The Numbers Tell The Story: Banks Are Far Safer, Simpler, And TBTF Is Over

An overview of the evolution of safety and soundness at the six largest financial institutions since the passage of Dodd-Frank

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Hamilton Place Strategies provides analysis, communications, and advocacy solutions at the intersection of government, business, and media.

Executive Summary

In 2015, the debate on financial regulation has more or less ignored the actual changes to largest U.S. banks. The fact is reform has dramatically changed the largest banks. Capital has doubled. Liquidity has tripled. Large banks have reduced legal entities by 20 percent. Four of the largest banks have shrunk and overall the largest banks have grown far slower than the U.S. economy, regional banks, and community banks. This presentation provides a summary of these significant changes.

- **To date, the six largest banks have increased their core capital by 78 percent and their median simple leverage ratio by 46 percent since the quarter before the crisis**. Large banks have also more than tripled their liquid assets.
- **All six institutions have made signification reductions and have reduced legal entities by 20 percent since 2009.** Goldman has trimmed $250B in assets, Morgan Stanley has reduced its assets by 22 percent, Citi has shed $700B in noncore assets, BofA has eliminated 746 legal entities, and JPM has cut ties with more than 2,000 customers who were creating regulatory burden.
- **Large banks' holding companies have only grown 0.23 percent since the crisis compared to 20+ percent growth by smaller bank holding companies**, reducing financial market concentration.
- **New rules like ISDA's 48 hour-stay on derivatives and the Fed's total loss absorbing capacity (TLAC) rule ensure creditors, not taxpayers, absorb losses during failure.** These developments will help facilitate resolution of a large bank failure.
- **Any potential funding advantage of large banks due to market perceptions of government support has been eliminated or even reversed.** Academic research, the recent GAO report, and credit ratings all point to this conclusion.

Policy Responses Ended TBTF By Improving Bank Safety And Minimizing Impact Of Failure

Policies end TBTF by…

…Reducing the likelihood of failure.

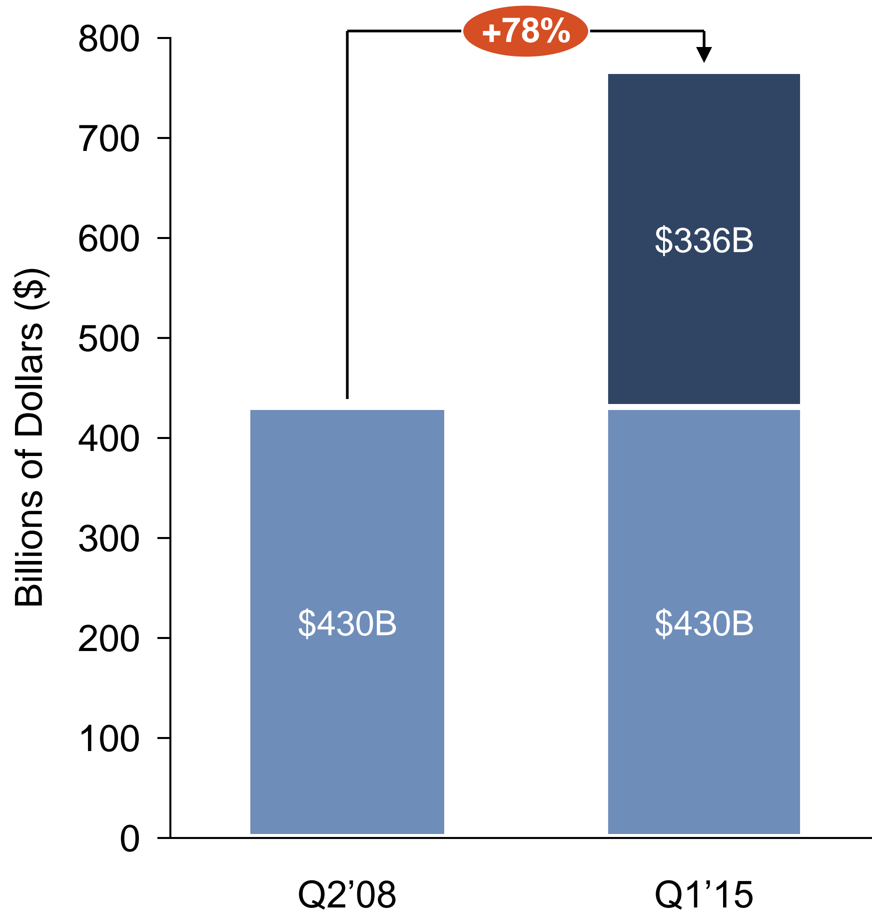
- **Doubling the quantity and improving the quality of capital, while tripling liquidity** dramatically reduces the likelihood that bank losses lead to failure.
- **Improved oversight through regular stress tests** and agency restructuring will keep banks and regulators more aware of risks.
- **Banning proprietary trading** through the Volcker Rule to reduce risks associated with trading operations at commercial banks.

