Subcommittee Examines Dodd-Frank Process for Declaring Banks “Too Big to Fail”

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The House Financial Services Financial Institutions and Consumer Credit Subcommittee held a hearing Wednesday to examine how and why bank holding companies are designated as “systemically important financial institutions” (SIFIs) under the Dodd-Frank Act.

A bank holding company is a company that owns or controls one of more U.S. banks or has a controlling interest in one or more banks. Dodd-Frank provides for the designation of both non-bank financial institutions and bank holding companies as “systemically important” – a practice that signals to market participants that these are “too big to fail.”

Subcommittee Chairman Randy Neugebauer (R-TX) said in his opening statement, "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."

Key Takeaways from the Hearing:

- 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. This has created a de facto designation of these institutions as SIFIs.

- By designating certain firms as SIFIs, Dodd-Frank codifies “too big to fail” and continues the taxpayer-funded Wall Street bailouts by providing assurance of a federal backstop in the event of a financial crisis.

- As former Dallas Federal Reserve Bank President Richard Fisher said, “as soon as a financial institution is designated systemically important…it is viewed by the market as being the first to be saved by the first responders in a financial crisis. SIFIs occupy a privileged position in the financial system.”

- Many commentators – including members of Congress and banking regulators – have criticized the arbitrary manner in which the Dodd-Frank Act designates bank holding companies as systemically important.

Topline Quotes from Witnesses:

“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.”

- James Barth, Professor of Finance, Auburn University

“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.”

- Harris Simmons, Chairman & CEO, Zions Bancorporation

“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.”

- Satish Kini, Partner, Debevoise & Plimpton LLP

“Many argue that the TBTF [Too Big to Fail] 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.”

- Paul Kupiec, Resident Scholar, American Enterprise Institute