapitalize critical BHC subsidiaries especially in cases where SPOE is needed to recapitalize a bank subsidiary.

If the SPOE solution is unavailable, then authorities will be faced with the same problem they faced in the last crisis. For example, unless the parent BHC is in danger of default, orderly liquidation authority is not authorized and regulators would be required to resolve the bank using authorities under the Federal Deposit Insurance Act.[10] Regulators will again confront the familiar problem they faced in the last crisis—that of finding a larger, healthier bank to purchase the troubled institution, perhaps aided by an FDIC loss-sharing arrangement. Without certain assurance that SPOE will be a legal option should a large bank subsidiary become insolvent, it is misleading to argue that the DFA has solved the TBTF problem in the U.S.

3. Systemic Risk is Caused by the Failure of Critical Operating Subsidiaries

The SIFI resolution strategy embraced by the FDIC, the Bank of England, and indeed the entire Financial Stability Board, treats the failure of the BHC parent as inconsequential and instead emphasizes the need to keep the 'critical' operating subsidiaries of the BHC open and operating in the SIFI resolution process to avoid causing systemic distress.

While none of the public documents from the FDIC, FSB or any other agency specify how they will identify a critical BHC operating subsidiary when faced with a SIFI resolution,[11] it is clear that the continued solvency of these operating subsidiaries is the key to supervisors' plan for maintaining financial stability; the solvency and continued operations of the BHC parent is inconsequential. Indeed the SPOE

---

[9] The TLAC proposal does not specify a specific mechanism for conversion of the subsidiary debt into equity.
[10] Including recent amendments to FDIA receivership powers.
[11] The Financial Stability Board has requested public comments on conceptual approach that might be useful for identifying 'critical' subsidiary operations in the context of SIFI insurers. See, "Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services," Financial Stability Board, October 2014.

strategy envisions using government OLA powers to declare the SIFI BHC parent insolvent so that the FDIC can seize its resources and use them to recapitalize the SIFI's critical operating subsidiaries.

The international planning for SIFI BHC resolution has reached an advanced stage, and it has become clear that the international consensus is that the continued operation of SIFI BHC critical subsidiaries—primarily their large depository institutions–is the key for financial stability. If this is the ultimate strategy for maintaining financial stability, DFA rules focused on identifying consolidated groups as SIFIs using consolidated asset size, interconnections, concentration, etc., are poorly focused if not misguided. Instead, the appropriate focus should be on the identification of the critical subsidiaries of BHCs that must be recapitalized and kept open and operating in a SIFI resolution to prevent wider damage to the financial system and the economy.

In the next section, I argue that DFA must be amended to drop the arbitrary $50 billion threshold for BHC SIFI designation and replaced with a requirement that the FSOC identify the critical BHC subsidiaries that must be recapitalized in a SIFI resolution. Following identification, the FSOC should be required to impose heighted prudential standards on these critical subsidiaries. Heighted prudential standards on operating subsidiaries should be designed to ensure [as nearly as possible] that these subsidiaries remain open and operating throughout a SIFI bankruptcy reorganization. These new heighted prudential standards would replace the current DFA approach of imposing heighted prudential standards on consolidated BHCs.

4. Identifying Critically Important BHC subsidiaries

The largest U.S. BHCs are comprised of thousands of subsidiaries, yet few of these subsidiaries are truly systemically important. Rather than designating all BHCs larger than $50 billion in consolidated assets and requiring the FSOC to designate non-bank financial holding companies groups as SIFIs, the DFA should be amended to require the FSOC to identify the critical financial subsidiaries that must remain open and operating to prevent a financial market crisis in the event that a parent SIFI suffer losses that mandate its reorganization in judicial bankruptcy.

When it comes to systemic importance, a BHCs' bank subsidiaries are perhaps the first subsidiaries that should be assessed, but some BHCs are likely to have non-bank subsidiaries that might also qualify as critical subsidiaries that need to be kept open and operating to prevent wider financial instability. It is highly unlikely that all thirty-eight BHCs identified as SIFIs by the DFA $50 billion threshold will have systemically important bank subsidiaries, but some may have non-bank subsidiaries that provide critical services.

The systemic importance of a BHC subsidiary can be judged by its relative importance in providing specific types of credit or specific financial services to the financial sector and the wider economy. Detailed regulatory reports and private industry data vendors already compile extensive databases that could be used for making assessments and any missing or incomplete information could be compiled and made available by the Office of Financial Research.[12]

An example of the data analysis that might be used in assessing the systemic importance of BHC bank subsidiaries appears in Figures 2 through 5. Figure 2 ranks all U.S. BHC bank subsidiaries by asset size; Figure 3 ranks these banks by total deposits; Figure 4 ranks the banks by the size of their trading account assets; and Figure 5 ranks them by their total income earned from providing fiduciary services.

I am not suggesting that Figures 2 through 5 represent the only relevant metrics that should be considered when evaluating bank subsidiaries, but even this simple example using a limited set of data on subsidiary bank activities suggests a clear pattern. JPMorgan Chase Bank, Bank of America, Wells Fargo Bank, and Citibank are almost certainly critically important BHC bank subsidiaries as they are among the most important institutions in each of the dimensions considered and the very largest banks in all but one dimension. Bank of New York Mellon and State Street Bank are also probably critically important bank subsidiaries given their dominant position in providing fiduciary services. A number of other bank subsidiaries might be considered to be systemically important after careful consideration of other dimensions of bank subsidiary activities. My objective is not to provide an exhaustive designation of systemically important bank subsidiaries in this testimony, but to provide a streamlined example of the methodology I am proposing.

Other non-bank BHC subsidiaries can be evaluated by the FSOC and designated for heighted prudential standards for supervision and regulation using data provided by functional regulators or from other data sources. For example, Figures 6 and 7 use CFTC data that can be used to assess the critical importance of Futures Commission Merchant operations. Other data such as these could be assembled and analyzed to judge the systemic importance of individual FCM operations using additional dimensions the FSOC and CFTC deem to be important. The FSOC would then designate specific FCMs that require heighted

[12] For example, banks provide extensive data in their quarterly "Reports on Condition and Income" which are compiled in the FDIC's "Statistics on Depository Institutions," https://www2.fdic.gov/sdi/index.asp; BHC report FCM to the CFTC http://www.cftc.gov/MarketReports/FinancialDataforFCMs/index.htm; private firms already track and sell data on BHC subsidiary securities underwriting activities and subsidiary mortgage servicing activities.

prudential standards and set these standards to ensure that these FCMs could remain open and operating should their parent BHC file for reorganization under bankruptcy.

Figure 8 illustrates data that might be used to designate subsidiaries that service mortgage loan portfolios and mortgage-backed securities. The data in Figure 8 is compiled by a private data vendor and is only intended to represent the type of data that might be assembled by the OFR to assist the FSOC designation process. The FSOC could assemble and analyze similar types of data for other operating activities performed by BHC subsidiaries and designate those subsidiaries that must be kept open and operating in a parent BHC reorganization to prevent financial instability.

5. Heighted Prudential Standards for Designated BHC Subsidiaries

Changing the FSOC designation process to focus on the designation of the specific BHC subsidiaries that are critical for market function and therefore must remain open and operating in a SIFI resolution will align DFA designation powers with the "best practice" resolution process identified by a consensus of internal financial regulators.[13] After aligning the designation process, the FSOC must specify appropriate heighted prudential standards for supervision and regulation of these subsidiaries. These standards should be designed to ensure that the subsidiaries remain open and operating without taxpayer support should their parent BHC become financially distressed. This approach to heighted prudential supervision and regulation is very different from the approach adopted by the DFA where the SIFI BHC parent entity is required to meet most of the DFA enhanced prudential requirements and it is left to regulators to determine how the parent's resources can be directed to support failing subsidiary operations.[14]

Most subsidiaries that are likely to be designated as "critically important" by an FSOC analysis will already have a functional regulator. In most cases, the functional regulator will not be the Federal Reserve Board. The functional regulator of a designated BHC subsidiary is the appropriate regulatory authority for enforcing the heighted prudential standards recommended by the FSOC. Since bank regulation is my area of expertise, in the remainder of this section, I will discuss the enhanced prudential standards that should be applied to every BHC bank subsidiary that is designated to be systemically important by the FSOC.

If the DFA designation process is re-focused on the identification of critical BHC operating subsidiaries, the design of enhanced prudential standards is streamlined considerably, especially compared to the existing Dodd-Frank approach. Regarding critical BHC bank subsidiaries, the imposition of substantially

[13] Financial Stability Board (2014), "Key Attributes of Effective Resolution Regimes for Financial Institutions."
[14] The DFA does include some enhanced prudential standards for depository institutions larger than $10 billion in assets.

higher equity capital requirements with correspondingly high prompt corrective action triggers are the only regulations needed to ensure that bank subsidiaries remain well-capitalized with ample access to liquidity should their parent BHC file for bankruptcy reorganization.

