Statement for the Record

On Behalf of the

AMERICAN BANKERS ASSOCIATION

For the Hearing

“Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts.”

Before the

Financial Services Committee

United States House of Representatives

June 26, 2013
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The American Bankers Association (ABA) is pleased that the Financial Services Committee is holding this hearing (Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts) and appreciates the opportunity to submit a statement for the record. The ABA represents banks of all sizes and charters and is the voice for the nation’s $14 trillion banking industry and its two million employees.

ABA strongly believes that no bank should be too big to fail. We urge policymakers to use all appropriate tools to ensure that no financial institutions are insulated from the consequences of their actions. A failing institution should be resolved, and its stakeholders should suffer losses—not taxpayers—regardless of size.

As Congress debates the effectiveness of the Dodd-Frank Act and what changes might be appropriate, it is important to look at the role that banks of all sizes play in supporting our economy, and evaluate the impact that any current and prospective laws might have on banks’ ability to support growth in our nation. We must ensure that our diverse banking industry remains equipped to support the needs of our large and diverse economy. Plans that seek to limit the size of banks, directly or indirectly, would have unintended wide-reaching consequences for consumers, the financial services industry and the broader economy.¹

Too big to fail, as a policy, can and should be ended without eviscerating the banking industry’s ability to compete internationally or risking an economic downturn. Federal regulators must continue to effectively implement provisions to end too big to fail. No policymaker should use this goal as an excuse to reach other nonrelated policy goals, such as breaking up banks based on size. Many changes have already been put into place or are underway that begin to address the issue. More may need to be done and hearings like the one today are critical to assuring that too-big-

¹ See Appendix for an example of the consequences associated with some of these plans, notably very high leverage ratio requirements. Although not directly related to the main purpose of this hearing, it provides a good example of how the costs and unintended consequences must be weighed against any benefits.
to-fail has been eliminated. All too often, the negative unintended consequences of any changes in law are not thoroughly examined. It is, therefore, critical that such an examination take place to assure that banks of all sizes will be able to serve the diverse needs of our economy.

A Strong Economy Requires a Strong Banking System

A $16 trillion economy must have a banking system large enough, diverse enough, and integrated enough to meet the needs of local, regional and global businesses. A modern, dynamic economy can only exist if it has an efficient banking and capital market that can support it. As the U.S. and global economies have grown larger and more complicated, banks of all sizes have responded to meet changing customer financial needs and increasing global integration. The U.S. economy is the most dynamic economic power because it is supported by its premier global banking and financial sector.

Today, our diverse banking industry is made up of banks of all sizes and types, from small community banks to community-based regional banks, to large money center and global banks. This depth and breadth is required to meet the broad array of financial needs of our communities and customers. It provides greater access to credit at lower borrowing costs and greater convenience to reliable affordable services. Without such a diverse banking system, businesses could not grow, could not sell locally and globally, and could not hire workers that produce and sell their products.

The U.S. financial services sector has been a leading driver of our country’s GDP, increasing in importance over time (i.e., its share of the total value of all goods and services produced). This reflects the increasingly complex needs of businesses for financial services and credit domestically and internationally. ²

² Federal Reserve Chairman Ben Bernanke explained the importance of financial services during a recent press conference: “The world is a lot more complicated. The world is a lot more international. You have large multinational firms that are connecting resources, savers and investors in different countries. There’s a lot more demand for risk
Importantly, the contributions from financial services have offset much slower growing sectors such as retail trade and manufacturing. Without the contributions to GDP—including adding a trade surplus of over $55 billion from financial services exports—U.S. growth would be weaker and fewer jobs would be created. Thus, any policies that would prevent the U.S. from having banks of all sizes will have negative consequences, including the inability to provide needed credit and financial services to large employers and exporters and a diminished global leadership role in financial services.

**Banks Large and Small Serve Businesses Large and Small**

The current structure of the U.S. banking industry uniquely positions it to serve the diverse needs of our economy. It has been shaped by market forces to most effectively serve the credit needs of our economy. Artificially altering this structure would only hamper the industry’s ability to meet our customers’ needs.

