September 30, 2020

VIA ELECTRONIC SUBMISSION

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] and the American Bankers Association[2] ("ABA" and, together with the Forum, "the Associations") appreciate the opportunity to submit this letter to the Financial Stability Board (the "FSB") on its evaluation of the effects of too-big-to-fail ("TBTF") reforms.[3] The FSB's consultation report presents the preliminary results of its evaluation of the effects of TBTF reforms adopted since the global financial crisis and examines the extent to which the reforms are reducing systemic and moral hazard risks associated with systemically important banks ("SIBs"). This consultation report is relevant to our member institutions, and in particular the U.S. global systemically important bank holding companies ("U.S. GSIBs"), which are key stakeholders with information and experience on the efficacy and effects of TBTF reforms in the United States. Below, we comment on the preliminary results of the consultation report, describe

1 The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system.

2 The American Bankers Association is the voice of the nation's $21.1 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $17 trillion in deposits and extend nearly $11 trillion in loans.

3 FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* (June 28, 2020), https://www.fsb.org/wp-content/uploads/P280620-1.pdf.

how post-crisis regulatory reforms and actions taken by our member institutions have addressed TBTF and highlight areas where reforms could be recalibrated.

Executive Summary

As stated in our previous comment letters on the FSB's 2019 evaluation,[4] the Associations believe that the TBTF reforms implemented in the United States since the global financial crisis have achieved the intended objectives of substantially reducing systemic and moral hazard risk. The Associations therefore agree with the FSB's consultation report in recognizing the significant progress made in achieving reform goals, specifically the substantial increases of total loss-absorbing capacity ("TLAC"), the implementation of robust crisis management plans through recovery and resolution planning, and the development of legal, financial and operational strategies to support orderly resolution if required.[5]

Although obliquely referenced in the consultation report, the Associations believe it is important that the report recognize in greater granularity the differences among jurisdictions in terms of the above achievements. In particular, the United States has achieved the goals set forth by the FSB in terms of resolution planning progress and the implementation of other TBTF reforms. Reforms in the United States have been broader and more substantial than elsewhere, and recent studies show that the market no longer perceives U.S. GSIBs as TBTF. Moreover, while we recognize that the FSB consultation report is limited in scope, we think it is critical that the FSB evaluate the full range of reforms, including derivatives reform, as it has in previous reports,[6] rather than limiting the scope of the evaluation to a subset of reforms.

At the same time, after a period of such significant change, and given that TBTF has been addressed successfully in the United States, it is important to step back and review the framework, how various rules interact with each other, and make adjustments as needed to

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[4] Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 2 (June 28, 2019), https://www.fsforum.com/wp-content/uploads/2019/07/forum_feedback_evaluation_of_tbtf-_reforms.pdf; American Bankers Association, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 2 (June 28, 2019), https://www.aba.com/-/media/documents/comment-letter/fsb-too-big-to-fail-062819.pdf?rev=11ffd77d5793491499b6feda84355e9b.

[5] *See* FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 1 ("The findings of the report suggest that TBTF reforms have contributed to the resilience of the banking sector and its ability to absorb, rather than amplify, shocks. Major banks are much better capitalized, less leveraged and more liquid than they were before the global financial crisis. Systemically important banks in advanced economies have built up significant loss absorbing and recapitalization capacity by issuing instruments that can bear losses in the event of resolution").

[6] *See, e.g.*, FSB, *Progress in Implementation of G20 Financial Regulatory Reforms* at 1-3 (June 25, 2019), https://www.fsb.org/wp-content/uploads/P250619-2.pdf.

avoid unnecessary mis-calibration and unintended consequences. Particularly, in the United States, we believe there is an opportunity to address adverse effects on financial markets without undermining the core progress made in addressing the problem of TBTF.

Our key observations and recommendations are as follows:

- **TBTF reforms and structural changes at the U.S. GSIBs have been successful in addressing the systemic and moral hazard risks associated with U.S. GSIBs, and the final FSB report should more directly recognize this success and the differences among jurisdictions based on the full array of TBTF reforms**. Consistent with the views of many prominent policymakers and economists, available evidence continues to show that both the probability and impact of a U.S. GSIB's failure have been reduced significantly. With respect to probability, improvements in the quantity and quality of bank capital and liquidity have significantly increased the ability of U.S. GSIBs to withstand stress. In the United States, a uniquely stringent stress testing program adds an additional buffer on top of reforms that, in many cases, already exceed internationally-agreed standards. Improvements to funding stability also have increased the resiliency of our member institutions. As a result, our member institutions have been a source of strength to the U.S. economy throughout the COVID-19 pandemic.

  Regarding the impact of failure, as the consultation report recognizes in Annex D, our member institutions are at the forefront, globally, of resolution planning. Through the United States' rigorous resolution planning process, they have demonstrated the ability to be resolved in an orderly fashion under the Bankruptcy Code through a single-point-of-entry ("SPOE") strategy without taxpayer or government support and without creating contagion.