…Minimizing the impact of a failure on broader economy.

- **Improved resolution strategies through Single Point Of Entry (SPOE)** gives regulators new tools to wind down large institutions without using taxpayer money.
- **Living Wills process helps drive reforms to improve resolvability,** including reducing bank legal entities by 20 percent.
- **Restrictions on bank size** through new rules that prohibit large banks from acquiring or merging with other firms.

In addition to these approaches, many of the emergency bailouts in 2008 are now illegal, requiring legislative overhaul to be implemented again.

Global U.S. Banks' Capital Increased 78 Percent Since Mid-2008



"Higher capital puts these firms in a much better position to absorb future losses while continuing to fulfill their vital role in the economy."

- Ben Bernanke, Former Fed Chairman

"The banking system is arguably as strong as it has ever been. […] Capital is at record levels, and there is ample liquidity. Credit quality is good and improving rapidly."

- Mark Zandi, Moody's Chief Economist

"The banks will not get this country in trouble, I guarantee it … The capital ratios are huge, the excesses on the asset side have been largely cleared out … Our banking system is in the best shape in recent memory."

- Warren Buffett

Source: Bloomberg

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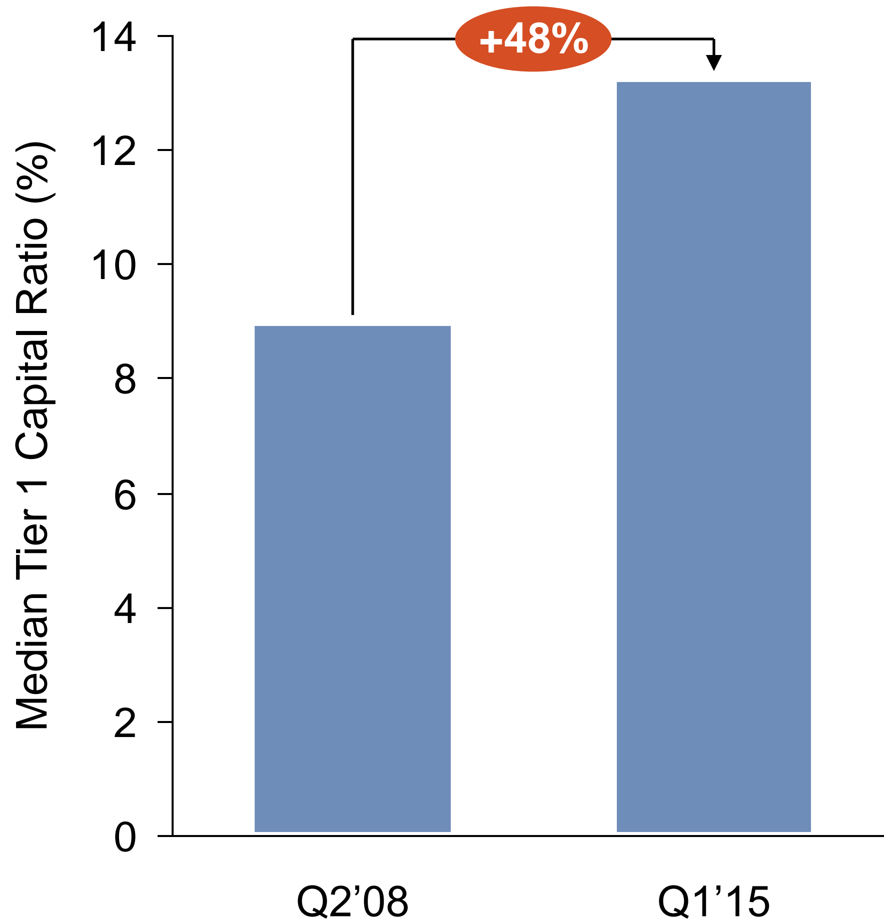
The Largest Banks Have Improved Their Tier 1 Ratio By 48% Since The Crisis

