BETTER MARKETS

July 28, 2020

The Honorable Mike Crapo
Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: The Leverage Ratio Is Essential to Protecting Main Street Families and Businesses

Dear Chairman Crapo and Ranking Member Brown:

I write to ensure that the members of the Banking Committee are aware of the importance of the tier I leverage ratio capital requirements for the largest banks in the country, which, as you know, each received massive taxpayer bailouts in 2008 because they did not have enough capital to prevent their own failure. Today's leverage requirements not only increase financial system stability and reduce the risk of taxpayer bailouts, but also facilitate those banks' lending to the productive economy, helping Main Street families and businesses. As Better Markets[1] details below, claims to the contrary are at best misleading or baseless, if not simply false.

The only thing that stands between a failing bank and a taxpayer bailout is the amount and quality of capital it has to absorb its own losses, as you know. Simply put, the less capital a bank has, the more likely it will fail, destabilize the financial system, endanger the economy and

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

necessitate taxpayer bailouts – again. That was the overriding lesson of the 2008 financial crash and is true in the ordinary course. That is all the more important today in the face of unprecedented uncertainty in the economic outlook and its ultimate impact on banks' financial soundness due to the COVID-19 pandemic. This is simply the wrong time to allow banks to weaken their capital positions.

Indeed, stronger bank capital requirements implemented after the 2008 financial crisis are a critical reason why Wall Street banks have, to date, been able to support the economy during this pandemic, rather than acting as a drain on it by requiring bailouts and withholding credit as happened in 2008.[2] The self-serving claims by Wall Street's largest, most dangerous banks that reducing capital requirements will allow them to increase their lending and better support the economy simply are not supported by evidence. Banks with strong capital positions are best able to support the economy by lending to consumers and businesses without increasing the likelihood of a taxpayer-funded bailout.

Importantly, allowing regulators to reduce required bank leverage ratios does not in itself create incentives for banks to increase lending any more than it provides an incentive to increase other types of assets. Thus, if there was an objective, evidence-based need to create specific incentives for the largest banks to lend more to Main Street families and businesses – a need for which evidence has not been provided to the public – any actions taken to that end must be carefully constructed, calibrated and targeted to achieve that specific goal in measurable ways. Moreover, any such changes should be temporary and in place only for the duration of the specific need created by the COVID-19 pandemic.

Prior to the 2008 crash, banks were allowed to basically police themselves with their own risk models, including de facto setting the size of their own capital cushions with the use of so-called "risk-based" regulatory capital requirements. Banks decided how much risk different types of assets and activities had and then they set aside the amount of capital that they claimed was appropriate for those risks. Of course, those banks failed spectacularly to properly identify, consider and weight their own risks and hardworking Americans paid the price of that devastating failure.[3]

That years-long systematic failure – by all of the most sophisticated, intelligent, highest remunerated bankers at Wall Street's biggest, most prestigious banks - to capture the actual riskiness of many if not most of their own banks' riskiest positions was a key contributor to banks' crippling weakness and, for some, their outright collapse in the 2008 crisis. That's why it was so critically important to establish the requirement that those banks ***also*** meet a simpler,

---

[2] See Dennis Kelleher and Tim Clark, *No Financial Crash Yet Thanks to Dodd-Frank and Banking Reforms*, July 8, 2020, available at https://bettermarkets.com/sites/default/files/Better_Markets_White_Paper_Dodd-Frank_Banking_Reforms%20%289%29.pdf

[3] See Better Markets, *$20+ Trillion and Counting: The Cost of the Wall Street Caused Financial Crisis,* October 29, 2018, available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf

more straightforward minimum leverage ratio. Such leverage ratios require no judgments, no guesswork, no analysis, no complicated models and, among other things, cannot be gamed, understated or miscalculated. Thus, the ratio directly addressed one of the most important deficiencies in the pre-crash financial protection architecture for the country's biggest banks.

It is important to recognize, however, that risk weights and a leverage ratio each have distinct benefits and shortcomings, which is why an appropriate capital regime requires both. By acting together, better designed and stronger post-crisis risk-based requirements complemented by simple leverage-based requirements -- and stress testing -- have dramatically strengthened U.S. banks and provided the foundation for them to support an historically long period of economic expansion.[4]

As important, for months now Wall Street's largest banks have claimed to have ample capital both to continue to serve customers and to pay out tens of billions of capital to shareholders via dividends. Frankly, it is impossible to reconcile such claims with the unprecedented uncertainty in the outlook caused by the pandemic. Nonetheless, if one were to assume these statements were accurate, it cannot also be true that there is a need to weaken critically important capital requirements. After all, if they needed more capital availability to increase lending to Main Street families and businesses, they could just voluntarily and unilaterally stop ejecting capital via dividends, immediately making tens of billions of dollars available for lending.

The fact that this contradiction is ignored and unacknowledged clearly reveals what is really going on here: the claims that weaker capital requirements for Wall Street banks are "needed" to increase lending is nothing more than those banks' latest opportunistic attempt to gut key capital requirements and increase their leverage, which helps boost executive compensation and bonuses.[5] As they have done since the beginning, Wall Street's biggest banks and their trade groups have tried to use the pandemic as a pretext[6] to get elected officials, regulators and policymakers to deliver the deregulatory wish list they have been lobbying for since 2010. Those self-serving claims must be rejected because such actions would needlessly increase the danger to the public at the very same time the American people are being asked to make tremendous sacrifices to fight the pandemic.

Thus, there is no independent, credible evidence to support any of the claims to weaken any of the capital standards at this time. However, there is clear evidence that doing so would

---

[4] See Dennis Kelleher and Tim Clark, *No Financial Crash Yet Thanks to Dodd-Frank and Banking Reforms*, July 8, 2020, available at https://bettermarkets.com/sites/default/files/Better_Markets_White_Paper_Dodd-Frank_Banking_Reforms%20%289%29.pdf

[5] Anat R. Admati and Martin Hellwig, *The Bankers' New Clothes: What's Wrong With Banking and What to Do About It*, 2013

[6] See Better Markets, *Wall Street Biggest Banks Shamelessly Trying to Use Coronavirus to Get Federal Reserve to Weaken Rules,* March 2, 2020, available at https://bettermarkets.com/newsroom/wall-street-biggest-banks-shamelessly-trying-use-coronavirus-get-federal-reserve-weaken

be dangerous and expose taxpayers to a heightened probability the banks could contribute to deepening the economic damage caused by COVID-19 and need another bailout as they did in 2008. As important, if the banks believe what they are claiming, they should put their money where their mouth is and stop shoveling capital out the door via dividends and redirect those billions to lending to the real economy.

Sincerely,

Dennis Kelleher
President and CEO
Better Markets Inc.
1825 K Street, NW
Washington, D.C. 20006
(202) 618-6464

dkelleher@bettermarkets.com
www.bettermarkets.com

Cc: Members of the Senate Committee on Banking, Housing and Urban Affairs