  The final FSB report should recognize these achievements, including with respect to capital and liquidity, in evaluating the success of various jurisdictions in implementing TBTF reforms. The FSB should also account for other post-crisis reforms that have reduced substantially systemic risk and improved the functioning and stability of U.S. and global financial markets. Such reforms include, for example, derivative market reforms (including central clearing, margin, and trade reporting requirements).

- **Regulators should address adverse effects without undermining core progress in addressing TBTF**. As noted, TBTF reforms have achieved their objectives. However, the resulting framework has certain negative unintended consequences that can be mitigated without undermining the original goals. For example, one unintended consequence has been the movement of financial intermediation outside of the regulatory perimeter. Therefore, we agree with the FSB that it should continue to monitor more closely the movement of activities outside the banking sector, and more generally should consider ways in which the adverse effects of TBTF reforms can be mitigated.

- **The FSB should reconsider the framework it uses to evaluate the costs and benefits of TBTF reforms**. The Associations believe that the current framework the FSB uses to estimate the social and economic costs and benefits of TBTF reforms could be improved. First, the consultation report does not sufficiently consider costs to borrowers and market participants that have been realized and measured over the past several years as these policies have been put in place. The final FSB report should consider these private costs as well in conducting its cost-benefit analysis.

  Second, the FSB relies on an estimation of costs and benefits using the framework developed by the Basel Committee on Banking Supervision ("Basel Committee") in 2010. This framework, however, is out-of-date and should be updated to account for the full array of TBTF reforms. In particular, the Basel Committee framework is not specific to—and in some cases not related to—the TBTF reforms considered in the draft report.

  Finally, the Associations believe the costs of reduced market liquidity should be assessed in the final FSB report, as a deterioration in market liquidity has important implications for the welfare of investors, corporations, pension funds, and other entities that use financial markets to manage risks and provide for the future. Moreover, recent market liquidity experience that has accompanied the COVID-19 pandemic provides an important data point that should be considered more directly in assessing how and whether certain TBTF reforms have limited market liquidity in some markets.

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I. TBTF reforms and structural changes at the U.S. GSIBs have been successful in addressing the systemic and moral hazard risks associated with U.S. GSIBs, and the final FSB report should more directly recognize this success and the differences among jurisdictions based on the full array of TBTF reforms.

TBTF reforms in the United States have achieved the intended objectives of substantially reducing systemic and moral hazard risks, and have addressed the perception of TBTF revealed by the global financial crisis over a decade ago. In fact, U.S. regulators and the Associations' member institutions have led the way in adopting post-crisis financial reforms and have served as a model for the rest of the world. Numerous policymakers across the political spectrum have reached the same conclusion.[7]

Accordingly, we believe the final FSB report should recognize in greater granularity the differences among jurisdictions in terms of achievements and acknowledge the unique success of reforms implemented in the United States, which have been broader and more substantial than elsewhere. In addition, we think it is critical that the FSB evaluate the full range of TBTF reforms, as it has in previous reports,[8] which would further highlight the success of the U.S. model.

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7 Randal K. Quarles, FSB, Ideas of Order: Charting a Course for the FSB (Feb. 10, 2019) ("The body of post-crisis regulation…was a tour de force of orchestration, and it has unquestionably made the financial system safer and more resilient."); Lael Brainard, Governor, FRB, Assessing Financial Stability Over the Cycle (Dec. 7, 2018) ("The regulated financial sector is also more resilient, owing to far-reaching reforms… Large banks have increased both the size and quality of their capital buffers… Financial reform has reduced funding risks associated with banks and money market funds. Large banks subject to liquidity regulation rely less on unstable short-term wholesale funding and have thicker liquidity buffers."); Janet L. Yellen, former Chair, FRB, Keynote Address at the Griswold Center for Economic Policy Studies Fall Symposium: The Tenth Anniversary of the Financial Crisis (Nov. 19, 2018) ("My assessment is that the reforms put in place significantly boosted the resilience of the U.S. financial system. The risk of runs owing to maturity transformation declined. Efforts to enhance the resolvability of systemic firms promoted market discipline and reduced the problem of too big to fail."); Interview by Ben White with Daniel Tarullo, former Governor, FRB, *Did We End Too Big to Fail? Are We Safer Now?*, Politico Money (Sept. 26, 2018) ("We are certainly a lot safer now than we were ten or twelve years ago. The largest institutions are substantially better capitalized, they have much more sustainable funding patterns"); Stefan Ingves, Chairman, Basel Committee on Banking Supervision, Keynote Speech at Basel III: Are We Done Now? (Jan. 29, 2018) ("The title of this conference is 'Basel III: Are We Done Now?'. Let me answer this question at the outset: yes, we are done… These reforms have demonstrably helped to strengthen the global banking system.").

