June 21, 2019

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Suite 3E-218
400 7th Street, SW
Washington, DC 20219

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

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

Re: Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries, OCC Docket ID OCC-2019-0009; Board Docket No. R-1628 and RIN 7100-AF21; FDIC RIN 3064-AE96

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Board of Governors of the

[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] 84 Fed. Reg. 24,297 (May 24, 2019).

Federal Reserve System ("Board"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") (the Board, the OCC, and the FDIC collectively, the "Agencies"), regarding revisions to capital and liquidity requirements for the U.S. banking operations of large foreign banking organizations. The rule is related to a prior proposal by the Agencies that would weaken capital and liquidity requirements for large U.S. banking organizations ("Domestic Capital Proposal").[3]

Unfortunately, like the analogous Domestic Capital Proposal, the Proposal is a dangerous step in the wrong direction as it includes de-regulatory provisions that, by themselves and in concert with other sweeping de-regulatory initiatives, pose a significant threat to financial stability and safety and soundness. Those changes conflict with the letter and spirit of the Dodd-Frank Act. Moreover, they lack any persuasive policy rationale, as banks are thriving, the financial markets are robust, and the current regime has proven its incalculable value in significantly strengthening our financial system and better protecting it from the ravages of another financial crisis.

The Agencies should be particularly mindful here regarding foreign banking organizations. It is one thing to put hardworking Americans and taxpayers at risk for the activities of domestic banks that at least theoretically support the U.S. economy, jobs, and growth. It is another thing altogether to put Americans and U.S. taxpayers at risk from the activities of foreign banks, which largely benefit foreign citizens and ship their revenues and profits overseas. It is particularly

[3] Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 83 Fed. Reg. 66,023 (Dec. 21, 2018). Better Markets hereby incorporates by reference the comment letter submitted in response to the Domestic Capital Proposal, as well as comment letters submitted on prior proposals related to capital and liquidity requirements. Better Markets, Comment Letter on Domestic Capital Proposal (Jan. 22, 2019), https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20Capital%20and%20Liquidity%20Proposal.pdf; Better Markets, Comment Letter on Proposal Regarding Enhanced Supplementary Leverage Ratio (June 25, 2018), https://bettermarkets.com/sites/default/files/Better%20Markets%20CL%20to%20OCC%20and%20Fed%20eSLR%206-25-18.pdf; Better Markets, Comment Letter on Proposal Regarding Net Stable Funding Ratio (Aug. 5, 2016), https://bettermarkets.com/sites/default/files/FDIC%20FRS%20OCC%20-%20CL%20-%20Net%20Stable%20Funding%20Ratio%20-%20%28Searchabe%20Text%20Version%29_0.pdf; Better Markets, Comment Letter on Proposal Regarding Risk-Based Capital Guidelines (Apr. 3, 2015), https://bettermarkets.com/sites/default/files/documents/FRS%20-%20CL%20-%20Risk-Based%20Capital%20Guidelines%20Implementation%20of%20Capital%20Requirements%20for%20Global%20Systemically%20Important%20Bank%20Holding%20Companies%20-%204-3-2015.pdf; Better Markets, Comment Letter on Proposal Regarding Regulatory Capital Rules (Feb. 7, 2015), https://bettermarkets.com/rulemaking/better-markets-comment-letter-proposed-regulatory-capital-rules; Better Markets, Comment Letter on Proposal Regarding Regulatory Capital Rules (Oct. 22, 2012), https://bettermarkets.com/rulemaking/better-markets-comment-letter-banking-regulators-regulatory-capital-rules.

pernicious to **substitute U.S. taxpayers for foreign taxpayers as the source of bailout funding for foreign banks,** which we witnessed in 2008-2009.

Although far from alone, Deutsche Bank is the leading example. In fact, Deutsche Bank's U.S. subsidiary, Taunus, was the single largest foreign bank recipient of bailout support during the crash, amounting to more than $350 billion.[4] If the U.S. government had not provided those bailouts, then Taunus would have had to seek support from its parent company in Germany, Deutsche Bank.[5] However, because Deutsche Bank itself was on the verge of collapsing into bankruptcy due to its own reckless and irresponsible conduct, it would not have been able to provide such support and would have had to seek a bailout from the German government and German taxpayers before bailing out its U.S. subsidiary.[6] Thus, the U.S. bailout of Deutsche Bank's U.S. operations effectively substituted U.S. taxpayers for German taxpayers in bailing out this foreign banking operation.[7]

Moreover, Deutsche Bank and Taunus were particularly irresponsible regarding their capital reserves and their failure to comply with U.S. regulations. For example, at the time of the crash in 2008, Taunus had **negative** capital.[8] Moreover, after receiving a generous bailout from U.S. taxpayers to save it from its reckless conduct, rather than comply with U.S. bank capital requirements, it reorganized its operations to avoid the requirements, resulting in its U.S. operations having a Tier 1 risk-based capital ratio of **negative 6.37 percent**.[9] This is, in part, what required the Agencies to impose capital and liquidity requirements on FBO's in the first place, which this Proposal is now seeking to weaken without taking any of these facts into account.[10]

Deutsche Bank was not an isolated incident; foreign banks operating in the U.S. were key actors before, during, and after the 2008 financial crisis, engaging in high-risk activities, suffering existential instability, and requiring massive bailouts from the U.S. government and taxpayers. In fact, fully **nine of the top 20** largest users of Federal Reserve emergency lending facilities were

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4 Letter from Dennis M. Kelleher, President & CEO, Better Markets, to the Honorable Randal K. Quarles, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System (Sept. 24, 2018), https://bettermarkets.com/sites/default/files/Ltr%20to%20Fed%20VC%20Quarles%20re%20Implementation%202155%209-24-18%20FINAL.pdf.

5 *Id.*

6 *Id.*

7 *Id.*

8 Marc Jarsulic & Simon Johnson, *How a Big-Bank Failure Could Unfold*, N.Y. TIMES (May 23, 2013), https://economix.blogs.nytimes.com/2013/05/23/how-a-big-bank-failure-could-unfold/.

