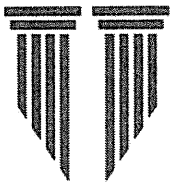

THE VOLCKER ALLIANCE
Working for Effective Government

February 21, 2018

Dear Senator Brown,

I appreciate your letter seeking my views on the *Economic Growth, Regulatory Relief and Consumer Protection Act*, S. 2155. I am pleased that the Senate Banking Committee has forged ahead with meaningful, bipartisan financial reform to ease the unnecessary regulatory strain on small banks, helping them flourish as an engine of economic prosperity. I appreciate your leadership and dedication, and that of Senator Crapo, to this bill over the last two years and congratulate the bipartisan coalition of senators on the Committee who have worked diligently to advance this legislation.

Your letter sought my views on three sections of the bill. Specifically: (1) Section 401, which would exempt some important banks from stringent prudential standards, such as those for capital, leverage, stress testing, and resolution planning; (2) Section 402, which would relax leverage limitations on custodial banks; and (3) Section 203, which would exempt small banks from the Volcker Rule ban on proprietary trading. I offer the following observations and possible alternatives for your consideration.

First, section 401 would raise from $50 billion to $250 billion the asset threshold at which banks begin to face increasingly tougher prudential standards. Eight years following the passage of Dodd-Frank, it is appropriate to reexamine whether the $50 billion asset threshold is set too low. Indeed, there may be an opportunity to raise it without endangering financial stability. However, an increase to $250 billion would go too far. It would have the effect of substantially reducing the regulation of 25 of the 38 largest banks to which these standards now apply, notably including the operating subsidiaries of several large foreign banks.

Clearly the distress or failure of some of these banks could trigger reactions spreading broadly to the financial system. To take specific examples, Countrywide, National City, and GMAC, standing well below the $250 billion mark, in fact, required billions of dollars in official capital assistance and debt guarantees either for themselves or their acquiring institutions. Failure of the large U.S. operating subsidiaries of foreign banks could pose similar risk. I urge consideration of raising the threshold to, say, $100 billion but building in additional flexibility for regulators to implement the standards below that.

Second, section 402 is a highly technical provision that relates to so-called custodial banks, institutions that specialize in safeguarding assets of their clients, including mutual funds, pension funds, asset managers, and other institutions. Given their size and importance to the financial system, some such banks, of which the sizable BNY Mellon and State Street stand out, are required to maintain a minimum supplementary leverage ratio ("SLR"), a measure of equity capital to total exposure.

Section 402 would mandate bank regulators to amend their regulations to allow "custodial banks" to exclude deposits they hold at the Federal Reserve and certain other central banks when calculating their SLR. While there may be reasons to adjust the SLR calculation for custodial banks, including during a crisis to facilitate the banks' ability to serve as a safe-haven for deposits, regulators already have broad authority to make those adjustments. They also are best positioned to decide how and when to exercise that discretion.

Section 402 does so preemptively, reducing leverage capital requirements for at least two of the most systemically important custodial banks by as much as 30 percent at a time when they should be building their capital cushion. It also would put Congress under pressure to expand the exclusion. Claims will be sure to arise that other banks in competition with the big custodial banks should have similar capital relief: that temptation should be resisted.

Finally, section 203 would exempt from the Volcker Rule banks with assets of less than $10 billion and whose trading assets and liabilities are no more than five percent of total assets. I'm in strong agreement with the aim of reducing unnecessary regulatory burdens on traditional community banks, not just from the Volcker Rule, but also more broadly. Community banks play a vital role in serving the needs of small businesses and do not require the full panoply of regulation or frequent full-scale examination.

An alternative to section 203 would be to simply relieve small banks from demonstrating compliance with the rule, while, at the same time tasking the bank regulators in their normal supervisory roles to detect persistent violations and demand remediation. This would have the advantage of preventing a small bank or a group of small banks protected by the Federal bank "safety net" from benefitting from risky proprietary trading activity. I know from my long experience in banking and savings and loan regulation that plausibly small loopholes can be "gamed" and exploited with unfortunate consequences.

I thank you for the opportunity to comment on this important piece of legislation and look forward to its swift passage.

Sincerely,

Paul A. Volcker

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