8 *See, e.g.*, FSB, *Progress in Implementation of G20 Financial Regulatory Reforms* at 1-3 (June 2019), https://www.fsb.org/wp-content/uploads/P250619-2.pdf.

a. *Financial reforms in the United States have reduced substantially the probability that a U.S. GSIB would fail.*

Post-crisis financial reforms in the United States have subjected U.S. GSIBs to enhanced prudential standards, including heightened capital requirements, liquidity requirements, and capital and liquidity stress testing. As a result of these reforms and other actions taken by the official sector and our members to improve resiliency, our member institutions today are more resilient than ever. Specifically, improvements in capital, liquidity, and funding stability have significantly increased the ability of our member institutions to withstand economic downturns and to continue to be a source of credit through the cycle.

Today, the current unprecedented and still-evolving COVID-19 pandemic represents "the biggest test of the post-reform financial system to date, as it has pushed the global economy into a recession of uncertain magnitude and duration."[9] Although the effects of the pandemic continue to put the financial system under strain, numerous policymakers have noted the strength of the U.S. GSIBs, and the banking industry as a whole, during the pandemic.[10]

While the report promises to evaluate the effects of TBTF reforms, it falls short of studying the full range of policies over the past decade that have reduced substantially the probability that a U.S. GSIB would fail. The report instead states that Basel III capital and liquidity requirements (other than capital surcharges for GSIBs) are not within the scope of its evaluation.[11] However, perhaps the clearest measurement of resiliency in the banking system is bank capital. By providing a constant buffer to absorb losses in the face of financial shocks, capital serves as a concrete and continuous guardrail against failure. In fact, the U.S. stress testing regime is broadly recognized as one of the most

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[9] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 1.

[10] Jerome Powell, Chair, FRB, Testimony Before the House Comm. on Financial Services (June 30, 2020) ("Unlike the 2008 financial crisis, banks entered this period with substantial capital and liquidity buffers and improved risk-management and operational resiliency. As a result, they have been well positioned to cushion the financial shocks we are seeing. In contrast to the 2008 crisis when banks pulled back from lending and amplified the economic shock, in this crisis they have greatly expanded loans to customers and have helped support the economy"); Randal K. Quarles, FRB, *Global in Life and Orderly in Death: Post-Crisis Reforms and the Too-Big-to-Fail Question* (Jul. 7, 2020) ("Banks entered the current crisis in a much stronger position than they did the global financial crisis. They are much better capitalized and more liquid than back in 2008. This is a direct outcome of the G20 regulatory reforms adopted in the aftermath of that crisis and measures taken by the banking industry, which have improved the resilience of the core of the financial system. This has allowed the banking system to absorb rather than amplify the current macroeconomic shock. It has also enabled banks to play a central role in measures to support the flow of credit to the economy. A number of stress tests carried out recently in FSB jurisdictions have confirmed that banks are able to continue lending even in the face of this extreme shock.").

[11] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 19.

extensive and stringent regimes in the world, which further shows how progress in the United States generally exceeds that of other jurisdictions.

Meanwhile, U.S. banking organizations, especially U.S. GSIBs, are subject to a number of risk-based and leverage capital requirements that were developed after the financial crisis. While these requirements largely reflect the U.S. implementation of Basel III,[12] in certain cases the standards that have been implemented by U.S. regulators are super equivalent to the standards developed by the Basel Committee.[13] For example, U.S. GSIBs are subject to more stringent leverage ratios, TLAC requirements, and liquidity coverage ratio.[14] Similarly, the U.S. GSIB surcharge includes a super equivalent "Method 2" construct.[15]

In addition to having a broadened set of regulations to promote resiliency, the U.S. GSIBs have also made structural changes to support the distribution of resources across the group in a manner that promotes resiliency and resolvability. For example, as discussed further below, the U.S. GSIBs have developed secured support agreements that contractually require their parent holding companies to provide support to material operating subsidiaries in resolution.

These facts underscore the importance of considering the range of policies designed to deal with TBTF at the national level and illustrate why a summary review of international standards is not sufficient. Accordingly, we strongly recommend that the FSB consider these reforms, which further demonstrate that U.S. GSIBs have significantly improved their resiliency.

b. ***U.S. statutory and regulatory reforms have reduced substantially the systemic impact of a U.S. GSIB failure.***

Statutory and regulatory reforms implemented in the United States also have reduced substantially the systemic impact of a U.S. GSIB if it were to fail and need to be resolved. Similarly, U.S. GSIBs have demonstrated that they can be resolved in an orderly manner without exposing taxpayers to loss and while maintaining continuity of their vital economic functions. While the consultation report acknowledges the credibility of the

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12 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62017, 62018 (Oct. 11, 2013) (implementing Basel III in the United States).

13 Nevertheless, as discussed below, certain super equivalent requirements may be mis-calibrated and impose costs that outweigh the incremental benefits they provide.