9 *Supra*, note 4.

10 *Id.*

foreign banks.[11] Moreover, ten of the top 16 beneficiaries of the AIG bailout, which paid its counterparties 100 cents on the dollar, were foreign banks.[12]

These facts should be uppermost in the minds of regulators who propose to lower the standards for foreign banks operating in the U.S., particularly when no persuasive factual or legal basis is proffered—and when the result will be to substitute U.S. taxpayer for foreign taxpayers in bailing out foreign banks.

INTRODUCTION AND SUMMARY

The stated goals of the Proposal are to "modify the regulatory framework applicable to foreign banking organizations in a manner commensurate with the risks such organizations pose to U.S. financial stability" and "to better address the risks presented by the U.S. operations of foreign banking organizations to U.S. financial stability."[13] However, by setting capital and liquidity requirements that are too low, in parallel with the proposed de-regulatory measures in the Domestic Capital Proposal, the actual impact of the Proposal will be to unnecessarily **increase systemic risk**. It is a premature and ill-advised attempt to scale back enhanced prudential standards applicable to some of the largest and most systemically risky banking organizations. And the negative impact of the Proposal will be intensified because it will be in addition to a much broader collection of de-regulatory measures now being pursued that collectively pose a substantial threat to financial stability.

The proposed de-regulatory changes are not justifiable. To the extent the underlying motivations for the risk-enhancing aspects of the Proposal are the same as those underlying the Domestic Capital Proposal—decreasing compliance costs for the industry and streamlining regulation—those considerations are found nowhere in the relevant statutory standards governing the Agencies' exercise of discretion. The Agencies' primary mandate in establishing or amending any enhanced prudential standards is to ensure that Americans are protected from the extraordinarily damaging consequences of another financial crisis, **not** to help financial companies, foreign or domestic, make (even greater) profits. The proposed de-regulatory measures are especially inappropriate and unnecessary in light of indisputable evidence that applying more stringent standards, such as the current framework for domestic banking organizations, has a proven track record of strengthening banks and increasing financial stability, while at the same time allowing lending activity to thrive and bank profits to soar to historic levels.

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11 *The U.S. Bailed Out Foreign Banks in 2008 & Shouldn't Have to Do That Again*, BETTER MARKETS BLOG (Jan. 23, 2014), https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again.

12 *Id.*

13 Release at 24,301.

The Release contains little substantive analysis justifying any of its risk-intensifying provisions. Until the Agencies can provide credible evidence that lower capital and liquidity requirements will not increase the risk of another financial crisis, and is otherwise appropriate, necessary, and consistent with the law, the Agencies should refrain from diluting the current requirements for the U.S. operations of large foreign banking organizations, especially those with $100 to $250 billion in assets.

BACKGROUND

The 2007-2009 financial crisis was catastrophic for our financial markets, our economy, and millions of American families. In monetary terms, it destroyed $20 **trillion** in GDP.[14] And the human toll resulting from millions of home foreclosures, deep and prolonged unemployment and underemployment, and massive loss of wealth is incalculable, and it continues to be felt today. Moreover, on top of the damage caused by the deep recession, as much as $29 trillion was lent, spent, pledged, committed, loaned, guaranteed, and otherwise used or made available to bailout the financial system during the crisis.[15]

Foreign banks were key actors during the financial crisis, engaging in high-risk activities, suffering existential instability, and ultimately requiring massive bailouts. In fact, fully **nine of the top 20** largest users of Federal Reserve emergency lending facilities were foreign banks.[16] Moreover, of the top 16 beneficiaries of the AIG bailout, which paid its counterparties 100 cents on the dollar, ten were foreign banks.[17]

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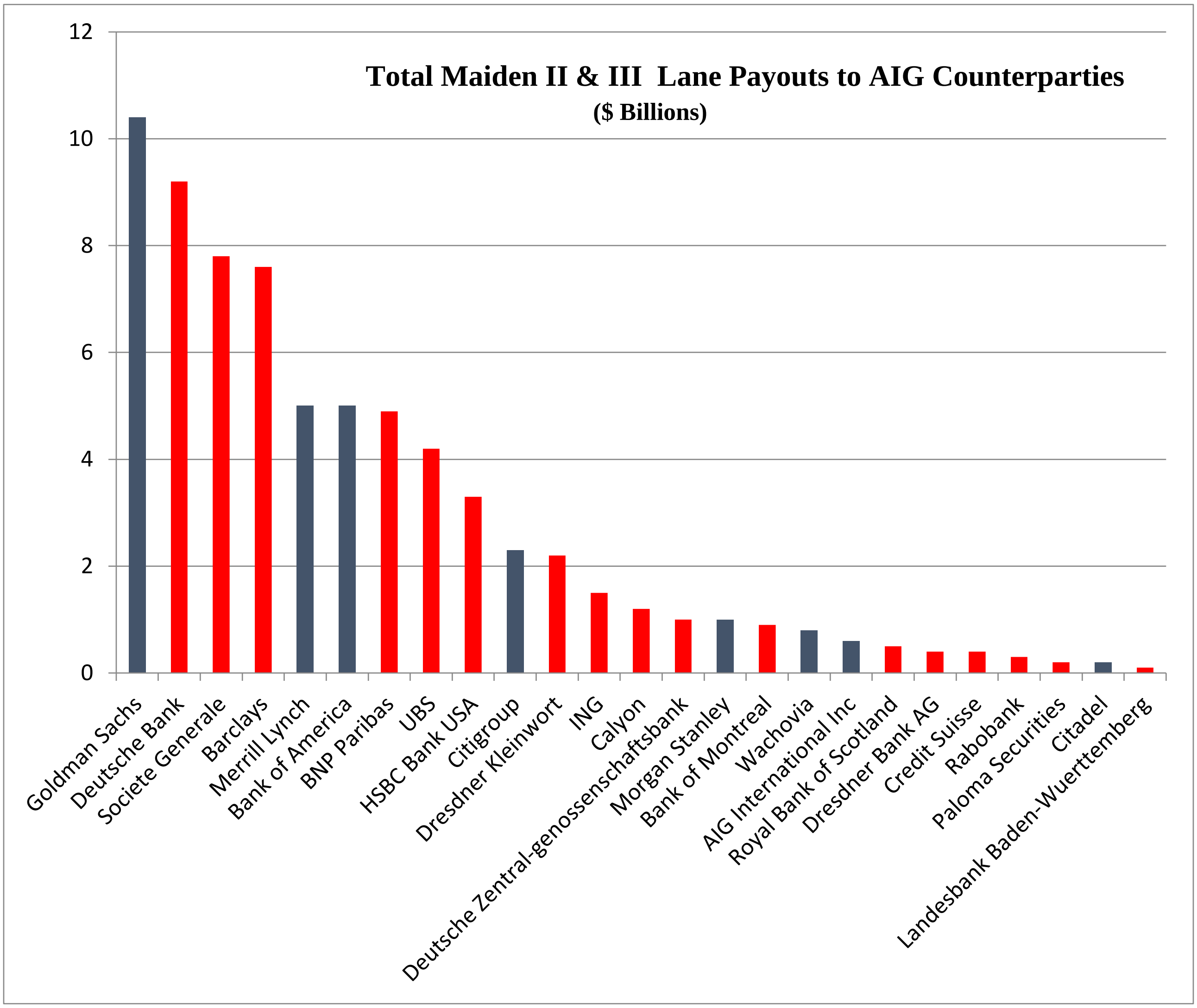
14 BETTER MARKETS, THE COST OF CRISIS, $20 TRILLION AND COUNTING (July, 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

