Written Testimony of

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before the

COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

United States House of Representatives

"Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?"

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PUBLIC CITIZEN

Chairman McHenry, Ranking Member Green, and members of the subcommittee:

Thank you for the opportunity to present written testimony on the government's authority to break up financial institutions under the Dodd-Frank Wall Street Reform and Consumer Protection Act. I am Micah Hauptman, financial policy counsel for Public Citizen's Congress Watch division. Public Citizen is a national nonprofit organization with more than 300,000 members and supporters.

Public Citizen commends the subcommittee for taking up this critical issue. Looking back on the last five years, it is deeply troubling that too much risk remains concentrated in and between the largest financial institutions. Preventing banks from becoming so large, complex, and interconnected that their failure would ravage the economy—and thus formally ending the policy that any institution is "too big to fail"—is the safest guarantee against a future "too big to fail"-driven financial crisis and resulting taxpayer bailout.

Public Citizen made this argument in January 2012, when we petitioned the Federal Reserve and the Financial Stability Oversight Council to break up and reform the financial behemoth Bank of America so that it is smaller, simpler—and therefore more susceptible to effective management and regulation—and, ultimately safer. Public Citizen relied on section 121 of the Dodd-Frank Act, which grants financial regulators authority to mitigate the "grave threat" that an institution poses to U.S. financial stability. Our petition (see attachment 1) argued that regulators must exercise their "grave threat" authority well before an institution is on the verge of collapse. If they do not, other provisions within the Dodd-Frank Act, including Title II Orderly Liquidation Authority, could be rendered ineffective.

We focused on Bank of America because publicly available information suggested that it was the riskiest and nearest to financial crisis. But the analysis that we offered could potentially apply to other "too big to fail" institutions as well, as suggested in a letter by a group of academics, advocacy groups, and other experts (see attachment 2). Banks have only gotten larger and more complex in the last twenty years. For example, in 1995 the six biggest U.S. banks had assets equal to roughly 18 percent of U.S. gross domestic product. That figure has grown to roughly 63 percent, with both calculations relying on U.S. Generally Accepted Accounting Principles (GAAP). However, using International Financial Reporting Standards (IFRS), which allows for less netting of derivatives exposures, the six biggest banks have assets equal to roughly 102 percent of U.S. gross domestic product, according to FDIC Vice Chairman Thomas Hoenig. Hoenig's analysis shows that the six largest U.S. banks are actually $4 trillion bigger under international accounting standards than U.S. accounting standards.[1]

Issues relating to financial institutions' excessive size and complexity have not just created a "too big to fail" problem; they have metastasized into a "too big to jail" problem. Just last month, U.S. Attorney General Eric Holder admitted that some of our banks are too big to

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[1] Press Release, Sen. Sherrod Brown (D-Ohio) "Brown Delivers Major Address On Efforts To End 'Too Big To Fail' Policies," February 28, 2013, http://1.usa.gov/Z0KD6E.

prosecute. He said, "I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if you do prosecute, if you do bring a criminal charge, it will have a negative impact on the national economy, perhaps even the world economy, and I think that is a function of the fact that some of these institutions have become too large."[2]

As David Arkush, former director of Public Citizen's Congress Watch and coauthor of the Public Citizen petition recently wrote, "Our argument regarding the 'grave threat' to financial stability centered on Bank of America's precarious financial condition. But a U.S. policy that big banks and their executives are largely immune from criminal prosecution will give 'grave threat' a whole new dimension. The mere existence of too-big-to-jail institutions likely poses a grave threat to the economy regardless of their present financial condition. Executives of the largest banks will have strong incentives—in fact, they will face *market pressure*—to engage in reckless, even disastrous, criminal conduct, so long as it benefits them in the short term. Honest banks will be out-competed by those that press these unfair advantages to the fullest."[3]

In the wake of the financial crisis and the passage of the Dodd-Frank Act, the apparent regulatory approach to dealing with "too big to fail" institutions has been dangerously short-sighted. Regulators do not appear willing to use all of the tools that they have at their disposal to safeguard financial stability. For example, the Federal Reserve Board's three-paragraph response to our detailed petition (see attachment 3) suggests that the Fed may not be taking seriously all of its responsibilities under the Dodd-Frank Act.

If financial regulators refuse to take decisive action to safeguard financial stability, then we will remain susceptible to another crisis. But there is still an opportunity for regulators to use their authorities under the Dodd-Frank Act—and we urge regulators to use those authorities, and Congress to continue to use its oversight authority to hold regulators accountable for their actions (or inaction).

We also support congressional efforts to limit the size or scope of financial institutions' activities, to increase transparency around deferred prosecution decision-making that may have been based on the systemic significance of the institution, and to craft higher equity capital requirements in a way that encourages the largest and most complex institutions to restructure their businesses.

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[2] Mark Gongloff, *Eric Holder Admits Some Banks Are Just Too Big To Prosecute*, HUFFINGTON POST, March 6, 2013, http://huff.to/XTwwDn.

[3] David Arkush, *'Too Big to Jail' Is a Grave Threat to Financial Stability and Economic Recovery*, HUFFINGTON POST, March 7, 2013, http://huff.to/13J5ItO.