14 *See* 12 CFR pt. 252, subpt. G (implementing the TLAC Rule); 12 CFR 217.10 (implementing the eSLR for bank holding companies); 12 CFR pt. 249, subpt. B (implementing liquidity coverage ratio).

15 12 CFR pt. 217, subpt. H (implementing the GSIB surcharge).

SPOE resolution strategy and indicates that the United States has scored high on various resolution reform indices in Annex D, it should more explicitly acknowledge in the report the unique achievements of the U.S. GSIBs in resolution planning and related reforms.

Our member institutions have led the way in developing successful SPOE resolution strategies that are designed to eliminate the need for a government bailout and minimize the contagion caused by a U.S. GSIB's failure, thereby addressing systemic and moral hazard risk.[16] In previous reviews, the Federal Reserve Board ("FRB") and Federal Deposit Insurance Corporation ("FDIC") did not identify any deficiencies in the U.S. GSIBs' resolution plans that would make them not credible.[17] While the FSB report mostly draws high-level conclusions, it neglects to differentiate substantial differences among jurisdictions in their progress on resolution planning. For example, the FSB assigns the United States high scores on the Resolution Reform Index, but this level of detail is only identified in an Annex to the report and is not adequately addressed in the report's conclusions.

The FSB also should differentiate among jurisdictions in assessing the success achieved in reducing the complexity of a G-SIB and should consider factors beyond just the number of legal entities. The FSB report instead broadly concludes that organizational complexity is still a problem by measuring the number of subsidiaries in a banking organization, apparently due to lack of other data.[18] The U.S. Treasury department, however, has previously noted that U.S. firms have "significantly reduced the number of their subsidiaries and taken steps to better align legal entity structures with distinct business lines"[19] One clear indication of this trend is that Forum member institutions have reduced their number of unique subsidiaries by 40% since 2009.[20]

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16 *See* U.S. DEP'T OF THE TREASURY, ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM at 10-11 (Feb. 21, 2018) ("In carrying out a resolution of a financial company under Title II, the FDIC has stated that it expects to use a [SPOE] strategy in which only the U.S. top-tier parent holding company would be placed into receivership. Under the strategy, solvent subsidiaries, such as broker-dealers, insured depository institutions, and overseas subsidiaries, would continue operating as usual (and paying their obligations when due), thereby avoiding multiple competing insolvencies and minimizing further disruptions to the financial system.") (hereinafter, "OLA Treasury Report"). *See also* FSB, *Thematic Review on Bank Resolution Planning: Peer Review Report* (Apr. 29, 2019) ("In most cases a single point of entry (SPE) combined with a bail-in is preferred for G-SIBs and most D-SIBs, as this enables the resolution authority to stabilize the firm and provide for continuity of its critical functions by keeping operational subsidiaries open.").

17 Press Release, FRB & FDIC, Agencies Find No Deficiencies in Resolution Plans from the Largest Banks; Find Shortcomings for Several Firms (Dec. 17, 2019), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191217a.htm.

18 FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 47-48.

19 OLA Treasury Report at 15.

20 Federal Financial Institutions Examination Council, National Information Center.

Moreover and more importantly, beyond merely reducing the number of legal entities, the U.S. GSIBs have undertaken extensive efforts in connection with resolution planning to rationalize their legal entity structures and reduce interconnectedness, thereby improving resolvability. For instance, the U.S. GSIBs are unique in that they have developed secured support agreements that contractually require their parent holding companies to provide support to material operating subsidiaries in resolution. A U.S. Treasury Report recognized this development, acknowledging that U.S. GSIBs have "taken important steps intended to ensure that the resources of the parent holding company can reliably be provided to operating entities in the event of bankruptcy."[21]

Other reforms such as the single-counterparty credit limit rule have also worked in the United States to address problems of interconnectedness and contagion by limiting the net credit exposure that a large banking organization can have to a single counterparty. In fact, under the rule, there is a more stringent limit on aggregate net credit exposure between larger, more complex institutions, such that GSIBs in the United States must limit their exposure to other U.S. GSIBs and other larger, complex firms to 15 percent of their tier 1 capital in contrast to the general limit of 25 percent of tier 1 capital.[22] By limiting such credit exposure, the rule mitigates the risk that interconnections among large banking organizations and their counterparties would have cascading effects during times of stress.[23]

c. *Other post-crisis market reforms have reduced substantially systemic risk and improved the functioning and stability of U.S. financial markets.*

In addition to the TBTF reforms described above, there have been demonstrated enhancements to financial stability from numerous market reforms that have reduced substantially systemic risk and improved the functioning and stability of financial markets—most notably derivative market reforms (including central clearing, margin, and trade reporting requirements). The FSB should consider these reforms as well in considering the efficacy of TBTF reforms.