All along the production chain, banks of varying sizes offer financial services. For example, community banks do not have the size or resources to lend to large manufacturers or other large businesses. However, community banks do lend to the small businesses that sell supplies and services to the large companies – tools, office supplies, carpet installers, to name just a few. Banks of all sizes provide loans to the employees who work in small and large business alike, and to the retail stores where those employees shop. It is this interconnectivity of businesses of all sizes and...
types served by banks of all sizes and types that makes the U.S. banking system so unique and valuable.

This interconnectedness of banks, from the largest to the smallest, facilitates job growth in our country. For example, America’s globally active companies employ 20 percent of U.S. workers. Tens of thousands of smaller companies all over the country supply products and services to these global firms, thus helping stimulate even more jobs. Credit and financial services provided by our largest banks supports the credit and financial services made available to all the firms and people that support these important companies. The presence of banks large and small is vital to job growth and economic health of communities throughout our country.

The borrowing needs of our largest companies require large amounts of capital that only the largest banks can provide. Some large companies have substantial credit needs—a billion dollar credit facility established in one day is not uncommon—and depend on a wide array of products and services, including cash management, cross-border payments and settlement, international trade finance, and the management of their interest rate, credit, and foreign exchange risks. Multinational companies also need merger and acquisition advice and access to debt and equity markets throughout the world. These financial needs are not isolated, but span dozens of countries in which the large companies operate.

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Our largest banks compete heavily with foreign banks to offer financial services to American businesses. AT&T, for example, sources 57 percent of its $5 billion revolving credit line from foreign institutions. Three U.S. banks have individual commitments of $385 million. A single line of credit this large can only be provided by a large diversified bank with resources and capital to back it up. Make no mistake about it: if U.S. banks were prevented from playing this lead role for U.S. global firms, foreign banks would gladly take over this business and are already positioned to do so.

Large Banks Compete to Offer Revolving Credit Lines

<table>
<thead>
<tr>
<th>Company</th>
<th>U.S. Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT&amp;T</td>
<td>57%</td>
<td>43%</td>
</tr>
<tr>
<td>Pepsi</td>
<td>47%</td>
<td>53%</td>
</tr>
<tr>
<td>Macy's</td>
<td>18%</td>
<td>82%</td>
</tr>
<tr>
<td>Nike</td>
<td>41%</td>
<td>59%</td>
</tr>
</tbody>
</table>

Participants With Largest Commitment:

- AT&T: Bank of America, Citi, JP Morgan, Barclays
- Pepsi: Bank of America, Citi, JP Morgan
- Macy's: Bank of America, Credit Suisse, JP Morgan, U.S. Bank, Wells Fargo
- Nike: Bank of America, Citi

Our large and diversified banking system is also the heart of our payments and settlement system. This is a complicated and highly efficient network that stands behind the hundreds of billions of financial transactions that take place every day. We take for granted the significant investment in these systems that support families as they pay their bills and receive their salaries, and businesses that buy parts and products. The modern payments system would not operate without the role played by the largest U.S. banks to create, operate and protect it with anti-fraud and cyber security countermeasures.
Conclusion

ABA firmly believes that no institution should be too big to fail. Policymakers should evaluate the impact of existing legislation as well as determine what additional measures may be necessary to ensure that no bank is insulated from the consequences of its actions. Regardless of its size, a failing institution should be resolved with its stakeholders—not taxpayers—suffering losses. In evaluating options to accomplish this, it is critical to understand fully the impact of current and prospective laws on our communities and our customers.

Any approach should preserve the great diversity of banks supporting our economy. The U.S. banking system is the premier global banking and financial sector. It has to be in order to finance the large domestic and global economy that we enjoy. Today, banks of all sizes—from the very largest to the smallest—work hand-in-hand with individuals, businesses and governments to meet their financial needs. It is an integrated, competitive, innovative sector that employs 2.1 million workers and supports tens of millions more in jobs through lending to businesses large and small, local and global.

No country in the world would consciously tear apart the financial heart of its economy. Doing so would be a disaster from which it would be hard if not impossible to recover and would have significant consequences for all bank consumers and the U.S. economy.
Appendix:

High Capital Requirements Have Consequences

Recent proposals advocate for substantially higher tangible capital-to-assets ratio for the banking industry, arguing that such standards would have made the financial crisis less severe and costly to the public. Higher capital levels, it is argued, would have prevented many banks from failing.

