BETTER MARKETS

February 19, 2019

Robert E. Feldman
Executive Secretary
ATTN: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Company-Run Stress Testing Requirements for FDIC-Supervised State Nonmember Banks and State Savings Associations, RIN 3064–AE84

Dear Mr. Feldman:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Federal Deposit Insurance Corporation ("FDIC"), regarding revisions to the company-run stress testing requirements for state non-member banks and state savings associations ("State Banks").

Better Markets recognizes that certain aspects of the Proposal are required by the Economic Growth, Regulatory Relief and Consumer Protection Act ("S. 2155").[3] In particular, S. 2155 requires raising the asset threshold for mandatory company-run stress tests from $10 billion to $250 billion and removing the "adverse scenario" from the list of mandatory stress testing scenarios.[4]

However, one change proposed by the FDIC is **not** required by S. 2155 and should not be adopted. S. 2155 modified the Dodd-Frank Act by changing the statutorily required frequency of

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 83 Fed. Reg. 67,149 (Dec. 28, 2018).

3 Pub. L. No. 115-174.

4 S. 2155 § 401 (2018).

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company-run stress tests for State Banks from "annual" to "periodic."[5] The FDIC proposes to implement this provision by reducing the frequency of stress tests for most covered State Banks from annual to biennial, thus cutting the frequency fully in half.[6]

This proposed change lacks a basis, and it is as unwise as it is unnecessary. S. 2155 does not require that the FDIC take **any** action with regard to the frequency of company-run stress tests for State Banks. An annual stress test is every bit as "periodic" as a biennial stress test. S. 2155 simply gives the FDIC additional discretion to establish the required frequency of company-run stress tests. The FDIC could (and should), consistent with S. 2155, exercise that discretion to maintain the current frequency of company-run stress tests or even **increase** the required frequency.

Before exercising the discretion Congress granted by drastically reducing the frequency of stress tests, the Board must conduct a robust, factual, detailed, objective, independently confirmed, and data-driven empirical analysis supporting the change. Yet the only rationale offered in the Release for decreasing the frequency of company-run stress tests is this conclusory observation, unsupported by any data:

> Based on the FDIC's experience overseeing and reviewing the results of company-run stress testing, the FDIC believes that a biennial stress testing cycle would be appropriate for most covered banks. For covered banks that would stress test on a biennial cycle, the FDIC nonetheless expects this level of frequency to provide the FDIC and the covered bank with information that is sufficient to satisfy the purposes of stress testing.[7]

This is little more than speculation, not robust analysis and certainly not a data-driven basis. A proper analysis taking into account the following factors would lead to the conclusion that reducing the frequency of company-run stress tests would be unwarranted and inappropriate.

THE CURRENT FRAMEWORK WORKS: BANKS ARE SAFER WHILE EARNING RECORD PROFITS

- **Banks Are Safer Than Ever.** Simply put, the current regulatory regime has done what it was designed to do: make the financial system safer by making banks safer. By all accounts, U.S. banks are more resilient than ever and much better able to withstand stress than before the 2008-2009 crisis.[8] In fact, as the FDIC knows, 2018 was the first year since

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5 *Id.*

6 Release at 67,150. Other State Banks that are subsidiaries of larger bank holding companies that are required to conduct company-run stress tests annually under a separate proposal by the Federal Reserve, would themselves need to conduct stress tests annually as well.

7 Release at 67,150.

8 Lael Brainard, Member of the Board of Governors of the Federal Reserve, Remarks at the Global Finance Forum, Safeguarding Financial Resiliencies Through the Cycle, at 7, 10 (Apr. 19, 2018) (emphasis added), available at https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

the financial crisis, and only the third year since 1933, in which **not a single bank failed**.[9] Credible stress testing has been key to this success. As Federal Reserve Board Governor Brainard observed, "One key benefit of our stress testing program is that it promotes a dynamic forward-looking assessment of a bank's capital adequacy in the face of severe stress."[10] Weakening regulations that have been so successful in making the financial system safer should only be considered if there is a substantial countervailing data-driven basis.

- **Banks Are More Profitable than Ever.** The FDIC should not be swayed by the banks' pleas to reduce "unnecessary" or "needless" compliance costs. In the first instance, the important role of **annual** stress tests fully justifies their costs. Moreover, those costs are plainly not unduly burdensome: Not only has the current regulatory framework made banks more resilient, it has done so while allowing them to make record profits.[11] If under the current framework banks are having no trouble making massive, if not historic, profits even as they are safer, what justification could there be for weakening the framework? There is none.