Instead of imposing TLAC requirements on the parent BHC and its subsidiaries, BHC bank subsidiaries designated systemically important should be required to have regulatory Tier 1 common equity capital ratios equal to the international TLAC minimums. With critical bank subsidiary minimum regulatory capital ratios set somewhere between 20 and 25 percent,[15] prompt corrective action guidelines should also be altered to prohibit the bank from paying its parent holding company a dividend should the subsidiary bank's regulatory capital ratio below a set minimum requirement (for example, below 15 percent of risk-weighted assets). The minimum bank capital requirement should be large enough and sufficiently well-protected against parent BHC withdrawals so that, should the parent BHC enter bankruptcy, the bank subsidiary would remain well-capitalized so there would be no question of its solvency or its ability to access the Federal Reserve discount window should it require liquidity.

It is often argued that elevating the required minimum level of bank equity capital would be prohibitively expensive because the bank would be required to forgo debt interest tax shields if it were funded with a larger share of equity capital. However, BHC taxes are computed on a consolidated basis. If parent BHC regulatory capital requirements are far more relaxed compared to bank minimum regulatory capital requirements, the holding company can issue external debt to finance the new higher minimum equity capital requirement at its bank subsidiaries, and the BHC would not suffer any loss in its debt interest tax shield.

Greater leverage at the parent holding company is not a systemic risk concern because regulatory authorities have already determined that the parent BHC failure will not cause systemic risk provided the critical operating subsidiaries are well-capitalized, liquid, and remain open and operating during the reorganization process.

While this proposal for heightened bank regulatory capital requirements may sound radical, it is in fact identical— in financial engineering terms–to the FSB's TLAC proposal that requires minimum external

[15] Minimum regulatory capital ratios could be set as a percentage of risk-weighted assets (minimum ratio yet to be determined –e.g., 20 to 25 percent) or in terms of a minimum Basel III leverage ratio (e.g. 12 to 15 percent) or as a complex minimum requirements as envisioned in the FSB TLAC proposal.

TLAC at parent BHCs and minimum internal TLAC at critical operating subsidiaries.[16] My proposed rule differs from the FSB's TLAC proposal in that, in my approach, the bank is fully capitalized at all times, internal equity TLAC is required to retire insured deposits or purchase 0 risk-weight assets, and there is never a need to worry about complications associated with TLAC debt conversion at the bank subsidiary.[17]

The other heighted prudential standard that would be required under my designation proposal involves the DFA requirement for BHCs to file an orderly liquidation plan. Under current DFA rules, these submissions are required to discuss how a BHC could be reorganized in a judicial bankruptcy proceeding without creating turmoil in the financial markets. Under my proposal to re-focus FSOC designation on the identification of critical operating subsidiaries, annual orderly liquidation plans would be required to demonstrate that FSOC-designated subsidiaries would have access to all information systems, personnel, and services that these bank subsidiaries would require to remain open and fully operational during a prolonged BHC bankruptcy reorganization.

This approach to FSOC designation and heightened prudential standards would replace the current DFA language that designates all BHCs larger than $50 billion in consolidated assets and Section 165 FRB heighted prudential standards with a requirement for heighted prudential standards for critical BHC subsidiaries. Similar to proposed TLAC regulations, parent BHC leverage will be used to ensure that critical operating subsidiaries remain well-capitalized should the parent BHC become financially distressed. In contrast to the proposed FSB TLAC regulations, subsidiary TLAC should be the form of equity capital which would remove any complications and uncertainties surrounding TLAC debt conversion.

6. **Re-Orienting BHC SIFI Designation Removes Unnecessary Costly DFA Regulations**

Refocusing heightened prudential regulations on BHC's critical operating subsidiaries would eliminate the need for the Board of Governors annual stress tests. Section 165 requires the FRB to administer annual stress test to BHCs with consolidated assets in excess of $50 billion and designated non-bank

[16] My regulatory capital proposal is equivalent to a minimum TLAC requirement of the same percentage (20 to 25 percent) when the TLAC rules requires that subsidiaries also meet the minimum TLAC target using internal TLAC where the new subsidiary TLAC is used to replace insured deposits or to purchase Treasury securities. I provide a formal proof in my forthcoming AEI Working paper, "Will TLAC Regulations Fix the G-SIB Too-Big-to-Fail Problem?" (July 2015).

[17] In our AEI Working Paper "Can the "Single Point of Entry" strategy be used to recapitalize a systemically important failing bank?" Kupiec and Wallison (revised June 2015) discuss legal issues associated with parent BHC forgiving internal TLAC debt.

financial institutions and to publically report on the results. The FRB may use the stress test results to require designated institutions to modify their capital planning processes or alter their orderly resolution plans.

Section 165 FRB stress tests are perhaps the most problematic form of enhanced prudential supervision required by the Dodd-Frank Act. The value of these exercises for identifying and mitigating financial sector excesses is highly questionable, and yet the Federal Reserve System and designated BHCs spend an enormous amount of resources on this activity.

There is little if any evidence that coordinated macroeconomic stress tests will be effective in preventing a future financial crisis. Already, FRB stress tests have missed the "London Whale" at JPM Chase and, the following year, a multibillion dollar hole in Bank of America's balance sheet. Fannie Mae and Freddie Mac both passed severe government-designed macroeconomic stress test right before they failed in September 2008. Even before the financial crisis, many countries produced financial stability reports that included bank stress tests and none anticipated or prevented the crisis. Pan-European EBA stress tests failed to identify a number of institutions that subsequently (and almost immediately) required extensive government support. Stress tests have a pretty poor record of anticipating financial crisis or detecting "problem" institutions.

Stress tests face two gigantic measurement problems. First, the macroeconomic scenario must actually anticipate the next financial crisis. The FRB, and indeed most economic forecasters, rarely anticipate a recession before it arrives and so accurately forecasting the next financial crisis is nearly an impossible task. Secondly, regulators must be able to translate the macroeconomic crisis scenario into accurate predictions about actual bank profits and losses. Bank profits and losses are not highly correlated with changes in macroeconomic indicators. Quarter-to-quarter bank profits do not closely follow quarterly changes in GDP, inflation, unemployment, or any other macroeconomic indicator and so the best macroeconomic stress test models explain only a small part of the observed variation in bank profits and losses.

Because of these measurement issues, bank loss predictions from macroeconomic stress tests have very little objective accuracy. Even the best models produce poor predictions of how banks actually perform historically, and their predictions will be even worse in the next financial crisis.

Macroeconomic stress testing is more of an art than a science and there is no formula or procedure that will lead to a single set of stress test bank loss estimates that can be independently calculated by different stress test modelers. Thus, it is not surprising that the FRB and the U.S. banks rarely agree on stress test results.

The stress test injects the FRB into the modeling, operations and exposure evaluations of each large banking institution. It requires the FRB to use its own judgment to set each large bank holding company's 'stress-tested' capital plan. Stress test regulation has become so intrusive that in many respects, important BHC business decisions are being made by the FRB.

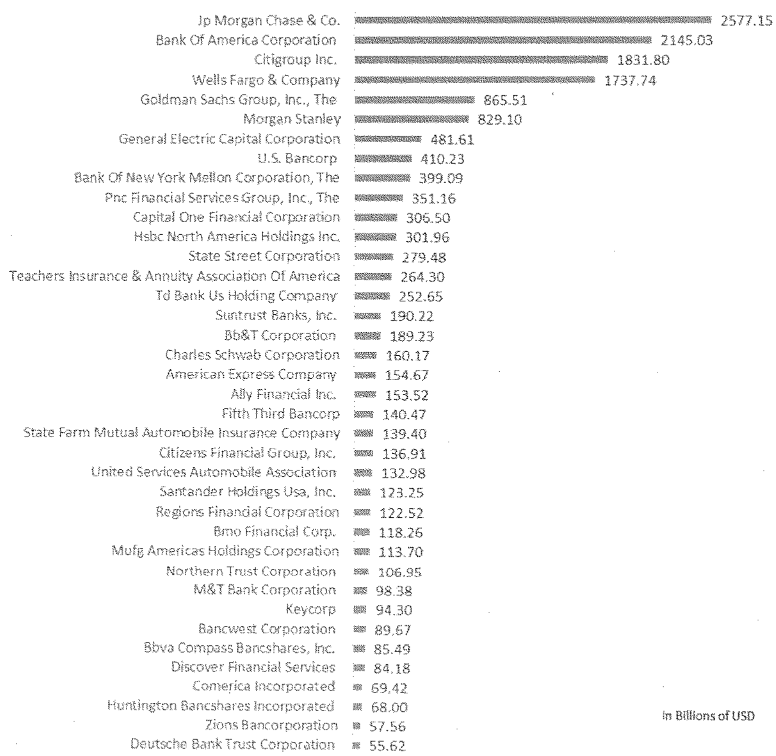
Many financial sector experts believe that coordinated supervisory stress tests encourage a "group think" approach to risk management that may increase the probability of a financial crisis. FRB stress test scenarios have to be specific so that banks and regulators can model the same event. Moreover, the FRB imposes uniformity in the stress test loss rates across all designated banks by using its own stress test estimates. The FRB acts much like a coach or a central planner and tries to ensure coherence in firms' estimates and capital plans. Unintentionally perhaps, by requiring all firms to approach the stress test problem in the same way, these tests encourage participating institutions to think and operate similarly. What happens when all the largest banks are steeled against the wrong crisis?

