ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA®

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Too-Big-To-Fail Subsidies Threaten Economy, Community Banks, and Taxpayers

On behalf of the more than 6,500 community banks represented by the Independent Community Bankers of America, thank you for convening today's hearing titled: "Examining the GAO Report on Expectations of Government Support for Bank Holding Companies." Government subsidies for a small number of too-big-to-fail firms increase systemic risk and pose a direct threat to our economy and to taxpayers. ICBA looks forward to reviewing the GAO report in detail. In the interim, we are pleased to present the community bank perspective on too-big-to-fail subsidies in the following statement for the record.

Government-Subsidized Industry Concentration Continues Unabated

According to recent data provided by SNL Financial, the five largest U.S. banks now control 44.2 percent of the industry's assets, a share that has steadily increased in recent years. In 1990, the five largest banks controlled only 9.7 percent of all bank assets.[1] The greatest threat to the safety and soundness of our financial system today is the dramatic concentration of assets in a small number of megabanks.

How do we account for accelerating industry concentration? The exponential growth of these large firms is a direct result of government support in the wake of the financial crisis and its distortionary impact on competition. Too-big-to-fail is explicitly recognized by the bond rating firms who give the largest, most interconnected firms a ratings lift based on their implied U.S. support.[2] Bond buyers accept lower returns from megabanks because they assume the government will support them if they falter.

Today's GAO report adds to the number of independent studies finding a too-big-to-fail subsidy. Notably, a study by two International Monetary Fund (IMF) economists estimates the value of the too-big-to-fail subsidy at $83 billion a year.[3] Various cost-of-funds studies estimate the megabank subsidy as being anywhere from 20 basis points to 80 basis points. ICBA has reviewed 15 studies that examine the question of whether a significant too-big-to-fail subsidy exists. All but one – which was conducted by a megabank – confirmed a significant subsidy does exist.

Lower borrowing costs give the too-big-to-fail firms a clear competitive advantage, fueling yet more industry concentration, increasing systemic risk, and further entrenching the policy of too-big-too-fail. This trend can only be broken by a decisive change in policy. Tinkering with existing rules will not suffice.

[1] "Biggest Lenders Keep on Growing." Shayndi Raice. Wall Street Journal. January 3, 2014.
[2] "No Lehman Moment as Biggest Banks Deemed Too-Big-To-Fail." Bob Ivry. Bloomberg Markets Magazine. May 10, 2013.
[3] "Why Should Taxpayers Give Big Banks $83 Billion a Year?" Bloomberg View Editorial. May 20, 2013.

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Too-Big-To-Fail and Community Banks

Community banks are particularly vulnerable to the circumstances of too-big-to-fail. Over 400 community banks failed in the wake of the financial crisis fueled largely by the reckless behavior of mega financial firms. They were too small to save! And while these community banks were not deemed systemically important, at least on a national level, their failures continue to have a painful and lingering effect on the communities they served, as well as a lasting impact on the competitive landscape.

A less-noted legacy of the financial crisis is the onslaught of new regulations enacted in response to the irresponsible actions of the too-big-to-fail banks. Community banks are low-risk, community-based institutions that did not cause the crisis and pose no threat to consumers or the financial system. While the new regulations are aimed at large banks and non-bank lenders, they often sweep in banks of all sizes, creating a crushing new burden for community banks, layered on top of an already significant regulatory burden. Large banks may not welcome new regulation, but, with their sizable legal and compliance departments, they have ample resources to comply with them. For community banks, on the other hand, with their relatively small asset bases and compliance staffs, regulation is a disproportionate burden and poses a threat to their very existence. New regulations only heighten the competitive advantage of large banks. While we welcome efforts to recognize the distinct business model of community banks by tiering regulation, this tiering provides only partial relief. Costly new regulation inhibits new bank charters, prompts the sale of community banks and leads to more consolidation, which exacerbates the threat of too-big-to-fail. The problem is the most significant threat to the future of a strong, free-market, competitive banking system.

Potential Solutions

ICBA is open to considering any constructive proposal to address the too-big-to-fail problem. Among other proposals, ICBA has endorsed the Terminating Bailouts for Taxpayer Fairness (TBTF) Act (S. 798), introduced by Sens. Sherrod Brown (D-OH) and David Vitter (R-LA). S. 798 takes a clean approach to the problem—requiring the largest, riskiest banks to hold more leverage equity capital will allow them to operate more safely, absorb more losses and avoid a government or taxpayer bailout. S. 798 can be implemented without complex new rules. Banks over $500 billion would be required to have a minimum of 15 percent leverage equity capital to reflect their scale and associated systemic risk. Banks between $50 billion and $500 billion would be required to have a minimum of 8 percent leverage equity capital. Banks under $50 billion will be subject to capital rules comparable to the risk-based and leverage ratios that apply today.

S. 798 recognizes that community banks and larger banks with less than $50 billion in assets were not the problem. Importantly, there will be no complex risk weighting of the assets used to calculate the equity capital ratio. Risk weighting has been too easily gamed by the megabanks. In addition, off-balance-sheet exposures that sharply increase the risk level of megabanks would be included in total assets, as would certain derivatives exposures.

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Additional proposals supported by ICBA include the plan put forth by Federal Reserve Bank of Dallas President and CEO Richard Fisher and the industry restructuring proposed by FDIC Vice Chairman Thomas Hoenig. Hoenig's proposal would separate the core banking activities of deposit taking and lending, which are covered by deposit insurance, from dealing and market making, brokerage and proprietary trading. These latter would be pushed out. All of these proposals are thoughtful and constructive.

The Plan for Prosperity

In closing we note regulation should be calibrated to reflect the true risk posed by a bank and the complexity of its balance sheet and activities. ICBA's Plan for Prosperity (PFP) would help offset the growing regulatory burden of too-big-to-fail on community banks and their customers. While too-big-to-fail is the ultimate source of the problem, and we urge this committee to pursue vigorous and practical solutions to too-big-to-fail, the regulatory relief provided by the PFP will help community banks promote entrepreneurship, economic growth, and job creation. ICBA is grateful to Senators Brown and Vitter for including a number of key PFP provisions in S. 798. ICBA encourages the Senate Banking Committee to consider that bill and other legislation that embodies PFP provisions. In particular, the CLEAR Relief Act (S. 1349), introduced by Sens. Jerry Moran, Jon Tester, and Mark Kirk, contains four PFP provisions, including mortgage reform, an increase in the SOX 404(b) exemption, and other provisions. We are very pleased that S. 1349 has 38 bipartisan cosponsors.

Thank you again for the opportunity to submit this statement for the record. ICBA is committed to working with this committee to end the problem of too-big-to fail and to advance the provisions of the PFP.