15 *See* JAMES ANDREW FELKERSON, A DETAILED LOOK AT THE FED'S CRISIS RESPONSE BY FUNDING FACILITY AND RECIPIENT, PUBLIC POLICY BRIEF NO. 123 4, LEVY ECONOMICS INSTITUTE OF BARD COLLEGE (2012) ("Levy Report"), https://www.econstor.eu/bitstream/10419/121982/1/689983247.pdf; *see also* BETTER MARKETS, WALL STREET'S SIX BIGGEST BAILED-OUT BANKS; THEIR RAP SHEETS & THEIR ONGOING CRIME SPREE 1 (Apr. 9, 2019), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Wall%20Street%27s%20Six%20Biggest%20Bailed-Out%20Banks%20FINAL.pdf.

16 *The U.S. Bailed Out Foreign Banks in 2008 & Shouldn't Have to Do That Again*, BETTER MARKETS BLOG (Jan. 23, 2014), https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again.

17 *Id.*



The Agencies have a continuing responsibility under the Dodd-Frank Act to exercise their discretionary rulemaking authority to protect and promote financial institution safety and soundness, to prevent another devasting financial crisis, and to spare American taxpayers from again having to bail out the global financial system. Given the dismal track record of foreign banks during the crisis, the Agencies must be no less diligent in applying prudential standards to foreign financial institutions as they are in regulating domestic firms.

Preserving the regulatory reforms enacted in the Dodd-Frank Act is especially critical in part because of the difficulty in identifying all sources of systemic risk in advance. The financial crisis certainly illustrated the point. Financial regulators, and in particular banking regulators, have been heavily criticized for failing to fully appreciate the risks facing banks and other entities they supervised. However, in the runup to the crisis, few appreciated these risks and even fewer appreciated the potential consequences, as the housing market was teetering on the brink of collapse, toxic mortgage-backed securities were spreading like a virus, banks and other financial companies were dangerously over-leveraged and undercapitalized, and sophisticated financial companies were blindly accumulating over-the-counter derivatives positions they could not price, trade, or honor, all of which pushed the global economy to the brink of collapse.

As shown by this history, it will be extraordinarily difficult, even for experienced financial regulators, to predict in advance the precise contours and causes of the next financial crisis. Specifically, it will be nearly impossible to predict in what sector the crisis will originate, through what financial instruments it might spread, and which entities' failures may exacerbate the crisis. As the Congressional Research Service has put it,

> [d]efinitively identifying banks that are systemically important is not easily accomplished, in part because potential causes and mechanisms through which a bank could disrupt the financial system and spread distress are numerous and not well understood in all cases.[18]

That history and the undeniable lack of clairvoyance should cause all elected officials, policymakers, and regulators to be humble and cautious when deregulating systemically significant financial institutions.

What we do know is that dealing with this uncertainty requires being prepared for any number of scenarios through the application of strong prudential standards, including capital, liquidity, and risk management requirements, coupled with robust stress testing. They not only reduce the risk that banks and other financial firms will fail during periods of economic stress, but—equally important—also ensure that they will be able to continue responsibly serving their core economic functions, such as lending, which can help mitigate the severity of the crisis. Put differently, being strong enough to lend through the cycle enables these financial institutions to navigate a shallow downturn and quick recovery rather than making it deeper and longer as their losses and retrenchment contribute to the downward spiral. Moreover, strong prudential standards serve to assure markets that large financial companies are strong enough to weather a period of stress.

Thus, attempting to too-finely tailor risk-mitigating prudential standards to precisely match the currently perceived (but possibly erroneous) risk profile of large FBOs is likely to exacerbate the risk and severity of another financial crisis without a persuasive basis or rationale. Instead, the Agencies should be focused on preserving, if not enhancing, the current prudential standards to

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18 CONGRESSIONAL RESEARCH SERVICE, ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT (P.L. 115-174) AND SELECTED POLICY ISSUES 35 (June 6, 2018), https://crsreports.congress.gov/product/pdf/R/R45073.

the fullest extent allowed by statute. At the very least, the Agencies should stay their de-regulatory hands until the current set of prudential standards has been tested through a full business cycle. Certainly, the banks have no basis for complaint, as they continue to reap record-breaking profits, and the credit markets are being well-served.