The final Section 165 issue I will discuss is related to the requirement that designated firms file annual orderly resolution plans. Section 165 directs the FRB and the FDIC to determine whether designated firms' orderly resolution plans are credible or whether they would fail to facilitate an orderly resolution of the company under title 11 of United States Code. However, Section 165 does not provide any specific guidance that constrains the agencies' judgment. There are no specific criteria specified that can be used to identify a credible plan; there are no objective standards that must be met. The credibility of a plan is entirely based on subjective judgments by the FRB and the FDIC.

In 2014, the House Financial Services Committee released a report that was highly critical of the DFA requirement for Orderly Resolution Plans. The report concluded that there is no basis for assuming that creditors would accept these plans as a pre-packaged bankruptcy, and no requirement that the firm must follow the Orderly Liquidation Plan it files with regulators. There is no judicial review or other avenue to challenge FDIC or FRB opinions as to the acceptability of these plans, and the DFA empowers the FDIC and FRB to require operational changes and even require divestitures if a designated firm does not remedy regulatory objections to an orderly resolution plan.

My proposal for refocusing FSOC designation on the identification of critical BHC operating subsidies would redirect the orderly resolution planning process to focus on ensuring that critical subsidiaries have the information systems, personnel and other services required to continue normal operations uninterrupted should their parent BHC file for bankruptcy protection. The goal of orderly liquidation planning would no longer be focused on judging a successful hypothetical bankruptcy reorganization of the consolidated SIFI, but on the much narrower and more specific goal of ensuring that critical BHC operating subsidiaries have access to resources provided by other SIFI subsidiaries and affiliates that are needed to continue their operations while the consolidated SIFI group is undergoing a bankruptcy reorganization.

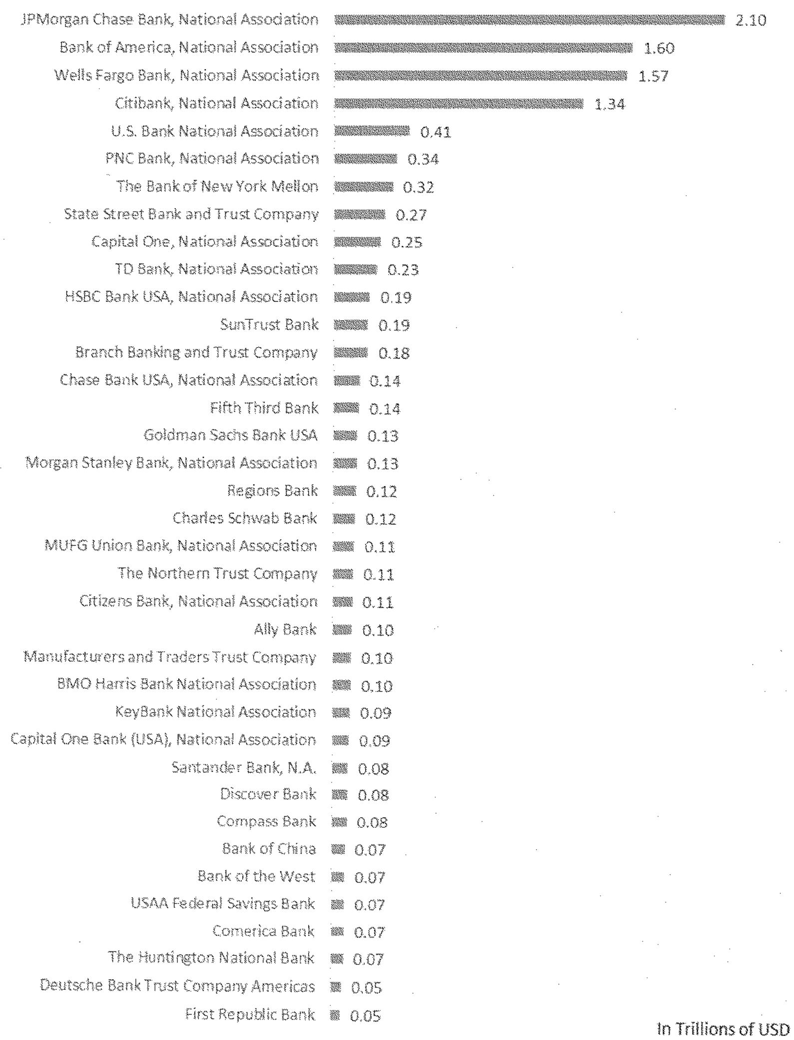
Figure 1: Bank Holding Companies with Assets Larger than $50 Billion



Data Source: the Federal Reserve Board National Information Center (March 31, 2015)

http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx

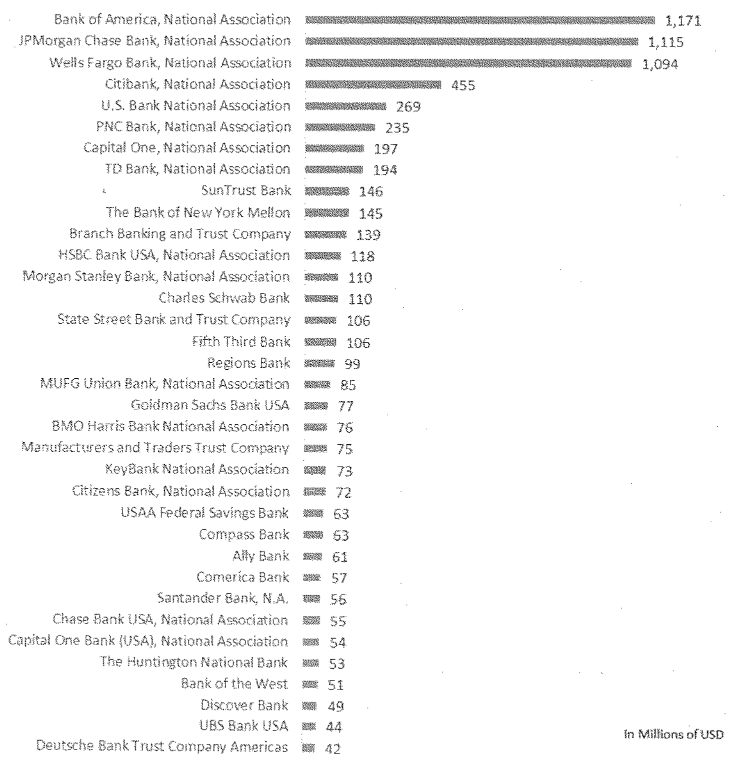
Figure 2: BHC Bank Subsidiaries by Asset Size



*The sum of all assets owned by the institution including cash, loans, securities, bank premises and other assets. This total does not include off-balance-sheet accounts.

Source: FDIC (March 31, 2015)

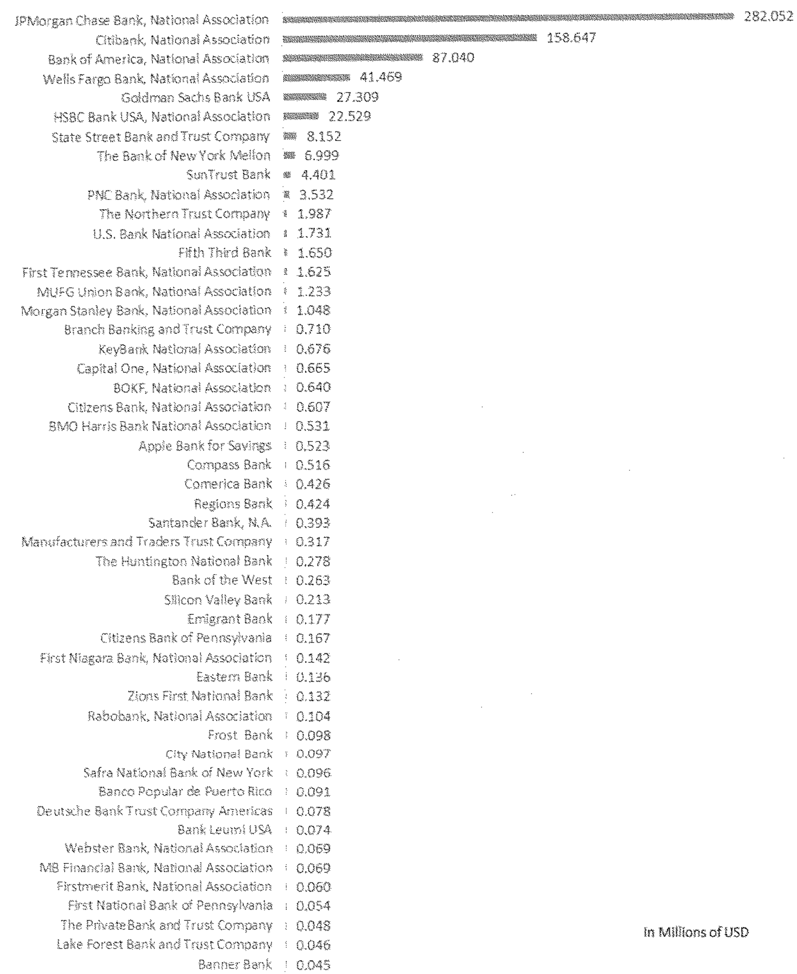
Figure 3: BHC Bank Subsidiaries Ranked by Domestic Deposits



*The sum of all domestic office deposits, including demand deposits, money market deposits, other savings deposits and time deposits.

