STATEMENT

OF

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"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

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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

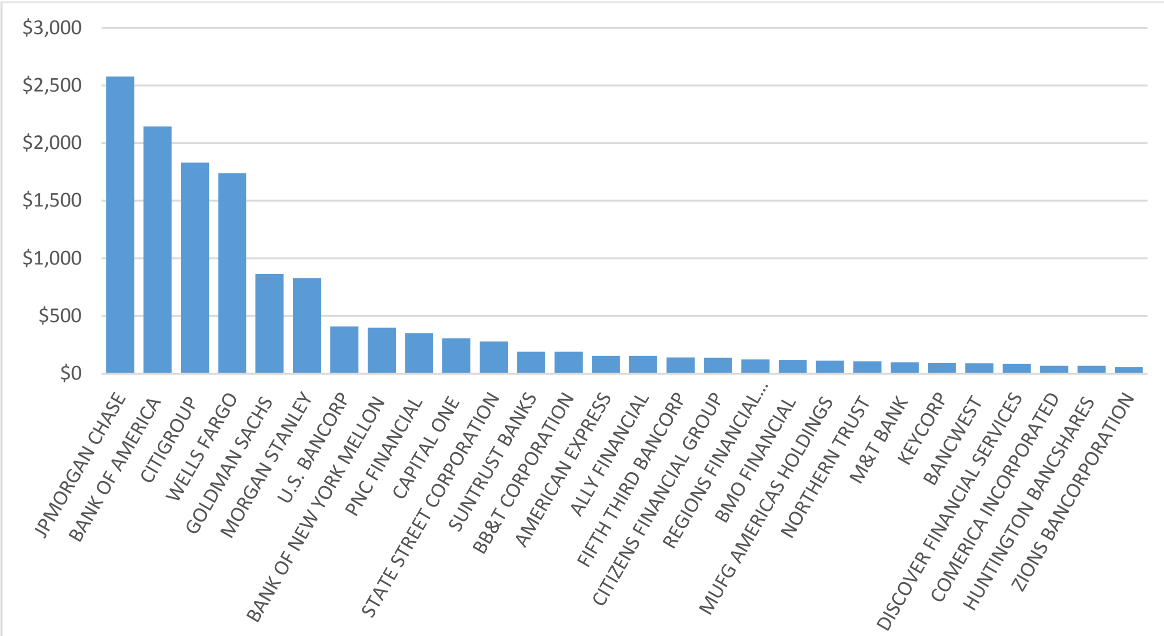
X denotes institutions that participated in DFA stress test and/or designated as G-SIBs by Financial Stability Board (As of March 31, 2015)

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.

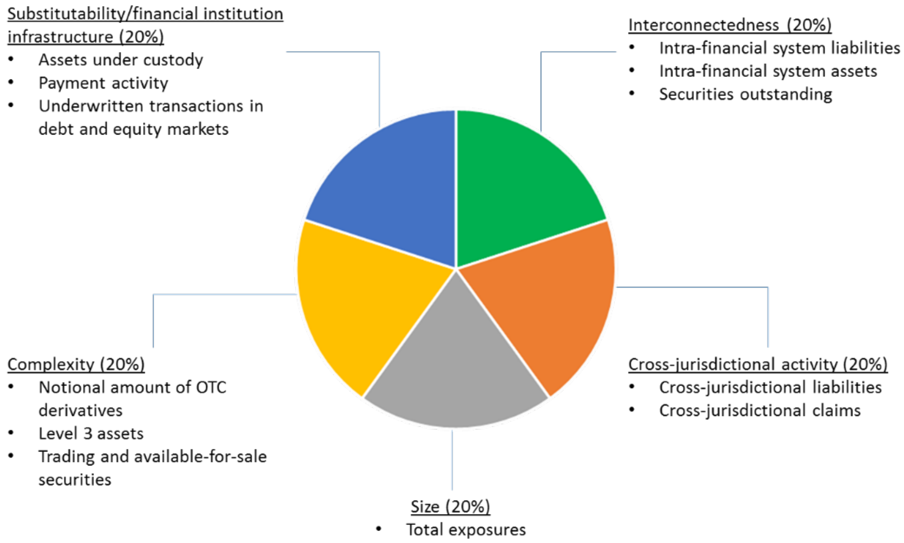
Figure 1. U.S. bank holding companies with total consolidated assets greater than $50 billion
($ billions)



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