BANK POLICY INSTITUTE

Applying Global Bank Resolution Rules to Regional Banks Would Undermine Bipartisan Tailoring Efforts, Increase Costs for Borrowers and Produce No Tangible Public Benefit

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Coming out of the global financial crisis, U.S. and international regulators sought to address the "too big to fail" problem by enacting sweeping reforms, which in the U.S. principally included the 2010 Dodd-Frank Act. Many of the reforms were designed to strengthen banks, making them more resilient to stress and therefore reducing the likelihood that they would fail in the future. Wisely, other additional reforms sought to ensure that even if the largest banks did fail in the future, they could do so in a way that was safe and orderly, and that would not lead to contagion in the system. Paramount among these latter reforms was the development of a "single point of entry" resolution strategy and new requirements for additional loss-absorbing capacity at these banks. The reforms designed to increase banks' loss-absorbing capacity have worked well so far (particularly during the economic fallout from COVID) — no large bank has failed since the global financial crisis. Although the reforms ensuring those banks are safe to fail have not been tested, they are universally recognized among domestic and international policymakers and standard setters as game-changers when it comes to ending the perception that those firms are, or could be in the future, too big to fail.

Now, certain U.S. regulators are suggesting that large regional banks in the U.S. should adopt the same resolution approaches that were developed for the GSIBs – notably, that they too should adopt the single-point-of-entry and higher loss absorbency requirements – despite a consensus that regional banks do not pose the same problems in failure as larger global institutions, and that they are already subject to a robust, workable resolution framework prescribed by the FDI Act and administered by the FDIC.

Lawmakers and Regulators Recognized that Rules Designed for Larger, More Complex Institutions Aren't a Good Fit for All Banks

Due to the size and complexity of GSIBs' businesses, the global regulatory community agreed to subject GSIBs to the most stringent prudential and supervisory requirements, including the resolution requirements mentioned above, while tailoring requirements for small and regional institutions to make them less onerous and align with these banks' lower risk levels.

Among the GSIB-specific reforms was a total loss-absorbing capacity (TLAC) requirement that was agreed upon by the Financial Stability Board in 2016. Regulators designed the TLAC requirement and other resolution-related reforms, such as streamlining of organizational structures and the imposition of a "single point of entry" resolution strategy, to enable a GSIB's major subsidiaries to continue serving the needs of customers around the world if the top-tier holding company failed. These reforms, while extremely costly, were considered necessary due to the severe repercussions an interruption in these institutions' operations would pose to the global financial system and economy. U.S. regulators also imposed heightened resolution requirements on non-GSIBs, including regional banks, but determined that TLAC and related resolution requirements were not necessary for these non-systemic institutions.

Why is applying these potential reforms to regional banks so problematic?

The potential reforms under consideration would reduce borrower lending options and increase loan rates for consumers and businesses, ignore bipartisan efforts to tailor regulation to bank risk, upend existing resolution plans and weaken financial stability.

- **Reduces Borrower Options and Increases Loan Rates to Businesses and Consumers.** Applying TLAC to a regional bank would require it to exchange stable, low-cost funding sources, such as deposits, for market-sourced long-term debt funding. Debt funding is associated with a higher interest rate than deposits, thus increasing the bank's overall funding costs, which translates to higher lending rates charged to consumers and businesses. This would have a more pronounced effect on regional banks than on the GSIBs (to which TLAC requirements already apply) because regional banks are more heavily reliant on deposits for their business models, while GSIBs have traditionally used more wholesale and debt funding due to their size and scale. The increased funding costs would make regional banks less competitive than fintechs and other nonbank providers and ultimately reduce the number of affordable options available to borrowers.

- **Reimposes a One-Size-Fits-All Model.** Unlike GSIBs that operate complex business models involving legal entities and significant business lines in both the U.S. and abroad, large regional institutions hold the vast majority (typically 90% or more) of their assets and activities in a single U.S.-based insured depository institution, which carries considerably less complexity and risk. The reforms being considered would restore the "one-size-fits-all" regulatory model and undermine bipartisan efforts to tailor requirements to a bank's size and risk profile established by S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act.
- **Upends Existing Resolution Plans and Imposes Onerous New Requirements.** All banks over $250 billion in total assets are required to submit resolution plans under the Dodd-Frank Act, and banks over $100 billion are required to submit resolution plans to the FDIC under the Federal Deposit Insurance Act. These resolution plans are reviewed by regulators, who have found regional banks' plans to be credible. Imposing TLAC requirements would require regional institutions to undertake what would likely be a multi-year process to substantially overhaul their resolution strategies and their business-as-usual funding structure without yielding any meaningful public policy benefits.
- **Weakens Financial Stability.** Because the cost of wholesale funding is market-dependent, it is significantly more volatile than the cost of deposits. As we saw during the onset of the COVID event, firms drew on a massive scale on their preexisting credit lines, which lowered banks' TLAC ratios and required them to issue long-term debt during a crisis. At the same time, the cost of long-term debt rises due to an overall tightening in financial conditions. This would further increase banks' funding costs due to TLAC requirements and reduce their ability to lend, thereby amplifying the reduction in the availability of credit in bad times and harming financial stability.

Reinforce Regulatory Tailoring, Preserve Consumer Choice and Protect Financial Stability

Policymakers should reject any changes to the regional bank resolution framework that would inappropriately require regional banks to comply with rules designed for GSIBs. These changes would not contribute to a safer financial system but would weaken financial stability, undermine years of bipartisan progress to tailor regulation and ultimately reduce the borrowing options available to consumers and businesses.

To learn more, please click here.