Source: FDIC (March 31, 2015)

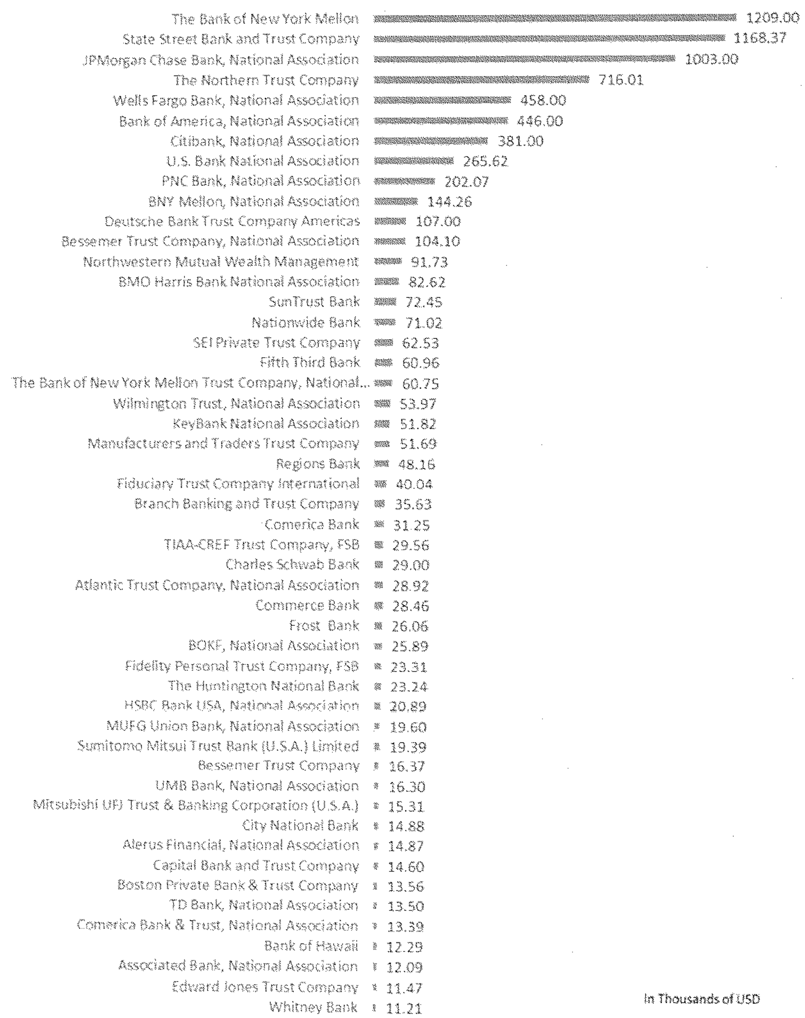
Figure 4: BHC Banks Subsidiaries by Trading Account Assets*



*Securities and other assets acquired with the intent to resell in order to profit from short-term price movements. Effective January 1, 1994, this item includes revaluation gains.

Source: FDIC (March 31, 2015)

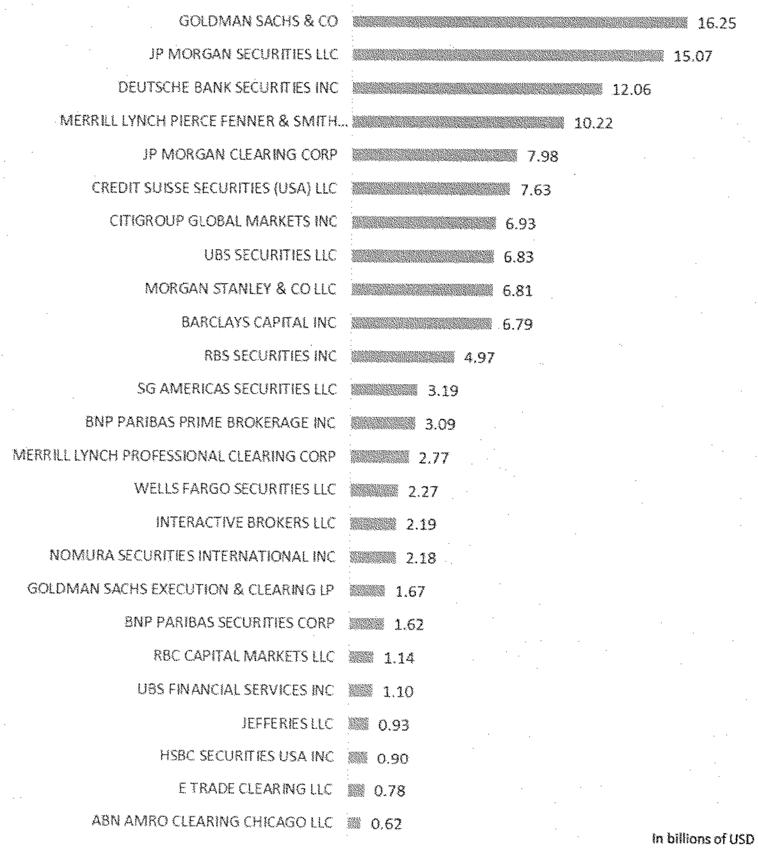
Figure 5: BHC Subidiary Banks Ranked by Gross Fiduciary Activities Income



*Income from servies rendered by the institutions's trust department or by any of its consolidated sibsidaries acting in any fiduciary capacity.

Source: FDIC SDI (March 31, 2015)

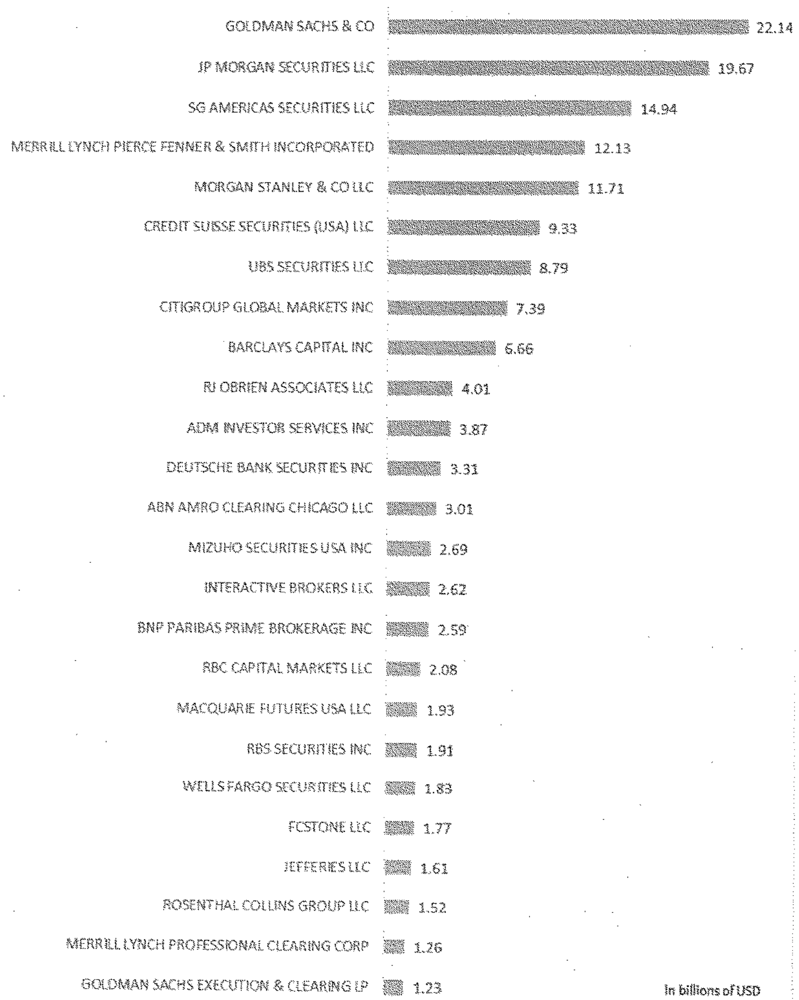
Figure 6: Future Commission Merchants Ranked by Capital*



*The total amount of funds that an FCM is required to segregate on behalf of customers who are trading on a designated contract market or derivatives transaction execution facility. This is the sum of all accounts that contain a net liquidating equity.