Tier 1 Ratio For Six Largest Banks



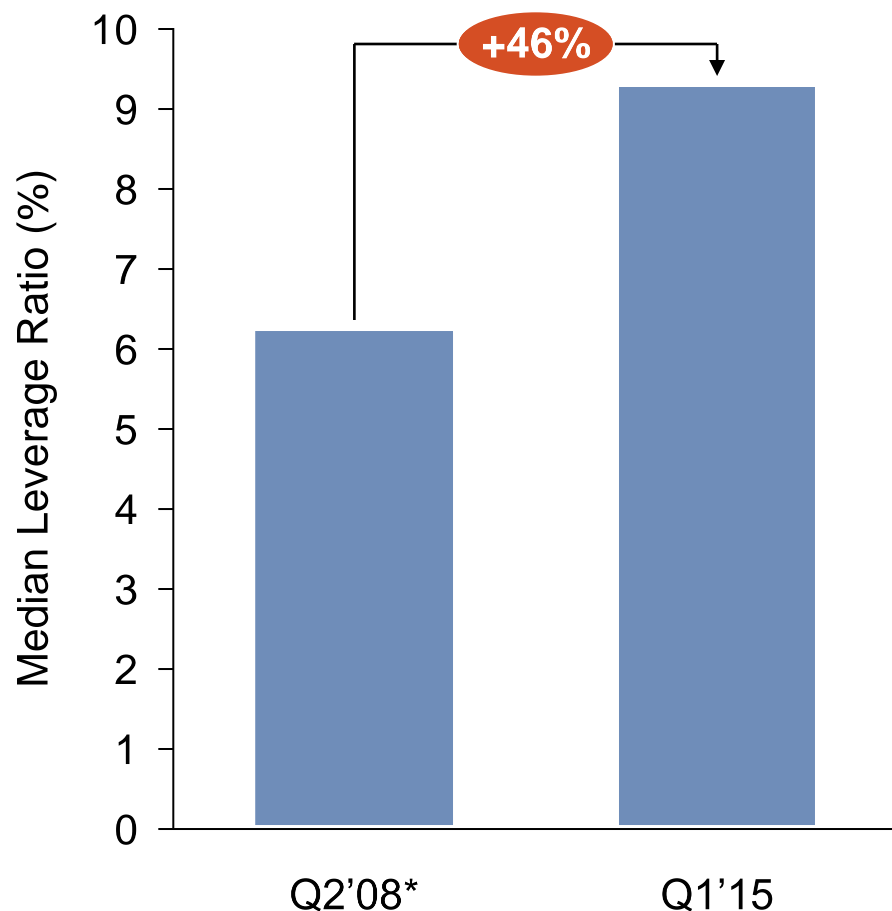
Source: Bloomberg

Tier 1 Capital Ratio:

- **New, Stricter Requirements:** The minimum Tier 1 ratio under the new Basel III rules, including a capital conservation buffer, is 8.5 percent.
- **Stronger Capital Base:** The median Tier 1 ratio for the largest six banks is 13.2 percent, up from 7.4 percent at the peak of the crisis.
- **Tougher Risk-Weights:** Updated risk-weights require banks to hold more capital against most types of assets, reducing the ability to 'game' regulators.

Large Banks' Simple Leverage Ratio Has Increased 46%, Acting As A Credible Backstop To Risk

