Federal Reserve Bank of Minneapolis

90 Hennepin Avenue
Minneapolis, Minnesota 55401

612-204-5176 Phone
612-204-5430 Fax
1-800-553-9656

DATE: November 19, 2018

TO: Board of Governors of the Federal Reserve System

FROM: Federal Reserve Bank of Minneapolis

RE: Comment on RIN 7100-AF20, Prudential Standards for Large Bank Holding Companies and Loan Holding Companies

We write respectfully to oppose the proposal for modifying enhanced prudential standards for large banking organizations. In short, the proposed rule-making would weaken the resiliency of large banks at a time when it should be strengthened. We explain our views in detail below.

Throughout recorded financial history, there are numerous, repeated examples of financial crises. They are a remarkably consistent occurrence in economies around the world. They happen again and again because future generations forget the past. People forget the mistakes that led to prior crises and believe: "It can't happen again. Things are different now." In the wake of the 2008 financial crisis and Great Recession, our key challenge is to find a way to institutionalize what we have learned so that future generations don't repeat our mistakes.

This proposal to weaken regulations on banks is particularly alarming. Primarily, it extends a movement to roll back regulations that were put in place after the Great Recession. History suggests that while not desirable, this is to be expected. What is most alarming is that this is not a future generation forgetting mistakes of their parents or grandparents. It is the same generation that made the terrible mistakes in the first place that is already forgetting and now is following the same path again. If our own memories are so short that we have already forgotten the lessons from just a few years ago, what hope do future generations have to avoid making these same costly mistakes?

In this specific case, we are concerned about the unnecessary relaxation of liquidity-related regulations for large banks. Governor Lael Brainard highlights the issues that concern us in her statement, and we agree with her analysis and share her view that the proposed changes should not move forward.

More generally, we agree with Governor Brainard's overall concern that relaxing recently enacted regulations for large banks is a threat to financial stability:

> Unfortunately, the proposals under consideration go beyond the provisions of S. 2155 by relaxing regulatory requirements for domestic banking institutions that have assets in the $250 to $700 billion range and weaken the buffers that are core to the resilience of our system. This raises the risk that American taxpayers again will be on the hook. The proposed reduction in core resiliency comes at a time when large banks have

> comfortably achieved the required buffers and are providing ample credit to the economy and enjoying robust profitability. In short, I see little benefit to the institutions or the system from the proposed reduction in core resilience that could justify the increased risk to financial stability and the taxpayer.[1]

In addition, we are deeply troubled by ongoing efforts of the Board of Governors to change rules in a way that reduces the equity funding of the largest banks. In particular, proposed tailoring of the eSLR and alterations to the existing stress testing that the Board is considering will weaken taxpayer protection from bailouts. Recent evidence – some of which economists from the Board of Governors itself has produced – finds that equity funding requirements for the largest banks are too low, not too high. Even measures of the credit cycle and financial stability risk indicate that it is likely prudent for banks to continue to build capital. The Board of Governors has the power to maintain the current regulatory regime for large banks and strengthen it where needed. Now is not the time to abdicate that power and put taxpayers at greater risk of future bailouts.

In sum, there are many benefits to maintaining or even expanding the current regulatory regimes for the largest banks. What about the alleged costs of these rules justifies regulatory rollback? Those costs seem much smaller than the benefits. Large banks frequently argue that their capital requirements are too high and are holding back lending, thus restraining economic growth. These same large banks are also buying back large amounts of stock year after year, thus rendering their argument absurd. In addition, U.S. small banks tend to have higher levels of equity funding than do large banks. That makes no sense – as small banks do not pose a systemic risk to the U.S. economy, while 2008 showed clearly that large banks do. Large banks should have enough skin in the game, through equity funding, to ensure that their shareholders bear the risk of their investments, rather than taxpayers.

[1] https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20181031.htm