Source: US Commodity Futures Trading Commission (April 2015)

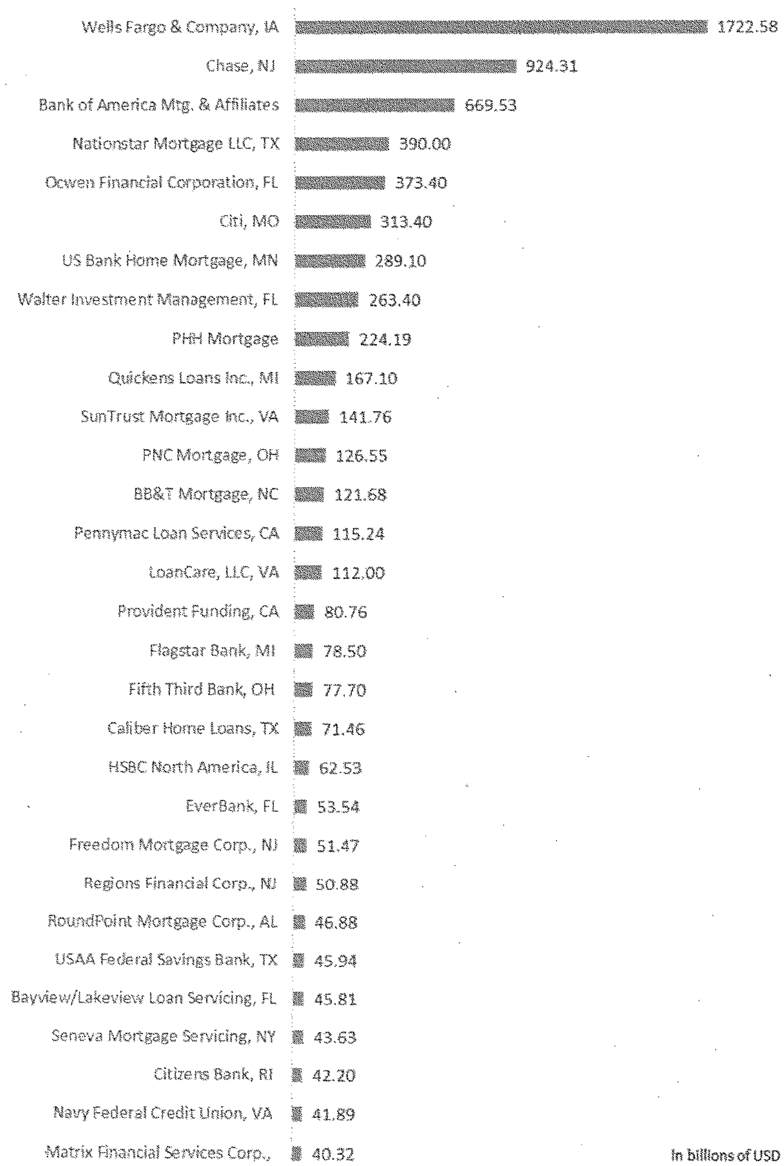
Figure 7: Future Commission Merchants Ranked by Customer Assets*



*The total amount of money, securities, and property held in secured accounts for futures and options customers who trade on commodity exchanges located outside the United States in compliance with Part 30 of the Commodity Exchange Act.

Source: US Commodity Futures Trading Commission (April 2015)

Figure 8: Top 30 Mortgage Servicing Operations



Source: Inside Mortgage Finaance June 19, 2015
Data from the first quarter of 2015.

Appendix: Paul Kupiec Resume

Current Position

2013- *Resident Scholar, American Enterprise Institute*

Prior Experience

2004-2013 *Director FDIC Center for Financial Research (CFR)* and, *Associate Director, Center for Financial Research Branch, Division of Insurance and Research, Federal Deposit Insurance Corporation*

2010-2013 *Chairman, Research Task Force Subcommittee of the Basle Committee on Bank Supervision*

2000–2004 *Deputy Division Chief, Banking Supervision and Regulation, Monetary and Financial Systems Department, International Monetary Fund*

1998-2000 *Director / Principal Economist, Financial Research, Freddie Mac, McLean, Virginia.*

1997-1998 *Vice President, The Risk Metrics Group, J. P. Morgan, New York, New York.*

1988 -1997 *Senior Economist, Division of Research and Statistics, Federal Reserve Board, Washington, D.C.*

1990-1991 *Official, Bank for International Settlements, Basle Switzerland*

1985-1988 *Assistant Professor of Finance, North Carolina State University, Raleigh, NC.*

Professional Service

Editor, *The Journal of Financial Services Research* (2007-2013)

Associate Editor, *The Journal of Financial Services Research* (2005-2007)

Associate Editor, *The Journal of Risk* (1998-present)

Editorial Board, *The Journal of Risk Management in Financial Institutions* (2007-present)

Associate Editor, *Journal of Investment Management* (2013-present)

Director, Southern Finance Association (2013-present)

Referee for many academic journals

Education

The University of Pennsylvania
Ph.D in Economics, 1985. Specialization in Finance, Theory and Econometrics

The George Washington University, Washington D.C., B.S. Economics, 1980.

Publications
(Chronological)

"Initial Margin Requirements and Stock Returns Volatility: Another Look," *Journal of Financial Services Research*, Vol. 3, No. 2/3, pp. 189-202, 1989.

"A Survey of Exchange-Traded Basket Instruments," *Journal of Financial Services Research*, Vol. 4, No. 3, pp. 175-190, 1990.

"Animal Spirits, Margin Requirements and Stock Price Volatility," *Journal of Finance*, Vol. 46, No. 2, pp. 717-732, 1991. (joint with Steve Sharpe).

"Stock Market Volatility in OECD Countries: Recent Trends, Consequences for the Real Economy, and Proposals for Reform," *OECD Economic Studies*, No. 17, Autumn, pp. 31-62, 1991.

"A Primer on Program Trading and Stock Price Volatility: a Survey of the Issues and the Evidence," in *Research in Financial Services Private and Public Policy*, Vol. 4, (joint with Pat White and Greg Duffee).
—Reprinted in: *Finanzmarkt und Portfolio Management*, 1992.

"A Securities Transactions Tax: Beyond the Rhetoric," Research in Financial Services Private and Public Policy, Vol. 5, 1993. (joint with Pat White and Greg Duffee)

"Futures Margins and Stock Price Volatility: Is There Any Link?", *The Journal of Futures Markets*, Vol. 13, No. 6, 1993.

"Do Stock Prices Exhibit Excess Volatility, Frequently Deviate from Fundamental Values, and Generally Behave Inefficiently? "(Monograph) *Financial Markets, Institutions & Instruments*, 1993.

"Prudential Margin Policy in a Futures-Style Settlement System," *The Journal of Futures Markets*, Vol. 13, No. 8, 1993. (joint with George Fenn)

"The Performance of S&P500 Futures Product Margins Under the SPAN Margining System," *The Journal of Futures Markets*, Vol. 14, No. 7, 1994.

"A Securities Transaction Tax and the Efficiency of Capital Markets," *Contemporary Economic Policy*, Vol. 13, No. 1, 1995.

"Internal Affairs," *Risk*, May, 1995. (joint with Jim O'Brien)

"Model Alternative," *Risk*, June, 1995. (joint with Jim O'Brien)

"Techniques for Verifying the Accuracy of Risk Measurement Models," *The Journal of Derivatives*, Vol.3, No. 2, pp. 73-84, 1995.
—Reprinted in: *VAR: Understanding and Applying Value at Risk*, Risk Publications, 1997.
—Also reprinted in: *Risk Measurement and Systemic Risk*: Proceedings of a joint Central Bank Research Conference, Federal Reserve Board, 1996.

"Noise Traders, Excess Volatility, and a Securities Transactions Tax," *Journal of Financial Services Research*, Vol. 10, No. 2, pp. 115-129, 1996.

"Regulatory Competition and the Efficiency of Alternative Derivative Product Margining Systems, *The Journal of Futures Markets*, 1996. (joint with Pat White)

"Commitment is the Key," *Risk*, September, 1996. (joint with Jim O'Brien).
"Pre-Commitment," *The Financial Regulator*, Vol. 1, No. 3, pp. 41-46, 1996. (joint with Jim O'Brien).

"Recent Developments in Bank Capital Regulation of Market Risks," in *Advances in Finance, Investment and Banking: Derivatives Regulation and Banking*, Barry Schachter editor, Amsterdam: North Holland, 1997. (joint with Jim O'Brien)

"Margin Requirements, Volatility, and Market Integrity: What have we learned since the Crash?" *Journal of Financial Services Research*, Vol. 13, No. 3, 1998.

"Deposit Insurance, Bank Incentives, and the Design of Regulatory Policy," *The Federal Reserve Bank of New York Economic Policy Review*, Vol. 4, No. 3, 1998. (joint with Jim O'Brien).

"Stress Testing in a Value at Risk Framework," *The Journal of Derivatives*, Vol. 6, No. 1, 1998.

"Risk Capital and VaR," *The Journal of Derivatives*, Vol. 7, No. 2 (Winter), 1999, pp. 41-52.
—Reprinted in Risk Publications volume on "Model Risk".

"On the Origin and Interpretation of OAS," *Journal of Fixed Income*, Vol. 9, No. 3 (December), pp. 82-92, 1999.

