February 26. 2018

Senator Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Brown,

Like most Americans, I watched in horror ten years ago as our financial system came under severe strain and then finally collapsed, leading to an astonishing decimation of American jobs, livelihoods, homes and accumulated wealth. At the time, I was the Commissioner of Financial Regulation for the State of Maryland; subsequently, I was a Federal Reserve Governor and the Deputy Secretary of the United States Treasury.   During the years of the financial crisis and our early attempts to recover from the trillions of dollars lost in savings, home values and investments, the economy stagnated and its resilience was impaired; people had no money to spend, and businesses, facing low demand for their goods and services, had no capacity to hire new workers and in many cases were forced to close. The economy was in a brutal downward spiral. The legislative and regulatory efforts required to restore economic resilience, stabilize homeownership and chip away at the massive resulting unemployment were difficult and momentous. I write to you to tell you that certain provisions of S. 2155 will turn the clock back and return us to the days when our financial system engendered widespread mistrust, structural weakness and systemic crisis.

At the outset, let me express my long-stated view that community banks need meaningful regulatory relief. Community banks, at their core, represent what is best in our financial system: a source of enduring strength, sound financial intermediation, and local responsiveness in the face of economic cycles that can wreak havoc on communities and neighborhoods.   Federal financial regulators have not done an adequate job of tailoring

regulatory requirements to the specific risk profile and compliance capacity of many community banks. A lot of the rules applying to the mega-banks have little or no relevance to the community banks, which also lack the staff and expertise to deal with irrelevant and time-consuming regulations.

Regulatory relief is in order, and I understand the desire to intervene with legislative directives to regulators. But S. 2155 is the wrong directive to achieve this necessary regulatory relief for community banks. It does little or nothing to strengthen community banks but uses their situation to demolish important regulatory structures and processes put in place to prevent a repeat of the last systemic crisis. If particular provisions of this bill were merely a neutral intervention in markets, there would be minimal harm; instead, they are a distorted and lopsided intervention that will undermine the resiliency of the financial sector, raising the probability that the financial sector will not be able to withstand the stress of another exogenous or endogenous shock, and the probability that a banking crisis will not remain contained.

For example, the bill removes necessary guardrails that were installed to reduce the chances of foreign megabanks drawing on U.S. bailout funds when their home country regulators fail to assure that they are conducting their US business safely and soundly. Without these guardrails – consisting primarily of an intermediate holding company structure and the application of enhanced prudential standards – the US economy becomes susceptible to weaknesses transmitted via the financial sector to the real economy. Abolishing these regulatory safeguards exacerbates the risk that foreign banks will hoard the capital that would be necessary in the event of a crisis to keep their US operations sufficiently separated from US taxpayer resources. It is beyond me to see how this potential destabilization of our bailout funds assists community banks, whose real needs are essentially being used as an excuse to weaken the integrity of our overall financial system.

Another set of ill-advised provisions in S. 2155 would strip away guardrails we have imposed on banks between $50 and $250 billion in size, 25 of the largest 38 banks in the country. Banks in that size range, such as Countrywide, National City and GMAC , played a major role in transmitting and magnifying risk in the financial crisis, spreading the crisis beyond Wall Street into businesses and households in towns and communities across the country. Banks in that

size range received $47 billion in government bailout money precisely because they had no meaningful and effective regulatory direction of their behavior and performance.

Bizarrely, provisions in S. 2155 dismantle the guardrails erected for these banks, forfeiting the lessons learned in the last crisis and re-exposing our whole economy to strategic vulnerabilities in these financial institutions. Again, I don't see how this effort to undercut regulation for large bank actors has anything to do with providing relief for community banks. This proposal is just injecting a lot more danger into the financial system.

In answer, advocates of these provisions in S. 2155 point to the proposed grant to the Federal Reserve of power to "reach back" and apply enhanced prudential standards to bank holding companies that are smaller in size than $250 billion in total consolidated assets. This is legislative fool's gold. My time serving as a Federal Reserve Governor taught me that the Federal Reserve has never been inclined to act quickly and proactively when bank conditions begin to deteriorate but almost always waits until a crisis has peaked and the costs of remedy are already extremely high. In any event, the terms of S. 2155 essentially prevent the Federal Reserve from being able to do any meaningful "reach back."   Under S. 2155, in order to "reach back," the Federal Reserve would need to make findings that the application of enhanced prudential standards would "prevent or mitigate risks to the financial stability of the United States" or "promote the safety and soundness of the bank holding company or bank holding companies" subject to consideration of multiple factors including "risk-related facts" that the Federal Reserve "deems appropriate." These statutory hurdles are unlikely to be surmounted in time to keep a potential crisis from catching fire and burning up critical parts of the financial system.

Needless to say, the purpose of legislative intervention in the financial system should be to correct a market defect that weakens the resilience of the financial system.   This bill does nothing to correct any such market defect.   Instead, if it were to enact these provisions of S. 2155, Congress would destabilize and erode the pillars of the financial system, exposing businesses and households to greater levels of insecurity and potential harm not unlike what we recently experienced. The resilience of our financial sector will be weakened, not enhanced. When this occurs, those who took part in dismantling the reasonable and well-designed guardrails that permit markets to thrive and people to trust them, will be responsible for the panic and contagion that result.

Please note that the views expressed in this letter are my own views, and may or may not represent any view of any institution that I may be affiliated with. Thank you for your consideration.

Sincerely,

Sarah Bloom Raskin