Simple Leverage Ratio For Six Largest Banks*



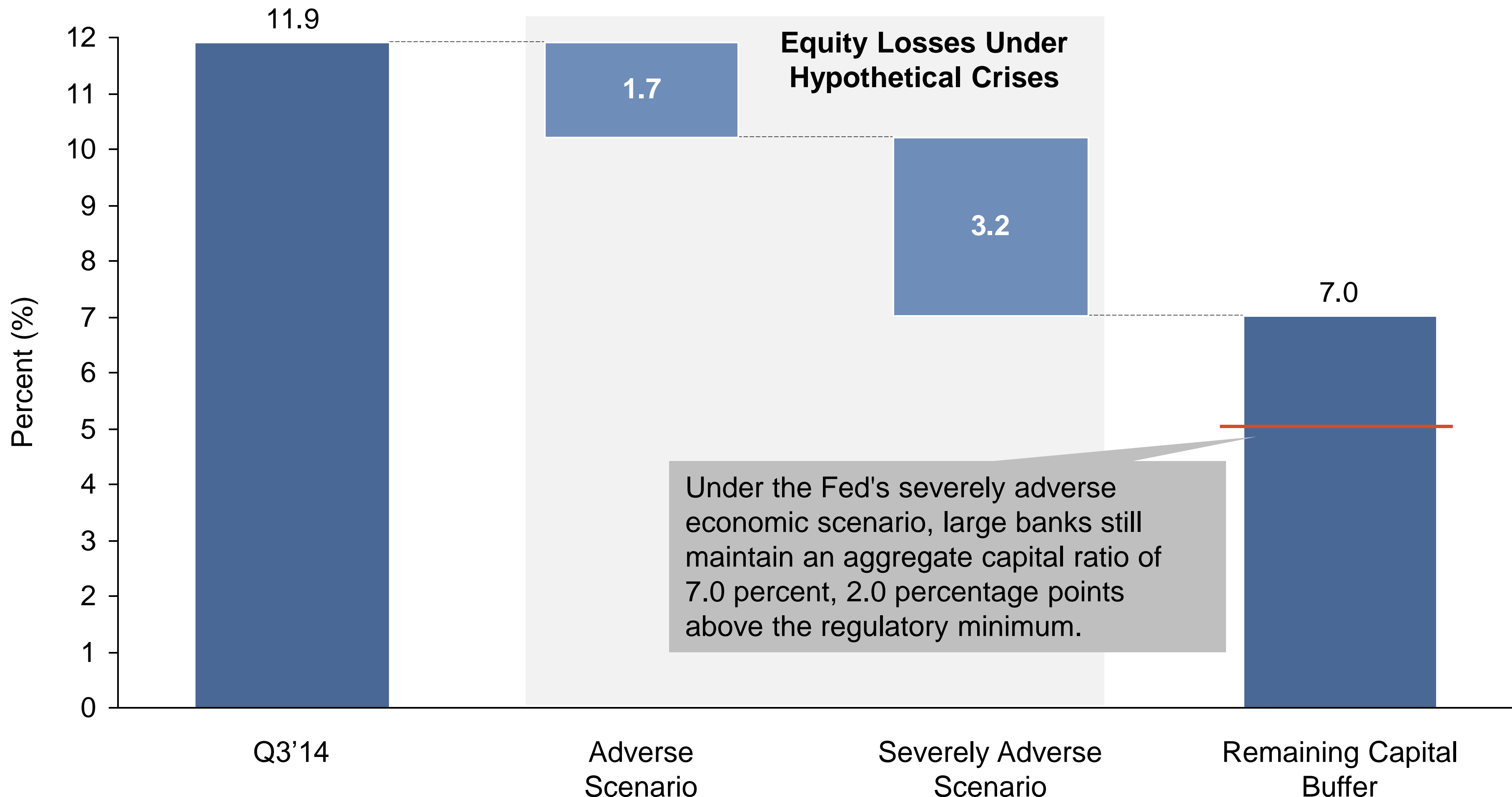
Simple Leverage Ratio:

- **New, Stricter Standards:** U.S. Banks' simple leverage ratio requirement is nearly double international standards.
- **A Stronger Backstop Is Already In Place:** The median simple leverage ratio for the largest six banks is 9.3 percent, up from 5.5 percent at the peak of the crisis.
- **$200B Extra:** Under the new leverage ratio rules, the 12 largest banks will have to raise an additional $200B in capital.

Source: Bloomberg

*Excludes Goldman Sachs and Morgan Stanley due to unavailability of data

With More Capital, U.S. Banks Withstood Both Of The Fed's Hypothetical Adverse Scenarios In 2015