OVERVIEW OF PROPOSAL AND ITS "IMPACT ANALYSIS"

The Three Categories and the Proposed Regulatory Requirements

The Proposal would create just three categories of foreign banking organizations ("FBOs") and intermediate holding companies ("IHCs")—omitting the most stringent Category I standards that would apply to globally systemically important banks ("GSIBs") under the Domestic Capital Proposal[19]—and apply differing levels of capital and liquidity requirements based on the Agencies' assessment of the risk profile of the institutions in each category.[20]

- **Category II:** Category II capital standards would apply to a U.S. IHC[21] with $700 billion or more in total consolidated assets or $75 billion or more in "cross-jurisdictional activity." Category II capital standards would include, in addition to generally applicable capital requirements, the supplementary leverage ratio, recognition of most accumulated other comprehensive income ("AOCI") in regulatory capital, and the countercyclical capital buffer, if applicable. Category II liquidity standards would apply to an FBO with $700 billion or more in combined U.S. assets, or $75 billion or more in cross-jurisdictional activity. These standards would include the full liquidity coverage ratio ("LCR") and the full proposed net stable funding ratio ("NSFR");

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19 The rationale given for omitting these standards from the Proposal is that the Board's GSIB surcharge rule would not identify any FBO or IHC as a GSIB.

20 The Agencies **do not** propose to apply liquidity requirements to the U.S. branches and agency networks of FBOs, but requests comment on whether they should do so, which the Agencies state they may do in a separate rulemaking. Release at 24,296. For reasons stated by Governor Brainard in her dissent, the Agencies **should** apply liquidity requirements to the U.S. branches and agency networks of FBOs. Specifically, these U.S. branches "rely heavily on runnable short-term wholesale funding," and indeed during the financial crisis "some foreign branches were among the most active users of discount window borrowing when wholesale funding markets became stressed." Press Release, Governor Lael Brainard, Statement on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks (Apr. 8, 2019), https://www.federalreserve.gov/newsevents/pressreleases/3B1F641BEB4A485B994EBC38165F0F3B.htm. We agree with Governor Brainard's analysis and are equally disappointed that this issue was not addressed in the Proposal, leaving an important regulatory gap. *Id.* The Agencies should promptly propose a rule to close this gap and impose necessary liquidity requirements on FBOs.

21 The Release also explains that the applicable standards would apply to "any depository institution subsidiary" of a U.S. IHC or an FBO. *See, e.g.,* Release at 24,302.

- **Category III:** Category III capital standards would apply to IHCs with $250 to $700 billion in consolidated assets or $75 billion or more in any of the following: (i) nonbank assets; (ii) weighted short-term wholesale funding; or (iii) off-balance sheet exposures. Category III IHCs would be subject to the supplementary leverage ratio and the countercyclical capital buffer, if applicable. However, they would not be subject to the recognition of most AOCI in regulatory capital. Category III liquidity standards would apply to FBOs with $250 to $700 billion in consolidated assets or $75 billion or more in any of the following: (i) nonbank assets; (ii) weighted short-term wholesale funding; or (iii) off-balance sheet exposures. Category III FBOs with less than $75 billion in weighted short-term wholesale funding would only be subject to less stringent or "reduced" LCR and NSFR requirements.

- **Category IV:** Category IV capital standards would apply to IHCs with at least $100 billion in total consolidated assets that do not meet any of the thresholds for Categories II or III. The Proposal would essentially treat these firms the same as banking organizations with under $100 billion in assets, subject only to the generally applicable capital requirements. Specifically, the countercyclical capital buffer and the supplementary leverage ratio applicable to Category III firms would not apply to Category IV firms. Category IV liquidity standards would apply to FBOs with at least $100 billion in combined U.S. assets that do not meet any of the thresholds for Categories II or III. Unless an FBO has $50 billion or more in weighted short term wholesale funding, it would not be subject to standardized liquidity requirements under the Proposal, such as the LCR and NSFR requirements; a Category IV FBO with $50 billion or more in weighted short term wholesale funding would be subject to reduced LCR and NSFR requirements.

The "Impact Analysis"

The Release sets forth the results of the Agencies' impact analysis. For purposes of considering changes to the amount of capital, the Agencies took "current levels of capital and holdings of HQLA at affected foreign banking organizations, potential benefits in the form of reduced liquidity risk at large foreign banking organizations, and potential costs related to decreased activity in global dollar funding markets."[22] The Release estimates that the Proposal would have no material impact on the capital levels of FBOs subject to Category II standards, but would "slightly lower" capital requirements for FBOs subject to Category III standards, by approximately $2-3 billion in the aggregate, as a result of some FBOs no longer being required to reflect AOCI in regulatory capital.[23]

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22 Release at 24,326-27.
23 *Id.*

With respect to liquidity, the Release estimates that under the Proposal, "liquidity requirements would be expected to increase by between $1 and $10 billion for foreign banking organizations in the aggregate."[24] The Release also recognizes and confirms the fundamental benefit of applying more stringent liquidity requirements to FBOs:

> One potential benefit [of the LCR minimum requirements] is that the proposal would strengthen the safety and soundness of foreign banking organizations with respect to their U.S. operations.[25]

However, **the impact analysis is also striking for its omission of two important points**.

First, while it highlights the stability **benefits** of increasing liquidity requirements, if only modestly, it is silent regarding the stability **costs or risks** of decreasing capital requirements, as predicted in the impact analysis. Second, the Release neglects to mention a critical contextual fact: Because certain of the liquidity requirements are being proposed for the first time as to FBOs, their comparatively weak or de-regulatory tenor is to some degree camouflaged.[26]

One would expect any new regulatory standards, even modest ones, to have a beneficial impact—indeed, it is troubling that the Proposal would in effect have a neutral impact, strengthening some requirements while weakening others. But the mere fact that new regulatory standards result in some claimed **net** marginal improvement in safeguards does not mean that those standards are by any means adequate. The real question is whether the requirements in the Proposal are sufficient to safeguard against systemic instability arising from FBOs and their U.S. operations. The Release fails to address this larger and more important question about which there is considerable doubt.