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[21] OLA Treasury Report at 15. *See also* Bank of America Corp., Resolution Plan Submission: Public Executive Summary at 22-24 (2019) (describing contractually obligated transfers under secured support agreements); BNY Mellon, Resolution Plan: Public Section at 13, 20 (2019) (same); Citigroup, Resolution Plan: Public Section at 4-6 (2019) (same); The Goldman Sachs Group, Inc., Resolution Plan: Public Section at 28-29 (2019) (same); JPMorgan Chase & Co., Resolution Plan Public Filing at 18 (2019) (same); Morgan Stanley, Resolution Plan: Public Section at 16-17 (2019) (same); State Street, Resolution Plan: Public Section at 14 (2019) (same); Wells Fargo, Resolution Plan: Public Section at 23-38 (2019) (same).

[22] *See* 12 CFR 252.72, 12 CFR 252.172(c)(2).

[23] *See* Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations, 83 Fed. Reg. 38460 (Aug. 6, 2018).

The structure and regulation of the global derivatives market has been transformed in the past decade.[24] Two key developments are (i) the substantial increase in central clearing of over-the-counter ("OTC") derivatives and (ii) the mandated exchange of initial and variation margin on all OTC derivatives that are not centrally cleared. Indeed, according to ISDA, over $185 billion in initial margin has been collected and over $1.4 trillion in variation margin has been exchanged on non-centrally cleared derivatives.[25] As we have previously noted,[26] central clearing is an important reform because clearing brings transparency and strict risk-management standards to derivative trading. The FSB consultation report similarly notes that "clearing makes the OTC derivatives market less complex and potentially less prone to contagion."[27]

In addition to these global, market-wide reforms it should be noted that the United States has taken further measures with respect to derivative markets that are intended to directly support and facilitate the resolution of a U.S. GSIB. Specifically, under the Dodd-Frank Act, U.S. GSIBs are subject to swap reporting requirements.[28] Moreover, U.S. GSIBs are required to maintain an ongoing inventory of contact information for each counterparty with which they maintain a swap transaction that can be transferred to regulators in a resolution. Both of these U.S. requirements are intended directly to support the efficient wind-down of a U.S. GSIB's derivative portfolio in a resolution event.

Nevertheless, as the FSB report recognizes, the requirement to use central clearing for standardized OTC derivatives has concentrated exposure with the central counterparties ("CCPs"). As a result, we agree with the FSB that "CCPs are increasingly important for financial stability."[29] Accordingly, the Associations support the FSB's continued focus on the resiliency and resolvability of CCPs.

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[24] *See* Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 27-30.

[25] ISDA, ISDA Margin Survey Year-End 2018 (Apr. 2019), https://www.isda.org/a/nIeME/ISDA-Margin-Survey-Year-End-2018.pdf.

[26] Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 28.

[27] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 57.

[28] To illustrate the newfound ubiquity of swap reporting, consider that only 15% of credit default swap trades included complete counterparty information in 2014, whereas 95% met this standard in 2018. *See* COMMODITY FUTURES TRADING COMMISSION, SWAPS REGULATION VERSION 2.0: AN ASSESSMENT OF THE CURRENT IMPLEMENTATION OF REFORM AND PROPOSALS FOR NEXT STEPS at 25 (Apr. 26, 2018), https://www.cftc.gov/sites/default/files/2018-04/oce_chairman_swapregversion2whitepaper_042618.pdf.

[29] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 7.

d. *Studies show that the market no longer perceives U.S. GSIBs as TBTF.*

Although the FSB report's aggregated results are somewhat mixed,[30] it is clear in the United States that the market no longer perceives U.S. GSIBs as TBTF. For example, all three major rating agencies "have effectively removed their expectations of government support for U.S. GSIBs' holding company creditors over the past several years."[31] Further, the Government Accountability Office conducted a study on the size of funding subsidies based on TBTF status, finding that they had "declined or reversed" since the pre-crisis era.[32] Moreover, research from the Federal Reserve Bank of New York examined the impact of living will requirements on bank funding costs of U.S. GSIBs. Its findings conclude that living wills—a key TBTF reform in the United States—led to an *increase* in bank funding costs for U.S. GSIBs of over $40 billion, which provides important evidence to support the view that the U.S. policy response has been effective.[33]

Importantly, a 2019 research paper by Darrell Duffie of Stanford University and Antje Berndt and Yichao Zhu of Australian National University draws a similar conclusion based on the funding spreads of U.S. GSIBs. As investors' bailout expectations recede, they demand a higher interest rate on funds they lend to the banking organization to compensate for the greater risk of loss in the unlikely event of default. The paper shows that the credit spread paid by U.S. GSIBs to borrow money from investors has actually increased by roughly one percentage point due to a decline in investor bailout expectations, which strongly suggests the success of TBTF. Notably, the paper concludes that: "[t]he data are consistent with significant effectiveness for the official sector's post Lehman G-SIB failure-resolution intentions, laws, and rules. G-SIB

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30 *Id*. at 40.