"Stress Tests and Risk Capital," *The Journal of Risk*, Vol. 2, No. 4, 2000, pp. 27-40.

"An alternative to Basle's reform proposals," *Risk*, March 2000, pp. 54-57.

"Estimating Credit Risk Capital: What's the Use?" *The Journal of Risk Finance*, Vol. 2, No. 3, pp. 17-34, 2001.

"The devilish detail of Basel," *Risk*, June 2001.

"Credit Risk Capital: More Than One Way to Guard a Guarantee," in *Risk Management: The State of the Art*, Stephen Figlewski and Richard Levich, editors. Boston: Kluwer Academic Publishers, 2002.

"What Exactly Does Credit VaR Measure?," *The Journal of Derivatives*, Vol. 9, No. 3, pp. 46-59, 2002.

"Does CP 3 get it right?, *Risk*, Vol. 16, No. 8, (August) 2003.

"Understanding the expected loss debate," *Risk*, November 2003.

"Is the Basel Accord Incentive Compatible?" in *The New Basel Accord*, Benton Gup editor. SouthWestern/Thompson Publishing Co., 2004.

"Assessing Systemic Risk Exposure from Banks and GSEs Under Alternative Approaches to Capital Regulation," (with David Nickerson), *The Journal of Real Estate Finance and Economics*, Vol. 28, No. 2&3, 2004.

"Estimating Economic Capital Allocation for Market and Credit Risks," *The Journal of Risk,* Vol. 6, No. 4, pp. 11-29, 2004.

"Internal Model-Based Capital Regulation and Bank Risk-Taking Incentives," *The Journal of Derivatives,* Summer 2004.

"Principles for the Supervision of State-Owned Financial Institutions" (with J. Fiechter), in, The Future of Financial Institutions. Washington DC: Brookings Institution Press, 2004.

"Insurers are not Banks: Assessing Liquidity, Efficiency and Solvency Risk Under Alternative Approaches to Capital Adequacy" (with Dave Nickerson), *The Geneva Papers on Risk and Insurance - Issues and Practice*, Palgrave Macmillan, vol. 30(3), pages 498-521, July 2005.

"Using a Mandatory Subordinated Debt Issuance Requirement to Set Regulatory Capital Requirements for Bank Credit Risks," in, *Capital Adequacy: Beyond Basel,* Hal Scott editor. Boston: Oxford University Press, 2005.

"Financial Stability and Basel II," *Annals of Finance*, Vol. 3, pp. 107-130, 2007.

"Capital Allocation for Portfolio Credit Risk," *The Journal of Financial Services Research,* Vol. 32, No. 1-2, p. 103-122, 2007.

"Estimating Recovery Discount Rates: A Methodological Note," *The Journal of Risk Management in Financial Institutions*," Vol. 1, No. 1, 2007.

"Basel II: A Case for Recalibration," in Handbook of Financial Intermediation and Banking, Anjan Thakor and Arnoud Boot, editors. New York: North Holland, 2008.

"A Generalized Single Common Factor Model of Portfolio Credit Risk," *The Journal of Derivatives,* Vol. 15, No. 3, pp. 25-40, 2008.

"Bank Failures and the Cost of Systemic Risk: Evidence from 1900-1930" (joint with Carlos Ramirez), *The Journal of Financial Intermediation,* Vol. 22, No.3, pp. 285-307, 2013.

"How Big is Big Enough?" *The Journal of Financial Intermediation*, Vol. 22, No. 4, pp. 529-531, 2013.

"Portfolio Diversification in Concentrated Bond and Loan Portfolios," forthcoming, *Journal of Investment Management.*

"Capital for Concentrated Credit Portfolios," forthcoming, *Journal of Risk Management in Financial Institutions.*

Other Publications

AEI Outlooks and Commentary

"When governments direct bank credit, the economy suffers," AEI, March 4, 2004.
"Basel III: Some costs will outweigh the benefits," AEI, Nov 12, 2013.
"SEC Comment on the OFR Report 'Asset Management and Financial Stability,' " AEI, Nov. 1, 2013.

Published Editorials

"Negative Interest Rates Threaten the Banking System" Wall Street Journal, March 6, 2015

"3 easy fixes to Dodd-Frank," Wall Street Journal, November 6, 2014.

"A loan to help home owners build equity fast," American Banker, October 28, 2014.

"SIFI designations aren't meant to last forever." American Banker, October 8, 2014.

"When central bankers become central planners," The Wall Street Journal, September 28, 2014.

"Why taxpayers will be on the hook when it's time to raise rates," American Banker, August 27, 2014.

"Why the 'living will' process sets banks up for failure," American Banker, August 11, 2014.

"The real 'systemic risk' is the FDIC's broken resolution process," Real Clear Markets, August 6, 2014.

"Dodd-Frank doesn't end 'too big to fail' ", The Hill, July 31, 2014.

"Scrapping Basel II for stress tests would be a big mistake," American Banker, July 2, 2014.

"The Fed's blueprint for financial control," The Wall Street Journal, May 21, 2014.

"Bank regulators do make more," The Wall Street Journal, May 13, 2014.

"Guess who makes more than bankers: Their regulators," The Wall Street Journal, April 21, 2014.

"SEC probe of mortgage securities sales is much ado about nothing," Real Clear Markets, Jan. 9, 2014.

"The Volcker Rule won't reduce risk," Real Clear Policy, Dec. 20, 2013.

"The worst fears about Dodd-Frank's FSOC are being confirmed," Forbes, Nov. 26, 2013.

"Basel II is just too complex as risks outweigh benefits," National Post, No 13, 2013.

Congressional Testimony

"Assessing the impact of the Dodd-Frank Act four years later," Testimony before the House Financial Services Committee, July 22, 2014.

"What makes a bank systemically important?" Testimony before the Senate Committee on Banking, Housing, and Urban Development, July 16, 2014.

"Government financial policy and credit availability," Testimony before the House Financial Services Subcommittee on Monetary Policy and Trade, March 12, 2014.

"Federal Reserve Accountability and Reform," Testimony before the Senate Committee on Banking, Housing, and Urban Development, March 4, 2015.

Co-Authored IMF Country Reports

Finland: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Financial Policy Transparency, Banking Supervision, Insurance Supervision, Securities Regulation, and Payment Systems. Country Report No. 01/214, November 2001.

Portugal 2002 Article IV Consultation Staff Report. Country Report No. 03/99, April 2003.

Portugal 2001 Article IV Consultation Staff Report. Country Report No. 02/90, April 2002.

Iceland 2001 Article IV Consultation Staff Report. Country Report No. 02/130, July 2002.

Iceland: Financial System Stability Assessment Update, including Report on the Observance and Standards and Codes on the following topics: Banking Supervision, Insurance Regulation, Securities Regulation, Payment Systems, and Monetary and Financial Policy Transparency. Country Report No. 03/271, August 2003.

Japan: Financial System Stability Assessment and Supplementary Information. Country Report No. 3/287, September 2003.

Singapore: Financial System Stability Assessment and Supplementary Information, No. 4/104, 2004.

New Zealand: Financial System Stability Assessment and Supplementary Information, No. 4/417, 2004.

Iceland FSAP Update, No. 8/369, 2008.

Netherlands FSAP, No. 11/144, 2011.

Mexico FSAP, March, 2012.

Ireland, Selected Reports on Irish Banking System Developments under the IMF Program (2013).

Recent Unpublished Working Papers

"Does bank supervision impact bank loan growth?" (joint with Yan Lee and Claire Rosenfeld). May 11, 2015. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2603850

"Testing for systemic risk using stock returns," (joint with Levent Guntay). Januarry 21, 2015. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2553356

"Can the 'single point of entry' strategy be used to recapitalize a failing bank," (joint with Peter Wallison) November 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2519229

"Incentive Compensation for Risk Managers when Effort is Unobservable," October 2013/revised January 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2344907

"Macroprudential Policies and the Growth of Bank Credit," (joint with Claire Rosenfeld and Yan Lee). Dec. 2013. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2368989

"Taking the Risk out of Systemic Risk Measurement," (joint with Levent Guntay), July 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2375236

Professional Conference Organization Committees

Program committee member, Southern Finance Association Annual Meetings, (2005-12).

Co-organizer (with Haluk Unal), the FDIC-JFSR Fall Banking Research Conference (2004-2012).

Co-organizer (with Robert Jarrow and Stuart Turnbull), the annual Derivative Securities and Risk Management Conference (2005-2012).

Program Committee and organizer for the 2007 Basel Research Task Force Workshop held at the FDIC.

Program Committee for Basel Research Task Force Conference on the Integration of Market and Credit Risk Measurement (Berlin 2007).

Program Committee for Basel Research Task Force on Stress Testing (Amsterdam 2008).

Other Professional Service

2009- The Financial Stability Institute (FSI), a service organization supported by the Bank for International Settlements and Basel Committee on Bank Supervision member institutions.

---Lecturer at multiple FSI Workshops on various topics in risk measurement, regulatory capital, stress testing, deposit insurance, financial sector crisis management, and Basle capital and leverage regulations.

