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Statement of the Shadow Financial Regulatory Committee on

**Questions about Brown-Vitter**

May 13, 2013

Senators Sherrod Brown and David Vitter recently introduced the Terminating Bailouts for Taxpayer Fairness Act (TBTF Act, get it?) in which they propose to increase capital requirements for the largest bank holding companies (BHCs) by scrapping Basel III and substituting a 15% leverage ratio for all BHCs larger than \$500 billion. BHCs smaller than \$500 billion, including community banks, will be subject to a leverage ratio of 8%.

According to their public statements, the Senators' purpose is to reduce the size of the largest BHCs, either because these organizations are thought to gain funding advantages from the market perception that they are too big to fail or because they are believed to be potential sources of instability in the US financial system if they should become insolvent.

Although the Shadow Committee has supported the use of a leverage ratio in the past in lieu of the Basel risk-based standards, it does not believe that imposing a leverage ratio as a penalty for large size is the most efficient way to deal with the funding advantage the largest BHCs might enjoy, or that it will necessarily cause these large institutions to become significantly smaller.

If the problem the Senators hope to solve is to terminate the perceived funding advantage of the largest firms, because the government may protect some or all of the depositors or creditors,

the best way to eliminate that advantage is through a fee or levy of some kind that extracts that benefits and levels the playing field between large and small institutions. A capital increase is a less flexible and efficient way to achieve this objective.

If the problem the Senators intend to solve is to reduce the danger to systemic stability that these large institutions may present, the Committee does not believe that there is any evidence that a 15% leverage ratio will cause \$2 trillion BHCs to become \$500 billion BHCs, and it could seriously erode the competitive position of the banking industry. In addition there is no assurance that a \$500 billion BHC will not also be viewed by the market as too big to fail.

The Committee believes that any efforts to reduce the size of BHCs should focus on creating incentives for the management of these organizations voluntarily to do so. To achieve this objective, the Committee would support legislation or regulatory actions that would make it easier for independent groups to make friendly or hostile bids for segments of a BHC's business.

This might be done, for example, by enhancing the segment reporting requirements under FASB's Statement of Financial Accounting Standards 131, which currently requires the separate reporting of each operating segment of a business if its profit (or loss) is 10 % or more of the profit (or loss) of all operating segments combined. If through this mechanism outside groups can identify areas of a BHC's operations that they believe they can manage more profitably than the holding company, it would provide the basis for a bid. That, in turn, would trigger the obligations of the BHC's board of directors to consider, when receiving a bid, whether the institution and its shareholders would be better off selling the particular line of business to the outside bidder.