31 OLA Treasury Report at 19. *See also* Moody's Investors Service, Rating Action: Moody's Concludes Review of Eight Large US Banks (Nov. 14, 2013), https://www.moodys.com/research/Moodysconcludes-review-of-eight-large-US-banks--PR_286790; Fitch Ratings, Fitch: TLAC Supports the Upgrades of Eight U.S. GSIB Operating Companies, (May 19, 2015), https://www.fitchratings.com/research/banks/tlac-supports-upgrades-of-eight-us-g-sib-operating-companies-19-05-2015; S&P Global, U.S. Global Systemically Important Bank Holding Companies Downgraded Based On Uncertain Likelihood Of Government Support (Dec. 3, 2015), https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=1490452&SctArtId=357868&from=CM&nsl_code=LIME&sourceObjectId=9438258&sourceRevId=1&fee_ind=N&exp_date=20251202-14:59:54.

32 U.S. Gov't Accountability Office, Report to Congressional Requesters: Large Bank Holding Companies: Expectations of Government Support at 46 (2014), https://www.gao.gov/assets/670/665162.pdf; *see also* Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 33-35.

33 Federal Reserve Bank of New York, *Resolving "Too Big To Fail"*, Staff Report No. 859 (Jun. 2018), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr859.pdf.

creditors now appear to expect to suffer much larger losses in the event that a G-SIB approaches insolvency. In this sense, we estimate a major decline in 'too big to fail.'"[34]

II. Regulators should address adverse effects without undermining core progress in addressing TBTF.

The FSB in its Questions for Consultation also asks about the broader effects of TBTF reforms on the financial system and markets. In particular, the FSB seeks comment on any changes in the financial system's resilience and structure and in financial integration.[35] For the reasons discussed below, we believe now is an appropriate time for regulators to address in a thoughtful way certain adverse effects of the post-crisis reforms, which can be done without undermining the substantial progress that has been made on addressing TBTF.

a. *TBTF reforms have resulted in certain unintended consequences.*

Some TBTF reforms have had unintended consequences in the form of negative effects on the structure and resilience of the financial system and financial markets—most notably the movement of certain activity outside of the regulated banking sector. In large part, this migration appears to be the result of the increased regulation of large banks following the financial crisis. Specifically, an increase in assets and activities outside the regulatory perimeter presents the potential for financial stability risks that may not be fully understood or mitigated. The FSB report notes: "[t]his shift may enhance the stability of the financial system, partly because it may lead to a diversification of funding sources. However, it could also be a source of financial instability."[36] Although diversification of funding sources to end users could be beneficial, diversifying by moving activities outside the regulatory perimeter is not beneficial and, as the FSB recognizes, could lead to financial instability. Accordingly, the Associations agree with the FSB that continued monitoring of non-bank financial intermediary risks is necessary.[37] We support the continued work by the FSB and standard-setting bodies to assess vulnerabilities and develop policy recommendations designed to address these risks.

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[34] Antje Berndt, James Darrell Duffie, and Zhu Yichao, *The Decline of Too Big to Fail* (Dec. 19, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3497897; *see also* Sean Campbell and Samim Ghamami, The Decline of Too Big to Fail, Financial Services Forum, (Jan. 8, 2020), https://www.fsforum.com/types/press/blog/the-decline-of-too-big-to-fail/.

[35] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 3.

[36] *Id*. at 9.

[37] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 54.

b. *There is opportunity to address adverse effects on financial markets without undermining the core progress made in addressing the problem of TBTF.*

The Associations believe that it is important to consider ways to refine the existing regulatory framework implemented since the financial crisis to enhance the ability of our member institutions to serve as a source of strength for the U.S. and global economy. Consistent with statements previously made by FSB Chair Randal K. Quarles,[38] we also think it is appropriate at this time to assess the coherence of the overall regulatory framework; in particular, we recommend that regulators consider ways to refine regulation to address instances where several policies may be working to address the same issue, thus resulting in duplicative regulations with overlapping effects. Below, we highlight certain international standards that we believe could be improved on this basis.

One example of duplication in the post-crisis regulatory framework is the GSIB surcharge, particularly as implemented in the United States.[39] Here, the calibration of the GSIB surcharge—both the Basel Committee's version and the super equivalent U.S. version—does not reflect the enhancements to resiliency, liquidity, and resolvability that have been achieved since the surcharge was first adopted, including: enhancements to resolution planning, minimum margin and capital requirements related to non-cleared swaps and security-based swaps, TLAC requirements, qualified financial contract contractual stay and recordkeeping requirements, and enhanced supervisory practices.