COMMENTS

I. THE AGENCIES HAVE FAILED TO JUSTIFY THEIR PROPOSAL.

The Agencies wholly fail to justify the proposals to impose weak or weakened capital and liquidity requirements for some of the largest FBOs operating in the U.S.[27] Why are the Agencies taking this approach? The Release offers the cursory explanation that the Proposal "builds on the

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24 *Id.* at 24,327.

25 *Id.*

26 Contrast the Domestic Capital Proposal, which constituted a weakening of requirements relative to what had previously been adopted and which therefore was more patently a de-regulatory measure.

27 Because certain liquidity requirements did not previously apply to FBOs, the Proposal would technically increase liquidity requirements for those firms. However, the liquidity requirements the Agencies propose to apply would still be those "tailored" and weakened requirements the Agencies proposed in the Domestic Capital Proposal. Accordingly, while Better Markets supports the application of liquidity requirements to FBOs in general, Better Markets opposes applying the weakened liquidity requirements from the Domestic Capital Proposal.

agencies' existing practice of tailoring capital, liquidity, and other requirements based on the size, complexity, and overall risk profile of banking organizations… to align requirements with a banking organization's risk profile."[28] In the Domestic Capital Proposal, the Agencies offered just slightly more of their justification, explaining that the Agencies intended to "to evaluate the requirements of these measures to ensure that they meet their objectives in a manner that minimizes unintended consequences and aligns with banking organizations' risk profiles" in accordance with "the agencies' existing practice of tailoring capital and liquidity requirements based on size, complexity, and overall risk profile of banking organizations."[29]

But the Agencies do not actually conduct any analysis to support their claimed justifications, either in the current Proposal or in the Domestic Capital Proposal. For example, how do the proposed requirements align "with banking organizations' risk profiles?" The lack of an answer to this question is a problem throughout the Proposal, particularly in the discussion of the requirements applicable to Category III and Category IV firms. For example, why should Category III firms not be required to recognize most elements of AOCI in regulatory capital? While there is no answer offered in the Release, the Domestic Capital Proposal reveals that the primary motivation for the weakened standards is to reduce the burden on the industry of regulatory compliance.[30]

This is an inappropriate and insufficient justification. In establishing or revising standards, the Agencies must remember that the Dodd-Frank Act was passed to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', [and] to protect the American taxpayer by ending bailouts."[31] These must remain the guiding principles in any implementing regulations: The Agencies have an overarching duty to protect the stability of the financial system and avert another financial crisis. Dodd-Frank directs that, when tailoring enhanced prudential standards for firms or groups of firms, the Agencies must "[take] 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."[32] These factors do not include reducing the burden on industry.

From a policy perspective, exempting large domestic or foreign banking organizations, which are currently extraordinarily profitable, from requirements that might impose some costs on them is not a reason to increase risk to the financial system; from a legal perspective, doing so is

28 Release at 24,301.

29 Domestic Capital Proposal at 66,027.

30 *See, e.g., id.* at 66,035 (explaining that Category III firms would not be subject to advanced approaches capital requirements because the "models for applying these requirements are costly to build and maintain.").

31 Pub. L. No. 111-203 (2010).

32 12 U.S.C. § 5365. This requirement was not altered by S. 2155.

simply impermissible. The Agencies must provide an evidence-based, credible analysis demonstrating that imposing weak or weakened capital and liquidity standards will not materially increase risks to the U.S. financial system. Without this, the Agencies are simply proposing to allow banking organizations to avoid costs with only the barest of speculation that doing so will not end up threatening safety and soundness, financial stability, the need for costly taxpayer bailouts in the future.

This omission of meaningful analysis is especially difficult to justify in light of the fact that the current requirements have **already been tailored** with bank size and other risk factors taken into account. The regulations were implemented with the assumption that banks with less than $250 billion in assets are less risky than banks with more than $250 billion in assets.[33] It is not enough to simply point out that Category IV firms are less risky than Category III or Category II firms and that they therefore should be subject to less stringent requirements. This purely relativistic analysis simply points out the obvious; it does not explain how or why the posited new standard is in fact appropriate for an FBO with the Category IV characteristics. An actual analysis would require the Agencies to explain why the current requirements applicable to Category IV firms do not align with their risk profiles, and why eliminating most of these requirements would better align with their risk profiles.

Moreover, it is unlikely that the Agencies could adequately justify such weak or weakened requirements, for a variety of reasons. Among them is the fact that the existing standards have not been fully tested. As leading policy-makers have recently confirmed, post-crisis reforms under the Dodd-Frank Act relating to capital and liquidity should not be re-visited until they have been tested through an entire business cycle. And as Board Governor Brainard has explained:

> I support efforts to identify improvements that make regulations less burdensome. But it is vital to be prudent regarding any material changes to the core capital and liquidity framework, and not lose sight of the need to safeguard financial resilience through the cycle. Prudence would argue for waiting until we have tested how the new framework performs through a full cycle before we make judgments about its performance. At this point in the cycle, it is premature to revisit the calibration of core capital and liquidity requirements for the large banking institutions.[34]

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33 *See* BETTER MARKETS, FACT SHEET: EVERYTHING YOU NEED TO KNOW ABOUT THE $50 BILLION THRESHOLD (Nov. 28, 2016), https://bettermarkets.com/sites/default/files/50b%20Fact%20Sheet%20Updated%20Long%20Version%2011.28.16_0.pdf.

34 *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), available at https://www.federalreserve.gov/newsevents/speech/files/brainard20180419a.pdf.

Of course, we have not yet experienced a complete business cycle since the crisis, and it is therefore premature to be modifying the capital requirements as proposed in the Release.

