S. 2155 Tailoring Issue Summary

The 2010 Dodd Frank Act established firm asset thresholds to designate financial institutions as “systemically important” and subject them to enhanced supervision. Recognizing the negative impact on economic growth of overly prescriptive regulations, in 2018 Congress passed S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act.

The bipartisan law updates the underlying regulatory architecture to better reflect economic reality for certain institutions. At its core, S. 2155 raises the threshold for the designation of systemic importance from $50 billion to $250 billion in assets, which impacts whether and how enhanced prudential standards apply to certain institutions. Institutions below $100 billion in assets gained immediate relief. In October 2018, the Federal Reserve, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued a proposal to tailor capital, stress testing and liquidity requirements, and the Fed issued a related proposal that changes the enhanced prudential standards for U.S. large bank holding companies and savings and loan holding companies. The proposals place firms into four categories and tailor the application of standards based on the following indicators: total assets, cross-jurisdictional activity, nonbank assets, reliance on weighted short-term wholesale funding, and off-balance sheet exposure.

BPI Response

The Bank Policy Institute supports S. 2155’s directive to better calibrate the financial regulatory system through tailoring. The Act reflects a bipartisan consensus that one-size-fits-all regulation does not effectively address risk or optimize economic growth. Collectively, the regulators’ tailoring proposals are an important step toward a regulatory framework for these firms that more appropriately aligns prudential regulatory standards with diverse business models and risk profiles.

1. BPI urges the agencies to adopt the general framework of the “risk-based indicator” approach set forth in the tailoring proposals, subject to important changes. Specifically, BPI recommends regulators:
   - significantly increase the dollar threshold for the risk-based indicator of cross-jurisdictional activity, based on results from a BPI quantitative study;
   - adjust all risk-based indicators annually to account for economic growth, so that those indicators retain similar relationships to risk;
   - immediately eliminate the use of the “adverse” scenario, qualitative assessment and objection framework, and mid-cycle, company-run-test-requirements from the current stress-testing regime;
   - carefully evaluate the changes contemplated to capital planning and stress testing to ensure they do not result in unintended, adverse consequences and also achieve the intended tailoring of prudential standards; and
   - simplify the liquidity requirements for qualifying firms.
2. BPI encourages the agencies to ensure that final regulations not be nullified through an examination process that re-imposes the same standards.
3. Further, BPI encourages the agencies to reconsider and revisit other aspects of the existing regulatory framework underlying the tailoring proposals, including the U.S. GSIB surcharge framework, Liquidity Coverage Ratio and proposed Net Stable Funding Ratio.

Greater Tailoring

This new law should compel a variety of other regulatory changes and serve as a catalyst to recalibrate the regulatory framework for banking institutions of all sizes. As the new law recognizes, an institution’s size is not an accurate reflection of risk. The new law replaces the vague encouragement in Dodd Frank that regulators should or “may” tailor with a firm requirement that regulators “shall” do so. Regulators should comply with the law’s new direction to assess the full characteristics of an institution’s risk.

Further, the Federal Reserve should adopt similar tailoring reforms for foreign banking organizations (FBOs) based on the characteristics of their intermediate holding companies. In fact, the Treasury Department’s report on banking recommends tailoring the application of enhanced prudential standards for FBOs based on their U.S. risk profile and the risk they present to the U.S. financial system. Such tailoring would be consistent with S. 2155 and the long-standing principles of national treatment and deference to home country supervision and ensure protection of American financial interests abroad.