Accordingly, the GSIB surcharge as currently implemented does not reflect a coherent view of the current regulatory landscape, is mis-calibrated and imposes costs that potentially outweigh the incremental benefits the surcharge provides. In the United States, the effect of this mis-calibration is even more pronounced because, as mentioned above, the U.S. GSIB surcharge is super equivalent to the Basel Committee's standard and often results in higher surcharges for U.S. GSIBs and because, as discussed above, the U.S. GSIBs are at the forefront of reforms to reduce systemic risk. Therefore, the surcharge raises costs, which are ultimately passed on to businesses and households that are seeking credit to make investments that contribute to economic growth.

Another example of mis-calibration is the TLAC rule. Our member institutions have previously recommended several modifications that would not diminish the objectives of

[38] *See, e.g.*, Randal K. Quarles, FRB, Early Observations on Improving the Effectiveness of Post-Crisis Regulation (Jan. 19, 2018), https://www.federalreserve.gov/newsevents/speech/files/quarles20180119a.pdf.

[39] For a further discussion of overlapping and duplicative requirements, *see* Financial Services Forum, Comment Letter to FRB Re: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules (June 25, 2018), https://www.fsforum.com/wp-content/uploads/2018/06/forum_scb_comment_letter.pdf.

the TLAC rule but would materially improve it.[40] These include lowering the internal TLAC calibration that applies to the covered intermediate holding companies of foreign GSIBs to avoid the similar ring fencing of U.S. GSIB operations in non-U.S. jurisdictions and making other adjustments to the calibration of TLAC requirements.[41] While we disagree with the FSB's conclusion that internal TLAC does not cause market fragmentation,[42] the Associations reiterate our recommendation that the FSB work to foster greater international coordination to avoid collective action problems that are harmful to both financial stability and economic growth, including coordination to facilitate cross-border resolutions. The FSB could start by strongly encouraging that the calibration of internal TLAC be at the low end of the range in the TLAC term sheet or by revisiting the standard set in that term sheet.

III. Regulators should re-examine the framework used to evaluate the costs and benefits of TBTF reforms.

The FSB report broadly concludes that TBTF reforms bring significant benefits for society, and further explains that "when interpreting the effects of reforms, it is important to distinguish private and social costs and benefits. . . [T]he proper way to evaluate the effects of reform is to focus on the latter, and that is what this evaluation has done."[43] However, the Associations believe that this oversimplified distinction fails to capture the realities of market behavior that the report even later acknowledges. For example, the report also notes: "Higher capital and TLAC requirements may increase the overall cost of funding for banks. G-SIBs may pass some or all of this increase in costs onto borrowers by charging higher interest rates on loans. If other firms do not take up the slack, that in turn may reduce investment output."[44] Here, the FSB acknowledges that

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[40] Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 42.

[41] U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 17-18 (June 2017) (recommending reevaluating the 90% internal TLAC standard); Bank Policy Institute et al., Comment Letter to FSB Re: Monitoring the Technical Implementation of the FSB TLAC Standard at 2-3 (Aug. 20, 2018) (arguing that the TLAC standard in the United States is too high and should be calibrated at the low end of the 75% to 90% range); The Clearing House et al., Comment Letter to FSB Re: Proposed Guiding Principles of Internal TLAC at 6 (Feb. 17, 2017) (same); The Clearing House et al., Comment Letter to FRB Re: the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. GSIBs, Annex 1-9 (Feb. 19, 2016) (same); The Clearing House et al., Comment Letter to Office of the Comptroller of the Currency & FRB Re: 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 at 13 (June 25, 2018) (arguing for recalibration of the TLAC and LTD SLR).

[42] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 69.

[43] *Id*. at 67.

[44] FSB, *Evaluation of the Effects of Too-Big-to-Fail Reforms: Consultation Report* at 14.

private costs are part of social costs in that they ultimately have an impact on the market and market participants. The final FSB report should consider these private costs as well in conducting its cost-benefit analysis.

Moreover, in order to estimate the economic costs and benefits of TBTF reforms, the FSB continues to rely on the framework originally developed by the Basel Committee in 2010.[45] Although the Basel Committee later updated this assessment to include some discussion of resolution planning and TLAC, it has not fully considered the impacts of all TBTF reforms.[46] We believe that this approach is suboptimal and could result in a material underestimation of the true cost of regulatory reform to the financial system and financial markets. We reiterate our desire to engage with the FSB in its further work on these topics.

Lastly, the Associations think the FSB should evaluate the costs associated with constraints on liquidity as a result of TBTF reforms. For example, several studies have shown that the post-crisis period has seen a reduction in financial market liquidity,[47] which commentators suggest might have been caused at least in part by post-crisis reforms such as heightened capital and liquidity requirements and the Volcker Rule.[48] TBTF reforms that constrain the market-making capacity of banking organizations[49]

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[45] *Id*. at 67.

[46] *Id*. at 68; *see also* Financial Services Forum, Comment Letter to FSB Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms at 38.