Certainly, there is general agreement that more capital would have helped banks weather losses with less stress and may have made the secondary impact less severe (such as the reduction of loans and other assets). In response to market and regulatory pressure since the crisis, banks have significantly increased both the dollar amount of capital and capital-to-asset ratios. Now both are near or at record levels.

Recent proposals have focused on capital measurements using a form of tangible equity, i.e., a more conservative form of capital that is immediately available for paying off creditors in the event of a failure or other unforeseen difficulty. Tangible equity capital is understood to be a higher quality of capital—even beyond the high standards of Tier 1 capital. Banks have increased not only the level of total capital but also the quality of the capital by raising the level and share of tangible equity capital.

Higher Mandated Capital Levels Have Significant Costs to Banks and Communities

Raising capital levels to arbitrary levels would be costly for both banks and the economies they support. In order to meet rising capital-to-asset ratios banks need to either secure additional capital from outside the institution or shrink their business (assets). Due to the current market conditions, many banks—particularly smaller community banks—have very limited access to outside capital, meaning that institutions would need to shrink to meet raised capital standards. This would mean a decrease in lending to the economy, just as it did during and just after the financial crisis and recession.

To illustrate the very negative consequences a significant increase in minimum tangible equity capital ratios will have on communities, consider the 10 percent tangible equity capital levels suggested by FDIC Vice Chairman Hoenig, that would require $230 billion of new capital (a 14 percent increase over current capital levels). If the increased minimum ratio was met solely by reducing assets, it would require the banking industry to shrink by nearly 16 percent, with assets falling by over $2 trillion. This shrinkage would come primarily from loans, which would fall by $1.4 trillion or more. Securities and other asset holdings of banks would also fall, creating large distortions in other markets.

4 For example, FDIC Vice Chairman Tom Hoenig advocated such a proposal in a November 30, 2012 speech “Financial Oversight: It’s Time to Improve Outcomes” to the AICPA/SIFMA FSA National Conference in New York.
The impact would be felt across banks of all sizes, and therefore, across all their customers. Businesses (large and small) and individuals would have fewer credit options and higher costs to borrow. Neither is a path that supports economic growth.

As large as the adverse impact would be of a 10 percent tangible equity capital ratio, the negative consequences naturally are significantly higher for higher minimum levels, such as 13 percent to 16 percent which have been mentioned by some commentators. The industry would need between one-half trillion and $1 trillion dollars in new capital; community banks (with assets less than $10 billion) would need an additional $85 billion to $163 billion in capital. In the alternative, assets would shrink by more than one-third, i.e., $4.7 trillion to $6.4 trillion. Obviously, any combination of new costly capital or reduced lending at these levels would slow economic growth severely.

Higher Capital Levels Offer Little Extra Protection

It is also the case that while strong capital levels are essential to running a healthy bank, they do not ensure the bank’s survival. In fact, excessive risk-taking can result in a failure regardless of the level of capital held. For example, an institution whose tangible equity to tangible assets ratio was as high as 35.4 percent in 2008 had losses so severe that it failed.\(^5\) Over half of the institutions that failed between 2008 and 2010 would still have failed if they had had a tangible equity capital ratio of 25 percent in 2008. Moreover, of the banks that failed in this time period, 32 percent already held tangible equity capital exceeding 10 percent, some vastly so. If all banks that failed from 2008-2010 had held 10 percent tangible equity capital in 2008, 95 percent would have failed anyway.

Simply put, the majority of failed institutions failed because the losses were so great that no reasonable level of capital would have been enough to absorb them.

Prior to the crisis, capital levels did little to distinguish banks that would go on to fail with those that remained healthy. As a group, the failed banks were more aggressive lenders with significantly higher loan-to-deposit ratios coming into the crisis than surviving banks. Once economic conditions deteriorated, losses overwhelmed capital and led to failures.

Although strong capital levels are important to a healthy banking sector, arbitrarily high capital levels do little to ensure further safety. Bank capital continues to grow and remains near record levels. It is important to remember that bank capital has increased throughout the financial crisis and is now 25 percent higher than 2008 levels. Further raising capital will do little to stop losses at poorly managed and high-risk institutions and comes with too great a cost.

\(^5\) The tangible-equity to tangible-asset ratio is calculated by taking the value of the bank's total equity and subtracting intangible assets, goodwill and preferred stock equity and then dividing by the value of the company's tangible assets. This ratio is a more exclusive, extreme version than current capital measures.