TESTIMONY OF

HARRIS H. SIMMONS

CHAIRMAN and CEO

ZIONS BANCORPORATION

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

July 8, 2015

I. Introduction

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, thank you for the opportunity to appear before you this afternoon. I am Chairman and CEO of Zions Bancorporation, a $58 billion dollar (total assets) bank holding company headquartered in Salt Lake City, Utah. We operate seven community banks, with local management teams and brand names, in eleven states from Texas to the West Coast. Indeed, we consider ourselves to be a "Collection of Great Banks," with a particular focus on serving small and mid-sized businesses and municipalities throughout the West. We believe we are very good at serving such customers, and are proud to have been awarded 24 Excellence Awards (placing us second among more than 750 U.S. Banks surveyed) in Greenwich Research Associates' survey of approximately 30,000 small and middle market businesses across the country in a variety of product and service categories in 2014.

Virtually all of our banking activities are very traditional in nature, with a straightforward business model that is highly focused on taking deposits, making loans, and providing our customers with a high degree of service. We are primarily a commercial lender, which is to say that we are especially focused on lending to businesses. And notably, roughly half of our total commercial loan commitments consist of loans of less than $5 million in size, underscoring our focus on serving smaller businesses throughout the West.

Zions Bancorporation has the distinction of currently being the smallest of the Systemically Important Financial Institutions – or "SIFIs" – in accordance with the $50 billion asset threshold for the determination of systemic importance as defined in section 165 of the Dodd-Frank Act. And while we are proud of the services we provide to our customers, and believe we incrementally make a real difference in the local markets in which we operate, we certainly do not consider ourselves to be systemically important to the United States economy. We in fact half-jokingly refer to our company as an "Itty Bitty SIFI," and we see evidence that an increasing number of thoughtful observers, including our own regulators, are of the opinion that we are of neither the size, complexity nor critical importance to the workings of the U.S. economy to warrant the scope, intensity and cost of additional regulation that the automatic designation as a SIFI carries with it.[1]

II. Stress Testing and Capital Planning

As a covered institution, or SIFI, under section 165 of the Dodd-Frank Act, Zions Bancorporation is subject not only to the Act's rigorous stress testing (Dodd-Frank Act Stress Test, or "DFAST") requirements, but to the annual Comprehensive Capital Analysis and Review ("CCAR") conducted in conjunction with the annual DFAST exercise.

The DFAST process is intensive, time-consuming and costly. It involves the development and continual maintenance of sophisticated statistical models designed to project a bank's performance over the course of a hypothetical nine-quarter period of severe economic stress, using scenarios incorporating a variety of macroeconomic variables supplied annually by the Federal Reserve, and supplemented by a bank holding company's own variables and assumptions reflecting any of its idiosyncratic risk exposures. These statistical models are expected to be capable of projecting the likely outcomes and interrelated effects of each line item on a bank holding company's income statement and balance sheet based on a granular analysis of a bank's individual assets and liabilities. They must be developed based on historical performance, back-tested, validated, audited and documented. So-called "challenger" models must also be developed to identify potential weaknesses inherent in the more material primary models. And the entire process must be conducted under a rigorous governance process involving both the bank's management and board of directors.

[1] See, *e.g.*, remarks of Federal Reserve Board Governor Daniel K. Tarullo in his testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

Each of the (currently) 31 bank holding companies required to participate in the Federal Reserve's supervisory stress test exercise furnishes the Federal Reserve with millions of data elements derived from individual loans and other balance sheet items on Form FR Y-14. This data is used both in the banks' internal stress tests and in the Federal Reserve's own models to project risk-weighted assets and capital levels during and at the conclusion of the hypothetical period of severe stress in an attempt to ensure that capital levels under stress will not breach minimum regulatory standards.

The CCAR exercise builds on the DFAST process by incorporating a firm's projected capital actions over the nine-quarter projection period. The objective is to determine that a bank holding company's projected capital actions would not, during a period of stress such as that reflected in the stress test, impair capital levels below required regulatory capital thresholds. After evaluating the results of its own and the banks' stress tests and capital plans, the Federal Reserve provides each covered institution with both a qualitative and a quantitative assessment of its stress testing and capital planning processes.

Zions Bancorporation has been a participant in the CCAR process for the past two years, after the Federal Reserve expanded the number of covered institutions from 18 to the current group of 31 participating bank holding companies. In preparing throughout 2014 for our participation in "CCAR 2015" – an exercise covering a planning period from September, 2014 through December, 2016, with our internal stress testing results and capital plan submitted in January of this year – we incurred approximately $20 million in direct expense, much of it with outside consultants. We also spent many thousands of hours of management and board time focused on CCAR. Our board of directors met twenty times in 2014; CCAR was a significant agenda item in seventeen of those meetings. During the first week of January, 2015, we submitted approximately 12,500 pages of detailed mathematical models, analysis and narrative to the Federal Reserve incorporating our CCAR 2015 product. We have recently been completing our mid-year stress test exercise to complement the more intensive annual submission.

I view stress testing as a fundamentally important tool in the management of a bank's risk and the assessment of its capital adequacy. The value of the insights it yields, however, does not increase in linear proportion to the investment made in the exercise, and this is particularly true for the smaller and less complex regional banking institutions. There are diminishing returns from this exercise for both the banking institutions and the regulators. Federal Reserve Governor Daniel K. Tarullo recently noted that "...the basic requirements for the aggregation and reporting of data conforming to our supervisory model and for firms to run our scenarios through their own models do entail substantial expenditures of out-of-pocket and human resources. This can be a considerable challenge for a $60 billion or $70 billion bank. On the other side of the ledger, while we do derive some supervisory benefits from inclusion of these banks toward the lower end of the range in the supervisory stress tests, those benefits are relatively modest, and we believe we could probably realize them through other supervisory means."[2]

Ideally, the stress testing process should inform management's and the board's thinking about managing credit concentrations, interest rate risk, underwriting standards, pricing, and maintaining an appropriate balance of risks in its portfolio. In our own experience, these objectives are largely thwarted by the reality that the results of the Federal Reserve's internal models trump our own internally modeled results. Although the Federal Reserve posed no material objection to Zions Bancorporation's qualitative processes in CCAR 2015, its own modeled measure of the firm's tier 1 common equity ratio after nine quarters of severely adverse economic conditions was *40%* below our own projected outcome. Such a variance in outcomes begs a reconciliation of the models used by each organization if the results are to be truly useful in the management of the company. And while Federal Reserve officials

[2]Federal Reserve Board Governor Daniel K. Tarullo, in remarks to the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

argue that "transparency around the stress testing exercise improves the credibility of the exercise and creates accountability both for firms and supervisors,"[3] they continue to maintain that it is important not to disclose details of their models, lest firms "manage to the test." Certainly it is not difficult to understand a regulator's perspective about this, but the notion that the rules – which are effectively incorporated into those models' algorithms – governing banks' capital distributions to the firms' owners should be kept secret finds little if any parallel in our legal and regulatory system.

This lack of transparency has the effect of creating uncertainty, and because the Federal Reserve's modeled capital results become the "binding constraint" for capital planning by some banks, including my own, we are *necessarily* led to attempt to "manage to the test" - even if it's not clear how the test works. This uncertainty echoes recent comments by Federal Reserve Governor Daniel K. Tarullo, who noted that "while enhanced prudential standards are important to ensure that larger banks can continue to provide credit even in periods of stress, some of those same enhancements could actually inhibit credit extension by rendering the reasonable business models of middle-sized and smaller banks unprofitable."[4] In our own case, we've in particular established limits on construction and term commercial real estate lending that are significantly more conservative than those incorporated in current interagency guidelines on commercial real estate risk management.[5]

Another example of the uncertainty around the Federal Reserve's models involves small business loans. The detailed FR Y-14 data templates used for the Federal Reserve's models to capture granular data on collateral values and other factors useful in evaluating potential loss exposures for commercial loans expressly exclude loans of less than $1 million and credit-scored owner-occupied commercial real

[3] Federal Reserve Board Vice Chairman Stanley Fischer, speaking at the Riksbank Macroprudential Conference, June 24, 2015
[4] Federal Reserve Governor Daniel K. Tarullo – before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

[5] Office of the Comptroller of the Currency, FDIC and Board of Governors of the Federal Reserve System: *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices,* December, 2006.

estate loans, the combination of which amounts to nearly 15% of our total loan portfolio. Rather, such loans are reported on a supplemental schedule that includes only the loan balances. We can therefore only suppose that such loans are treated relatively more harshly in the Federal Reserve's models, and consider whether this is another area where we should exercise restraint in extending credit in order to reduce the risk of a quantitative "miss" in the Federal Reserve's calculation of our required capital.