Source: Federal Reserve

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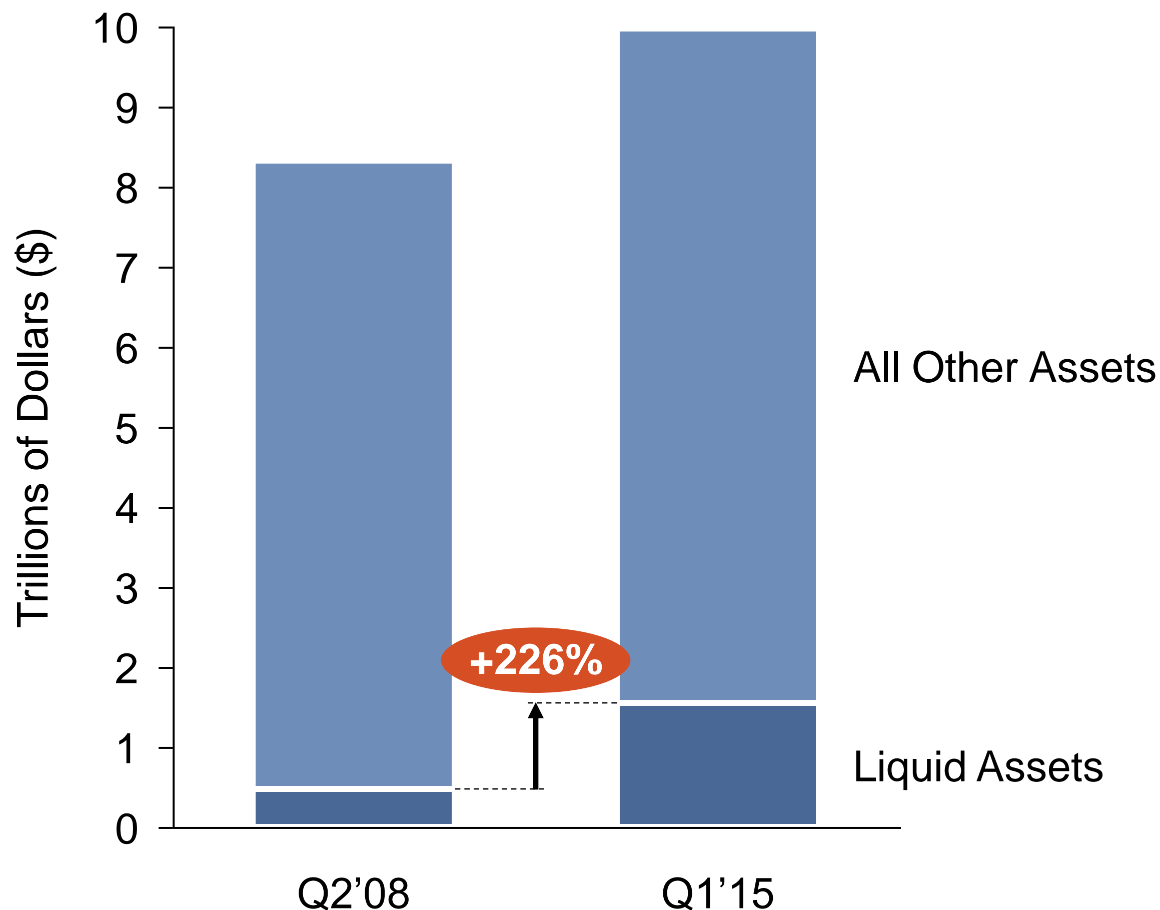
The Largest Banks Have Tripled Their Liquidity Position In Response To The Challenges Of '08



Liquidity:

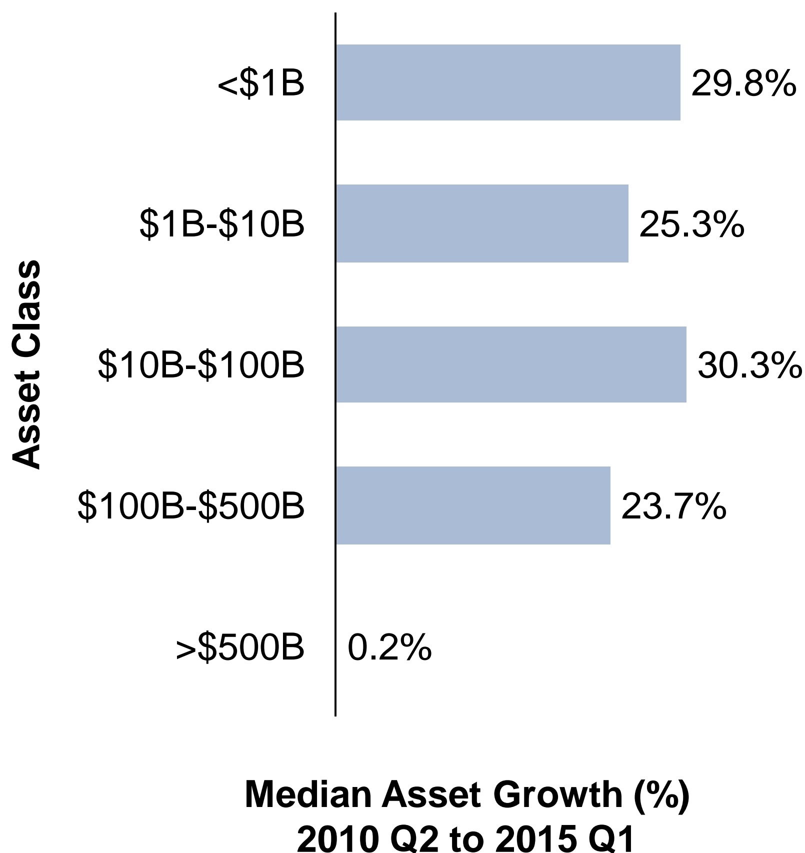
- **A stronger liquidity position enables banks to better fund obligations during crises**
- **Triple The Liquidity:** The largest banks have improved their aggregate liquid assets from $480B in Q2'08 to $1.56T in Q1'15