Under all of these circumstances, a robust, factual, detailed, objective, independently confirmed, and data-driven empirical analysis supporting the changes in the Proposal is all the more important. Without such a basis, the Proposal lacks the most rudimentary foundation. That is not only bad policy but also arbitrary and capricious rulemaking.[35]

II. <u>THE PROPOSED FRAMEWORK WOULD POSE SERIOUS DANGERS TO CATEGORY III AND IV FIRMS IN TIMES OF FINANCIAL STRESS, ESPECIALLY IN LIGHT OF MANY OTHER PROPOSED DE-REGULATORY MEASURES, THREATENING SAFETY AND SOUNDNESS AND SYSTEMIC STABILITY.</u>

A. <u>The Proposal would weaken important requirements applicable to large banks.</u>

The Agencies propose to apply significantly weakened enhanced prudential standards for Category III and IV firms—those firms with $100 billion to $700 billion in assets that do not meet the asset-based or risk-based thresholds to be Category II firms. Specifically, as noted above, Category III firms would see their enhanced capital and liquidity requirements significantly reduced; Category IV firms would see those requirements practically eliminated. Needless to say, all of these institutions are very large, with a significant U.S. presence. As Governor Brainard noted in her dissent to the analogous Domestic Capital Rule, "[d]uring the crisis, there were two large domestic banking institutions in the $100 to $250 billion size range whose liquidity stress necessitated distress acquisitions."[36] She also points out there is little doubt "that the liquidity insolvency of a large banking institution with $250 to $700 billion in assets would pose substantial risk of loss to the deposit insurance fund or that the need to monetize a large amount of assets associated with a balance sheet of that size in a time of market stress would generate large spillovers[.]"[37]

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35 Under the Administrative Procedure Act, an agency rule is arbitrary and capricious if the agency "has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

36 Lael Brainard, Member of the Board of Governors of the Federal Reserve, Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations, https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20181031.htm.

37 *Id.*

Compounding these flaws, the Agencies are not proposing to apply the most stringent Category I standards to FBOs that would qualify as GSIBs, which are, by definition, the largest and most complex firms. The Agencies evidently recognize the enormous significance of this regulatory gap, as the Release seeks comment on the "advantages and disadvantages" of imposing more stringent standards on FBOs whose "risk profile" is comparable to the U.S. "GSIBs."[38]

One key consideration in setting appropriate capital requirements is that those requirements must be credible. Capital requirements must be set so that banks are considered adequately capitalized by regulatory standards and market standards, particularly in times of stress. If panicky markets perceive the capital requirements applicable to banks, or to a certain subset of banks, to be inadequate in light of economic conditions, even banks that are actually strong can be subject to vicious panic cycles that endanger their survival.[39] This is a potential risk of attempting to overly tailor capital and liquidity requirements, an approach that may create a perception that banks subject to less stringent capital requirements are less likely to withstand a period of stress and, thereby, actually precipitate a panic in times of stress.

For this reason, the Proposal could severely endanger Category III and Category IV firms. Among the largest and potentially riskiest banks operating in the country, Category III and Category IV firms will have significantly weaker capital and liquidity requirements than Category II banks, and thus may be perceived as being significantly less likely to survive a period of stress—because, after the weakening of the regulations as proposed, they will in fact be significantly less likely to survive a period of stress. Similarly, by omitting Category I standards and not subjecting foreign GSIBs to similarly stringent capital and liquidity requirements as domestic GSIBs, the Proposal would set these large and complex firms up for failure. In addition to strengthening requirements for Category III and IV firms, the Agencies can and should, notwithstanding that the GSIB surcharge rule, by its terms, only applies to U.S. banks, apply Category I standards to FBOs

[38] Release at 24,303.

[39] Indeed, as Better Markets has demonstrated, empirical evidence measuring the devastating impact of the crisis on just four banks (Washington Mutual, Wachovia, Citigroup, and Bank of America) shows that banks require significantly more equity than currently required to survive financial crises like that experienced in 2008. Indeed ""Losses alone can exceed [10%], and to reassure counterparties and account for rapid asset devaluations during a crisis, banks must actually **have equity equal to 20-25% of assets to protect against failure**. Other analyses conducted by academics, the Financial Stability Board, and the Board itself, which are based on data reflecting actual losses incurred during the financial crisis, all support the conclusion that a capital cushion of at least 20% is appropriate and necessary to protect banks against the ravages of a financial crisis. *See* Better Markets, Comment Letter on Proposal Regarding Enhanced Supplementary Leverage Ratio (June 25, 2018), https://bettermarkets.com/sites/default/files/Better%20Markets%20CL%20to%20OCC%20and%20Fed%20eSLR%206-25-18.pdf.

or IHCs that would otherwise meet the requirements for a GSIB. This would achieve the goal of aligning the requirements applicable to banking organizations with similar risk profiles.[40]

Capital requirements are already tailored; at the very least, before further weakening requirements for a significant and systemically important subset of the largest FBOs and IHCs, the Agencies must wait until there is a period of actual financial stress to determine whether the current approach to tailoring adequately protects the safety and soundness of banks and the financial system. Further widening the gulf between capital requirements for subsets of the largest FBOs is a dangerous approach, particularly now when the country is on the verge of completing the longest recovery in history and when economic and financial warning signs are flashing caution if not danger.

B. The Proposal will act in concert with other de-regulatory proposals, magnifying its dangerous impact.

The Agencies must consider the impact of the Proposal not only in isolation but also in light of the overall environment that currently prevails, which is decidedly de-regulatory. The Proposal is part of a long series of statutory and regulatory measures that will collectively and substantially weaken the framework of reforms adopted in the Dodd-Frank Act, thus increasing the likelihood, proximity, and severity of another devastating financial crisis. For example, the Board and FDIC have recently proposed changes that would significantly reduce the frequency and content of resolution planning for large banking organizations.[41]

The Board has also proposed changes to the thresholds for application of certain stress testing requirements for domestic banking organizations, using the same four categories of banks set forth in the Proposal, as well as an analogous proposal for FBOs.[42] In addition, the Board and the other prudential regulators have previously issued numerous de-regulatory proposals, including proposed changes to the current requirements governing bank capital, capital planning, and stress testing,[43] as well as a proposal to modify the enhanced supplementary leverage ratio—

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40 *See* Release at 24,301.

41 Resolution Plans Required, 84 Fed. Reg. 21,600 (May 14, 2019).

42 Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 83 Fed. Reg. 61,407 (Nov. 29, 2018); Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies, 84 Fed. Reg. 21,988 (May 15, 2019).