III. Liquidity Management

Having been designated as a Systemically Important Financial Institution, Zions Bancorporation is also subject to the Modified Liquidity Coverage Ratio. The three primary federal banking regulatory agencies, in implementing the Basel III liquidity framework, jointly adopted the Liquidity Coverage Ratio ("LCR") rule in September, 2014. The rule is applicable to internationally active banking organizations, generally those with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposure. At the same time, the Federal Reserve went beyond the Basel Committee's LCR framework, and adopted a somewhat less stringent rule, the Modified Liquidity Coverage Ratio ("MLCR"), applicable to bank holding companies with $50 billion or more in consolidated assets but that are not internationally active. This quantitative measurement supplements a qualitative liquidity management framework introduced in early 2014 to fulfill Enhanced Prudential Standards requirements, including liquidity standards, required by section 165 of the Dodd-Frank Act. The MLCR requires a bank holding company to hold a narrowly defined portfolio of "High Quality Liquid Assets" ("HQLA") equal to or greater than expected net cash outflows over a 21-day period, in accordance with a prescribed set of run-off calculations established in the rule. The qualitative liquidity management framework requires, among other things, monthly internal liquidity stress tests to supplement the prescriptive MLCR in determining the size of the institution's required minimum liquidity buffer.

The full extent of the impact of the liquidity rules on SIFIs is almost certainly not fully apparent in the current economic environment. We have experienced a prolonged period of low interest rates without precedent, and liquidity in the banking system has been abundant by virtually any historical measure. But liquidity comes at a cost, and the true cost of these rules will become manifest as interest rates and liquidity levels eventually normalize. While it is important for every depository institution to maintain appropriate levels of reserves to deal with normal fluctuations in cash flows, maintaining additional liquidity buffers as an insurance policy against times of extreme stress will almost certainly be a costly exercise for banks and for the economy at large. Every dollar invested in high quality liquid assets is a dollar that cannot be loaned out and put to more productive use. The impact will likely be most particularly acute for smaller and middle-market businesses that do not have ready access to the capital markets, and for whom bank credit is their financial lifeblood. Regional banks subject to the MLCR and the additional enhanced prudential liquidity standards imposed by the Dodd-Frank Act provide a disproportionate share of credit to such businesses.

IV. Other Consequences of SIFI Designation

Since the financial crisis, Zions Bancorporation has added nearly 500 additional full-time equivalent staff in areas such as compliance, internal audit, credit administration and enterprise risk management. In an effort to manage costs, these increases have been accompanied by offsetting reductions in other areas of the organization, including many customer-facing functions. Many, though not all, of these increases in risk management staffing are directly attributable to the Enhanced Prudential Standards requirements of the Dodd-Frank Act and other regulatory requirements that have arisen in the wake of the financial crisis.

We have also embarked on an ambitious program to replace core software systems, revamp our chart of accounts and establish a data governance framework and organization in order to ensure our ability to meet the substantial data requirements necessary to fully comply with the stress testing and liquidity management protocols applied to SIFIs. We expect to spend well over $200 million on these projects, making this the most substantial investment in systems in our history. While we will derive ancillary benefits from modernizing our systems, ensuring regulatory compliance has been a significant factor in our decision to make these investments. Additional investments have been made in software systems directly related to compliance with the Enhanced Prudential Standards. An example is the expenditure of approximately $3 million in software that facilitates compliance with incentive compensation governance requirements. In addition to the software investment, thousands of hours have been spent redesigning incentive plans and validating their compliance with regulatory requirements.

We have also begun the annual production of resolution plans, or "living wills," in accordance with requirements of the Dodd-Frank Act. In the coming year, we expect to spend approximately $2 million in outside legal and consulting fees, and a great deal of additional time, effort and cost for the preparation of our resolution plan. Though not directly related to the requirements of section 165 of the Dodd-Frank Act, a recent advanced notice of proposed rulemaking from the FDIC that would require institutions with two million or more deposits accounts to calculate insured deposit coverage for each account on a daily basis will require additional substantial investment in systems by Zions Bancorporation and the other approximately 36 institutions the FDIC anticipates would be covered under the new rule - a group that roughly approximates the SIFI universe of bank holding companies.

V. Alternative Means of Designating Systemic Importance

There is no apparent analytical foundation for the Dodd-Frank Act's establishment of a $50 billion asset size threshold for the determination of an institution's systemic financial importance. Indeed, there is a lack of consistency in applying the Enhanced Prudential Standards of section 165 of the Dodd-

Frank Act to all insured depository institutions with over $50 billion in assets, with the result that some federally insured depository institutions with total assets greater than those of my own bank holding company are not automatically subject to these rules. For example, USAA, a diversified financial services company whose USAA Federal Savings Bank subsidiary has over $70 billion in assets, is not subject to the requirements of section 165 inasmuch as USAA is not a bank holding company. Likewise, the nation's largest credit union, Navy Federal Credit Union, with $67 billion in assets, is not subject to these requirements.

We are supportive of an approach to the determination of systemic importance that removes the hard-coded $50 billion asset threshold currently incorporated in the Dodd-Frank Act, and that substitutes banking regulators' thoughtful and transparent analysis, consistently applied, taking into account an institution's complexity, interconnectedness with the domestic and international financial system, funding structure, asset risk profile and other such factors. We believe that any such analysis would find that Zions Bancorporation and a number of other regional banking institutions would not be found to be systemically important using such an approach, and that the net benefit to the U.S. economy from redirecting the resources these institutions currently expend on compliance with section 165 requirements to the prudent extension of credit and other banking services to customers would be significant.

Thank you very much for allowing me the opportunity to present our institution's views on this important subject.

Regional Bank Coalition

July 8, 2015

The Honorable Jeb Hensarling
Chairman
House Committee on Financial,
Services
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Senate Committee on Financial
Services
4340 O'Neill Federal Office Building
Washington, D.C. 20515

Dear Chairman Hensarling and Ranking Member Waters:

The Regional Bank Coalition and its members – Zions, SunTrust, Regions, M&T, Huntington, Fifth Third, Discover, Capital One, BMO Financial, BBVA Compass, BB&T, Bank of the West, and American Express – applaud the House Financial Services Committee for holding a hearing examining the appropriate regulatory regime for bank holding company systemically important financial institutions, including regional banks. Regional banks, which overwhelmingly focus on straightforward lending in communities in all 50 states, believe that regulation based on risk – not arbitrary asset thresholds – will assure bank safety and soundness, unlock economic growth in the communities we serve, and allow regulators to focus their attention on those institutions that do pose systemic risk to the financial system and the economy.

When the Dodd-Frank Act was enacted, it imposed significant systemic risk regulations on regional banks based on an arbitrary asset threshold of $50 billion, rather than taking into account a bank's true risk profile or business model. At the time of its enactment, neither regulators nor Congress had developed a more sophisticated method for measuring systemic risk.

Since then, however, the Federal Reserve, the Financial Stability Board and the Basel Committee for Bank Supervision have used a test that examines five factors to measure systemic risk: size, interconnectedness, complexity, global activity, and dominance in certain customer services, also known as substitutability. The Treasury Department's Office of Financial Research recently applied those factors in examining the riskiness of U.S. banks; their analysis found that the largest global systemically important banks (G-SIBs) had a systemic risk score of 5.05 percent and 4.27 percent. None of the regional banks listed in the report have scores exceeding 0.35 percent.

Regional banks scored well in that analysis because they focus the core of their business on traditional banking activity, not on riskier, more complex lines of business. Regional banks hold assets predominantly in insured depository institutions, have limited broker-dealer or other non-bank operations, do not have significant cross-border operations, and do not rely to a significant degree on short-term wholesale funding.

For example, core deposits, as a percentage of total assets, are, on average, approximately 72% for regional banks, as compared to approximately 29% for G-SIBs. Reverse repurchase agreements average less than 1% for regional banks, as opposed to 15% for G-SIBs. Securities sold or subject to repurchase, as a percentage of total liabilities, are approximately 1% for regional banks, as opposed to 11% for G-SIBs.

Regional banks also hold far fewer foreign deposits and make far fewer foreign loans. They face far less exposure to derivatives, collectively holding approximately 1% of outstanding contracts in the derivatives markets. As the following table makes clear, regional banks' business operations look nothing like those of the globally systemic important banks.

Table: Assets & Liabilities of Regional Banks vs. Systemically Important Banks

	Regional Banks	U.S. G-SIBs
Core deposits, as % of total assets	72%	29%
Reverse repurchase agreements	<1%	15%
Securities sold or subject to repurchase	1%	11%
Foreign deposits	1%	28%
Foreign Loans	<1%	18%
Broker Dealer Assets	<1%	19%
Notional Value of Derivative Contracts, as % of total assets	<54%	2549%

Even though regional banks do not pose a systemic risk to the economy, the Dodd-Frank Act has imposed significant additional capital and regulatory requirements. To be clear, regional banks support robust regulation to assure safety and soundness. But applying regulations meant for globally systemic banks to banks that do not pose the same risk to the economy only diverts capital that could be otherwise spent on traditional lending activities that fuel the economy.

The Regional Bank Coalition supports a tailored, balanced regulatory structure that acknowledges that risk is not measured by asset size alone, but instead accounts for the diversity, resilience, and utility of different banking sectors. We hope the committee will pursue these important reforms, and we would be glad to work with its members as you move forward.

Sincerely,

William Moore
Executive Director