The Daily Dish

The SIFI Debate

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Eakinomics: The SIFI Debate

Senator Elizabeth Warren penned an op-ed in Bloomberg entitled “Don’t Let the Big Banks Escape the Fed’s Scrutiny.” In it she argues against raising the asset threshold for a bank to be subject to Federal Reserve supervision as a systemically important financial institution (SIFI). Specifically, she argues for maintaining the current $50 billion asset threshold, rather than increasing the threshold to $250 billion. Recall that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) of 2010 set the threshold to determine which banks should be subject to increased prudential regulation. The compliance costs for banks, especially regional and mid-sized banks, have been enormous, resulting in bank closures, mergers, and only one new bank charter granted since the crisis.

The Regional Bank Coalition (RBC) wrote a rebuttal to Senator Warren’s op-ed challenging her arguments for a lower threshold on the grounds that the $50 billion asset threshold ends up hurting regional and mid-sized banks instead of preventing any sort of real systemic risk at the big banks. RBC explains that regional banks, which generally fall just above the $50 billion asset threshold, are structurally very different than the big banks that these laws are intended to oversee. Where the largest banks participate in a number of activities that traditionally are considered “more risky,” the regional and mid-sized banks carry a large majority of their assets in loans and liquidity and are the drivers of small business lending and economic growth in our communities.

RBC proposes that instead of an arbitrary asset threshold the Fed should use a multi-factored, or activities-based approach to regulating banks. As AAF research has shown, using a more tailored regulatory approach would hold the most risky financial companies to a higher compliance standard while allowing the less risky ones to focus on their core activity, which is commercial lending and consumer banking.

In fact, just last week, the Office of Financial Research (OFR), another creation of Dodd-Frank, released a paper entitled "Size Alone is Not Sufficient to Identify Systemically Important Banks." In it, OFR explains that using arbitrary asset thresholds to measure potential risk at individual banks does not accurately reflect the other factors affecting systemic importance like interconnectedness, substitutability, complexity, and cross-jurisdictional activity, especially at regional and mid-size banks. Instead, OFR suggests that a multi-factor approach to identifying U.S. banks for enhanced regulation is preferable, would be more focused on systemic importance, and would be an improvement on the asset thresholds currently being used.

As Treasury and other regulators continue to develop their policy priorities for this administration, they should look to the overwhelming research which shows that multi-factor and activities-based approaches to financial regulation are more effective, more efficient, and could have prevented the most recent financial crisis. They should ignore rhetoric that disregards the data and runs the risk of damaging the financial system.