43 Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18,159 (Apr. 25, 2018). Better Markets also provided details on the dangerous deregulatory environment in its response to this proposal. *See* Letter from Dennis M. Kelleher, President and CEO, Better Markets (June 25, 2018), https://bettermarkets.com/sites/default/files/Better%20Markets%20CL%20to%20Fed%20-%20Cap%20buffer%20and%20stress%20testing%206-25-18.pdf.

a release deemed so dangerous and unnecessary that the FDIC refused to join its issuance.[44] And yet additional de-regulatory measures are forthcoming. As the Wall Street Journal has recently reported, "regulators say they are moving as fast as they can on more than 30" deregulatory changes, and they are being spurred in their efforts by the industry and lawmakers with an ambitious de-regulatory agenda.[45]

Because the Proposal would operate in conjunction with those other de-regulatory initiatives, it would pose a comparatively greater threat to the regulatory framework that helps protect and preserve the stability of our financial system. Just as the benefits of a single new regulation must be evaluated not only in isolation but also in terms of the larger benefits of the entire framework of which it is a part, the threats and risks of a single de-regulatory measure must be viewed in terms of the overall impact of a collection or series of related deregulatory measures. This deregulatory context intensifies the threat of any single proposal that seeks to unwind, rollback, or dilute the measures that were carefully put in place to prevent and mitigate any future financial crisis.

III. OTHER POLICY CONSIDERATIONS, INCLUDING THE SUCCESS OF THE CURRENT REGULATORY FRAMEWORK AND THE ROBUST STRENGTH OF THE CREDIT MARKETS, WEIGH HEAVILY IN FAVOR OF MAINTAINING OR ENHANCING PRUDENTIAL STANDARDS.

A. The current framework has substantially increased financial stability.

Any proposals to apply weakened capital and liquidity requirements to FBOs must be evaluated with the critical role of these regulatory requirements foremost in mind. As the Agencies explain:

> The capital rule strengthened the capital requirements applicable to banking organizations, including U.S. banking organization subsidiaries of foreign banking organizations, by improving both the quality and quantity of regulatory capital and increasing the risk-sensitivity of capital requirements.[46]

Similarly, the Board has recently explained that:

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44 Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies, 83 Fed. Reg. 17,316 (Apr. 19, 2018).

45 Andrew Ackerman & Gabriel T. Rubin, *Rewrite of Bank Rules Advances Slowly, Frustrating Republicans*, WALL ST. J. (June 10, 2019), https://www.wsj.com/articles/rewrite-of-bank-rules-bogs-down-11560159001.

46 Release at 24,299.

> Post-crisis financial regulations have resulted in substantial gains in resiliency for individual firms and for the financial system as a whole. Notable advances include higher amounts of better quality capital, a robust framework for assessing the capital adequacy of banking organizations under stressful financial and economic conditions, higher buffers of liquid assets and more stable funding profiles, and improvements in resolvability. Firms have also made significant improvements in independent risk identification and management, data infrastructure, and controls. **These improvements have helped to build a more resilient financial system that is better positioned to provide American consumers, businesses, and communities access to the credit they need even under challenging economic conditions.**[47]

Simply put, under the current regulatory regime, banks are profitable, safe, and serving the real economy. Given that, there is no legitimate reason for the Agencies to be considering applying weakened standards.

B. Banks require no relief from any regulatory requirements, as they continue to thrive and the credit markets remain robust.

For years, industry has been crying wolf about the supposed burdens of the Dodd-Frank Act and implementing regulations, continuing a long tradition of baselessly warning that regulation will prohibitively increase costs, stifle markets, and suppress economic growth.[48] This pattern has continued with virtually every rule that has been implemented under the Dodd-Frank Act, which has been met with warnings that the implementation of robust, risk-mitigating rules will be too burdensome for financial firms and ultimately detrimental for American investors and consumers. However, outside the world of industry's self-serving claims and those of its allies, the evidence is clear that responsible financial regulation mandated by the Dodd-Frank Act has **not** spelled doom for the financial industry and the consumers and businesses who depend on it.

As Governor Brainard explained in dissenting from the Proposal, currently "large banks have comfortably achieved the required buffers and are providing ample credit to the economy and enjoying **robust profitability**."[49] The American Banker, a trade publication, has also

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[47] Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies, 83 Fed. Reg. 61,408, 61,409 (Nov. 29, 2018) (emphasis added).

[48] Marcus Baram, *The Bankers Who Cried Wolf: Wall Street's History Of Hyperbole About Regulation*, HUFFPOST (June 21, 2011), https://www.huffingtonpost.com/2011/06/21/wall-street-history-hyperbole-regulation_n_881775.html.

[49] Lael Brainard, Member of the Board of Governors of the Federal Reserve, Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations (Apr. 8, 2019) (emphasis added),

reviewed the evidence and concluded that, while some assert the Dodd-Frank Act has increased the cost of consumer lending and cut off access to credit,

> the available data indicates otherwise. Consumer credit has roared back in the six years since Dodd-Frank, with a 46% jump in outstanding consumer credit to $3.8 trillion. . . . [T]he fact remains that mortgage, auto and credit card lending have all gone up since 2010. [Mortgage] lending standards are as loose as they've been since the downturn. . . . Auto lending has been on a tear since the financial crisis . . . . Credit card lending has returned to pre-crisis levels with total lending hitting an all-time high of $996 billion. . . .[50]

Additional data confirm that these trends have continued.[51] In short, there is widespread agreement that not only is the current robust regulatory regime working exactly as intended for the American public by leading to a safer, more resilient system that is able to serve the real economy, **but it has done so while allowing large banks to turn huge if not historic profits.**

Despite the clear evidence to the contrary, however, in response to the Proposal, affected industry participants will surely implore the Agencies to embrace those proposals that would weaken regulations, and will likely suggest even more de-regulatory changes. The Agencies should reject these entreaties. The post-Great Depression financial reforms, adopted amidst industry warnings about potentially disastrous consequences, instead accompanied a thriving financial system for decades, much as the current robust regulatory regime has accompanied a sharp upturn in lending activity and the performance of financial companies. Meanwhile, the de-regulatory movement that began in the 1980's led to a catastrophic and costly crisis less than a decade after its completion.