THE PROPOSAL IS PREMATURE AND DANGEROUS

- **The FDIC's "Experience" with Stress Tests Is Insufficient.** Despite the FDIC's assertion, it does not, in fact, have sufficient experience to determine whether it is safe and appropriate to reduce the frequency of company-run stress tests. As Governor Brainard has pointed out, it is imperative to "wait[] until we have tested how the new framework performs through a full cycle before we make judgments about its performance."[12] Until such time, at a minimum, the FDIC cannot reasonably assert that it can weaken the regulatory framework while still fulfilling its statutory obligation under Dodd-Frank to protect the public from another $20 trillion crisis.[13]

- **Credible Stress Tests Are Critical to Financial Stability.** As shown by prior experience, stress tests are an essential component in the regulatory toolbox for preventing or mitigating financial crises. In the midst of the 2008-2009 crisis, stressed if not panicky

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9 Hugh Son, *For the First Time Since 2006, Not a Single U.S. Bank Failed Last Year*, CNBC (Jan. 10, 2019), https://www.cnbc.com/2019/01/09/for-the-first-time-since-2006-not-a-single-us-bank-failed-last-year.html?__source=sharebar%7Ctwitter&par=sharebar.

10 Lael Brainard, Member of the Board of Governors of the Federal Reserve, Remarks at the Global Finance Forum, Safeguarding Financial Resiliencies Through the Cycle, at 7, 10 (Apr. 19, 2018) (emphasis added), https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

11 Kate Berry, *Four Myths in the Battle over Dodd-Frank*, AMERICAN BANKER, (Mar. 10, 2017), https://www.americanbanker.com/news/four-myths-in-the-battle-over-dodd-frank.

12 *See* Lael Brainard, Member of the Board of Governors of the Federal Reserve, Remarks at the Global Finance Forum, Safeguarding Financial Resiliencies Through the Cycle, at 7, 10 (Apr. 19, 2018) (emphasis added), https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

13 BETTER MARKETS, THE COST OF CRISIS, $20 TRILLION AND COUNTING (July, 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

markets were reassured when the government published stress test results demonstrating the resiliency of the largest banks. Indeed, many consider these tests and the related disclosure to be the turning point of the crisis.[14] However, stress tests are only useful if they are credible and viewed as such. Yet in rapidly changing economic conditions during a period of market distress, tests conducted up to two years earlier will not be sufficiently current and are unlikely to be considered credible. As Governor Brainard has pointed out:

> The stress testing capital regime applied to Fannie and Freddie before the crisis offers a sobering reminder of the dangers of failing to update stress tests in the face of changing market practices and emerging risks.[15]

And as another expert observer cautioned specifically with respect to biennial stress tests:

> Doing stress tests less frequently, such as only once every two years, would not be frequent enough to meaningfully promote financial stability. First, firms make choices about dividends and share repurchases at least once a year. Capital planning which should incorporate projected capital positions and risks to those positions should not be done less frequently than decisions about shareholder payouts.[16]

The Proposal threatens to significantly weaken one of the critical pillars needed to protect the financial system and support the economy through inevitable periods of economic downturn if not greater strain.

- **The Proposal's Danger is Amplified in the Current Environment.** The effects of reducing the frequency of company-run stress tests cannot be considered in isolation. Instead, the potential effects must be considered in light of the current dangerous deregulatory environment, including the mandatory provisions of S. 2155 noted above, and a series of regulatory proposals that would weaken capital and liquidity requirements for banks.[17] The current deregulatory environment will only compound the danger of reducing the frequency of company-run stress tests.

When these considerations are taken into account, it is clear that reducing the frequency of company-run stress tests is unjustified. This aspect of the Proposal does not serve a proper purpose and would, at most, only allow banks to save a relatively small amount in compliance costs. That is an insufficient reason to change this fundamental pillar of financial stability, which has proven

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14 MORRIS GOLDSTEIN, BANKING'S FINAL EXAM: STRESS TESTING AND BANK-CAPITAL REFORM 2 (2017).

15 *Cf.* Lael Brainard, Member of the Board of Governors of the Federal Reserve, Remarks at the Global Finance Forum, Safeguarding Financial Resiliencies Through the Cycle, at 7, 10 (Apr. 19, 2018), https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

16 NELLIE LIANG, BROOKINGS INST., HIGHER CAPITAL IS NOT A SUBSTITUTE FOR STRESS TESTS (2017), https://www.brookings.edu/wp-content/uploads/2017/04/es_liang_stresstests_04-24-17.pdf.

17 *E.g.* Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements 83 Fed. Reg. 66,024 (Dec. 21, 2018).

so successful. The FDIC should not reduce the frequency of stress tests in light of the factors identified above.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

[redacted]

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