*Liquid assets equals cash plus marketable securities

Source: Federal Reserve Economic Data

The Largest U.S. BHCs Slowed Growth Compared To Other Asset Classes, Contrary To Popular Thought

Asset growth since the passage of Dodd-Frank has occurred in the middle tier of banks…



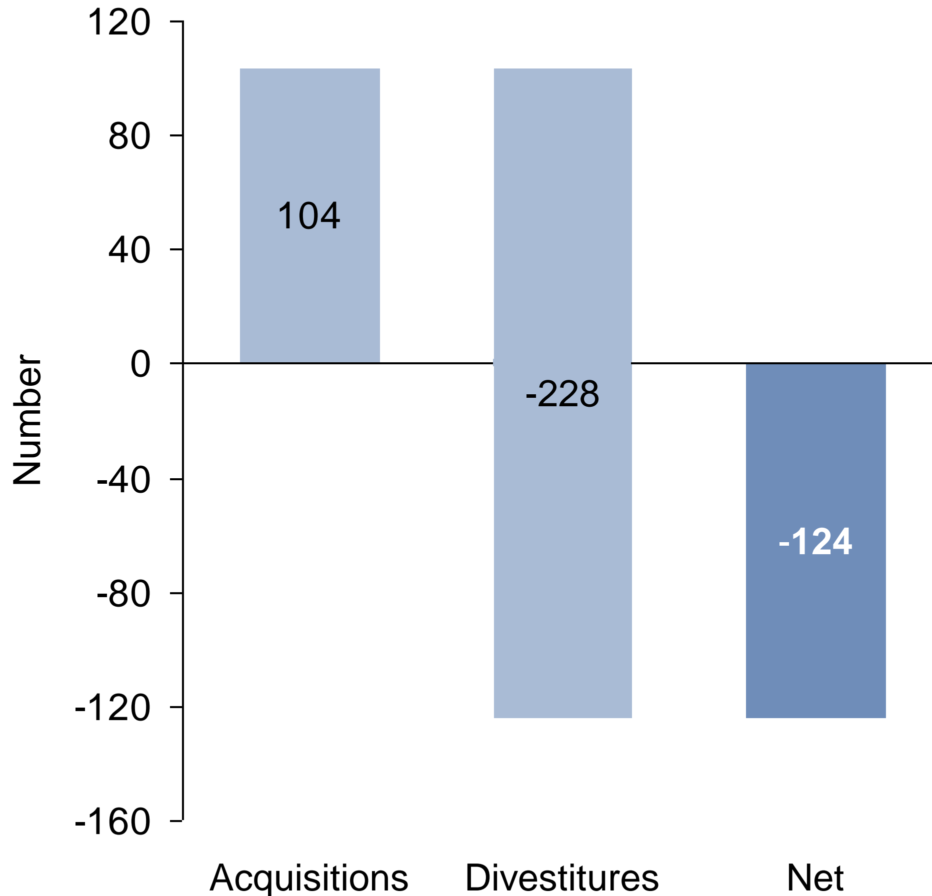
…While individually large banks have worked to slim down and simplify

- Bank of America has divested from $70B in non-core assets and reduced its number of legal entities by 36 percent.
- Goldman Sachs shrank 6 percent since 2010 and 24 percent since 2007, while the pay per employee fell 13 percent since 2010 and 43 percent since 2007.
- Citigroup has shed nearly $700 billion in non-core assets and divested from more than 60 non-core business lines.
- Morgan Stanley went from earning 70 percent from trading in 2007 to less than 50 percent today.
- JPMorgan has announced it will reduce non-operating deposits by $100 billion