Between robust regulation and weakened regulation, it is clear that the former leads to financial stability and broad economic prosperity while the latter leads to economic devastation,

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https://www.federalreserve.gov/newsevents/pressreleases/3B1F641BEB4A485B994EBC38165F0F3B.htm; *see also* Renae Merle, *Fed Proposes Easing Post-Crisis Rules for Big Banks*, WASH. POST (Apr. 8, 2019) (noting criticism of Proposal based on the fact that "the banking industry is already reporting record profits without a rollback of the rules."), https://www.washingtonpost.com/business/2019/04/08/fed-proposes-easing-post-crisis-rules-big-banks/?utm_term=.1ce17bd1861d..

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

51 Rachel Witkowski, *Bank Earnings More than Double Thanks to Tax Cut*, AMERICAN BANKER (Feb. 21, 2019) (noting that "[b]ank profits remained near historic highs," and that "loan growth continues to be a positive story for banks" with a "4.4% rise in loan balances" amidst improving credit quality and declining charge-offs.), https://www.americanbanker.com/news/bank-earnings-more-than-double-thanks-to-tax-cut.

not only for Americans but also for the very banks that seek regulatory relief. In crafting final rules, the Agencies should trust the facts and discount the industry's complaints and predictions. The wolf that forever lurks beyond the door is not prudential regulation; it is the high risk behavior of the largest Wall Street banks seeking ever higher profits, even if they are ultimately at the expense of the American people.

IV. NO INDUSTRY EVIL REQUIRED; JUST THE SIREN SONG OF COMPETITIVE PRESSURES

Importantly, the sort of excessive risk-taking that can lead to financial crisis, and which capital and liquidity requirements are intended to address, does not require evil actors or motives in the industry. It is the nature of markets and financial firms, individually and collectively, to take on risk in pursuit of higher short-term profits. This impulse is especially powerful where the cost of failure is likely to be externalized if, for example, there is an expectation that failing firms will be bailed out by taxpayer. That is the unsettling, but undeniable, truth behind former Citigroup Chief Executive Officer Chuck Prince's infamous and much misunderstood quote in July 2007:

> When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing.[52]

Translation: When a financial institution and its peer group are making lots of money doing roughly the same thing (**meaning**, the market "music" is playing), they have to keep doing the same thing ("dancing") or their revenues, profits, bonuses, and stock will go down **relative** to their peer group.

While doing otherwise may be tolerated by a board and stockholders for a short time, it will not last long as revenues, profits, and share prices drop relative to their peers. That is why Mr. Prince was right: "as long as the music is playing, you've got to get up and dance" or you will be replaced with someone who will.

That is the (oversimplified) history of Morgan Stanley in the 2000s. John Mack was CEO until ousted in 2001, when Paul Purcell was appointed CEO. Morgan Stanley then pursued a business diversification strategy, seeking relatively stable revenues and profits from a broad mix of businesses that avoided the high-risk, high leverage, and high return trading gambling that was taking off at its rivals. As its revenues, profits, bonuses, and share price lagged its rivals, the board ousted Mr. Purcell and in June 2005, brought back Mr. Mack as CEO, clearly with the mandate to catch up with its rivals by doing what they were doing.

As the Siren Song of deregulatory music played, Mr. Mack got Morgan Stanley up and dancing to the tune of big proprietary trading, structured products, and subprime mortgage

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52 *See* Michiyo Nakamoto and David Wighton, *Citigroup chief stays bullish on buy-outs*, FIN. TIMES (July 9, 2007), https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac.

activities. However, just a little over two years later in the fall of 2007, Morgan Stanley was forced to begin recognizing gigantic proprietary trading losses at the same time it was forced to take substantial subprime-related write downs, which eventually were cumulatively so crippling that Morgan Stanley was on the verge of failure in the days following Lehman's bankruptcy and required a bailout by the Board to survive.[53]

To his credit, Mr. Mack recognized what had happened and in 2009, embraced financial reform, regulation, and regulators. In fact, he went so far as to say

> [**w**]**e cannot control ourselves**. You [lawmakers and regulators] have to step in and control the Street. Regulators? We just love them.[54]

This cautionary tale and the broader history before, during, and after the 2008 crash demonstrate why banking regulators and supervisors as well as oversight, regulation, and enforcement generally are so critically important. Put differently, they have to step in and slow the tune if not change the song or stop the "music" altogether, regardless of how much "dancing" the private sector is doing or wants to do.

Without regulators taking such independent and, at times, unpopular actions, the public interest is subordinated and exposed to the erratic and volatile dynamics of the marketplace, with devastating crashes the inevitable result.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

[redacted]

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53 An internal Board email from September 20, 2008, shows that Morgan Stanley indicated they could not open the following Monday, and that Goldman Sachs, hearing this news, admitted that it was "toast" unless it could convert to a bank holding company. Better Markets Press Release, Email Shows Goldman Admitted It Was "Toast" (Sept. 21, 2018), https://bettermarkets.com/newsroom/email-shows-goldman-admitted-it-was-toast.

54 *Regulators? We Just Love 'em, says John Mack*, THE EVENING STANDARD (Nov. 19, 2009), https://www.standard.co.uk/business/regulators-we-just-love-em-says-john-mack-6744822.html (quoting John Mack) ("We cannot control ourselves. You have to step in and control the Street. Regulators? We just love them."); *see also* Dealbook, *Morgan Stanley's Mack: 'We Cannot Control Ourselves,'* N.Y. TIMES (Nov. 19, 2009), (same),.https://dealbook.nytimes.com/2009/11/19/morgan-stanleys-mack-we-cannot-control-ourselves.

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Legal Director & Securities Specialist

Jason Grimes
Senior Counsel

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
shall@bettermarkets.com
jgrimes@bettermarkets.com
www.bettermarkets.com