[47] *See*, *e.g.*, Hendrik Bessembinder et al., *Capital Commitment and Illiquidity in Corporate Bonds*, 73 J. Fin. 1615 (2017) (showing that large dealer banks are less willing to commit capital to bond inventory that would allow customers to complete trades, thereby reducing the liquidity they provide to their customers), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2752610; Mike Anderson & René M. Stulz, *Is Post-Crisis Bond Liquidity Lower?* (NBER Working Paper No. 23317) (finding that liquidity is worse post-crisis when market volatility is high), https://www.nber.org/papers/w23317; Jaewon Choi & Yesol Huh, *Customer Liquidity Provision: Implications for Corporate Bond Transaction Costs* (FRB, Finance and Economics Discussion Series Working Paper 2017-116) (finding evidence of deteriorating market liquidity), https://www.federalreserve.gov/econres/feds/files/2017116pap.pdf; Paul Schultz, *Inventory Management by Corporate Bond Dealers* (unpublished manuscript) (same), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2966919.

[48] *See* Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress* (FRB, Finance and Economics Discussion Series Working Paper 2016-102) (arguing that bond liquidity during periods of stress has worsened post-crisis as a result of the Volcker Rule), https://www.federalreserve.gov/econresdata/feds/2016/files/2016102pap.pdf; Lotfi Karoui et al., *The Great Liquidity Debate: Where We Stand 10 Years Later*, GOLDMAN SACHS CREDIT STRATEGY RESEARCH (Jun. 12, 2019) (arguing that post-crisis regulatory changes have resulted in deteriorating liquidity conditions for corporate bonds).

[49] For example, the U.S. Treasury Department and industry organizations have expressed concern that the proposed U.S. rule on TLAC cross-holdings may constrain market making in loss-absorbing debt instruments. *See* U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL MARKETS at 85-88 (Oct. 2017) (arguing that the Volcker Rule and heightened capital and liquidity standards have reduced market making and liquidity in the corporate bond market);

result in the GSIBs having to allocate balance sheets artificially in a way that could negatively affect the market liquidity problem, particularly during times of stress. In fact, the FRB recently noted that strains in the Treasury market in March indicated a decline in broker-dealer inventory capacity during the COVID-19 pandemic.[50] This deterioration in market liquidity has important implications for the welfare of investors, corporations, pension funds, and other entities that use financial markets to manage risks and provide for the future.

Further, banks now face high balance sheet costs to intermediate across different money market segments. As the FRB recently noted, "reserve-based liquidity provision has become the main response of large U.S. banks to dollar funding shortage, as it is neutral to key Basel III regulatory ratios, such as the Leverage Ratio (LR) and the LCR. Nevertheless, this intermediation strategy is still constrained by banks' requirements to hold reserves for liquidity stress tests and resolution planning purposes."[51]

Accordingly, the Associations believe costs of reduced market liquidity should be assessed in the FSB evaluation of TBTF reforms. The FSB is evaluating the market liquidity events of March 2020 and has begun a mapping of critical connections between banking and non-bank sectors.[52] If the FSB chooses not to address market liquidity in its TBTF evaluation, it should nevertheless make sure the topic of reduced market liquidity is on its agenda for specific evaluation in the near-term, whether as part of its evaluation surrounding the events of March 2020 or otherwise.

IV. Conclusion

The Associations believe the FSB should recognize the significant progress that U.S. regulators and U.S. GSIBs have made in reducing both the probability and impact of a U.S. GSIB's failure, and should account for that progress more expressly in its final

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Securities Industry and Financial Markets Association, Comment Letter to Office of the Comptroller of the Currency, FDIC & FRB Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019); Bank Policy Institute et al., Comment Letter to Office of the Comptroller of the Currency, FRB & FDIC Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019).

[50] FRB, FEDS Notes: Dealer Inventory Constraints during the COVID-19 Pandemic: Evidence from the Treasury Market and Broader implications (Jul. 17, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/dealer-inventory-constraints-during-covid-19-pandemic-evidence-from-treasury-market-broader-implications-20200717.htm.

[51] FRB, U.S. Banks and Global Liquidity, International Financial Discussion Papers 1289 at 6-7 (Jul. 2020), https://www.federalreserve.gov/econres/ifdp/files/ifdp1289.pdf.

[52] FSB, Addressing Financial Stability Risk of COVID-19 (2020), https://www.fsb.org/work-of-the-fsb/addressing-financial-stability-risks-of-covid-19/.

report. Now that the hard work of implementing reforms to solve the TBTF problem is largely complete, we believe regulators have an opportunity to more carefully calibrate and refine those TBTF reforms in a way that will foster growth without undermining the progress that has been made. In addition, the FSB should continue to monitor certain unintended consequences of TBTF reforms and work to fully understand and estimate the costs of TBTF reforms.

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Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com, or rnichols@aba.com) with any questions.

Respectfully submitted,

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