Source: Bloomberg (See research by BPC and IMF echoing these findings here and here), WSJ, WSJ Blog, NYT

Large Banks Have Divested From 124 Entities, On Net, And Reduced Legal Entities By 20 Percent

Acquisitions and Divestitures Since 2010



Fed Chair Janet Yellen on banks' simplifying

While noting a simple count of legal entities does not adequately capture complexity, Fed Chair Janet Yellen testified, "I would simply say that the regulatory reports that we receive indicate that these firms since 2009 have reduced the number of legal entities in their structures by approximately 1/5."

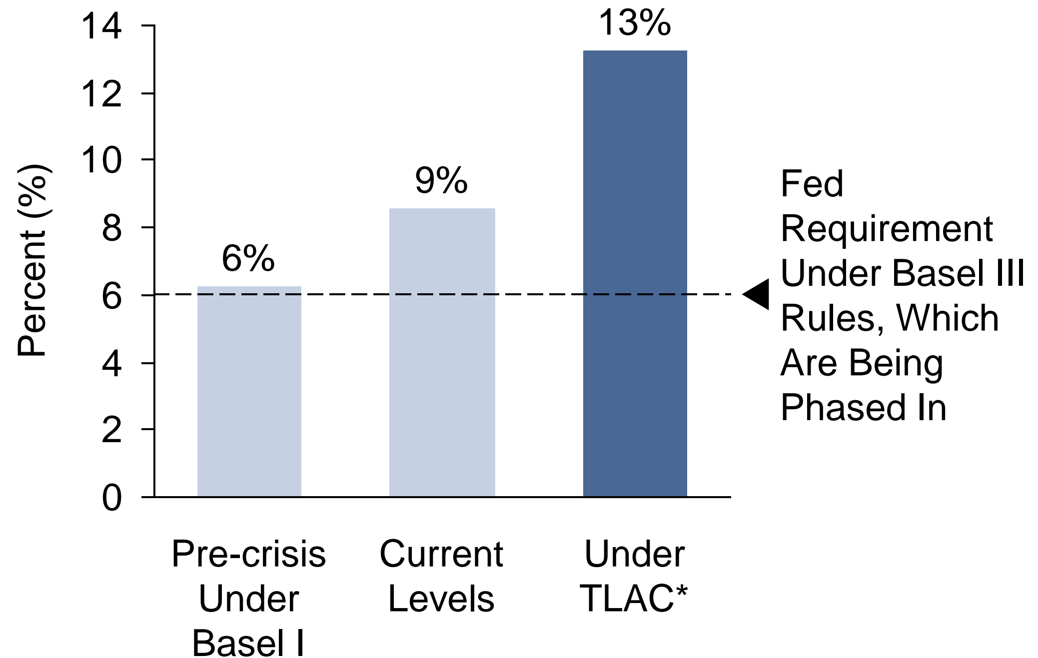
Source: CNBC, KBW, Testimony 7/18

New TLAC Rule Increases Total Loss Absorbing Capacity To 4-5 Times Level Of Losses During A Crisis

Background

- **Latest developments**: Last November, the Financial Stability Board introduced the TLAC rule, stating that GSIBs must maintain a TLAC between 16 percent to 20 percent of Risk Weighted Assets.
- **TLAC facilitates SPOE:** In the event of failure, TLAC ensures the ultimate parent has an adequate amount of capital available to absorb losses from operating entities
- **FSB Chair Mark Carney:** TLAC is a "watershed in ending 'too big to fail' banks."
- **Capital Impact**: The Clearing House estimates TLAC will raise capital requirements to 4.4-5 times the losses projected under the Fed's severely adverse scenario.

Median Leverage Ratios For The Six Largest Banks (%)



*****Methodology***: *Analysis identified total loss absorbing capital necessary to meet a 23 percent threshold of current risk-weighted assets and expressed this figure as a ratio to total assets. Note that certain capital instruments included in TLAC are not eligible for inclusion in regulators' supplementary leverage ratio.*

To Simplify The Resolution Process, Banks Have Agreed To A 48-Hour Stay On Derivatives Contracts

Agreement To 48-Hour Stay

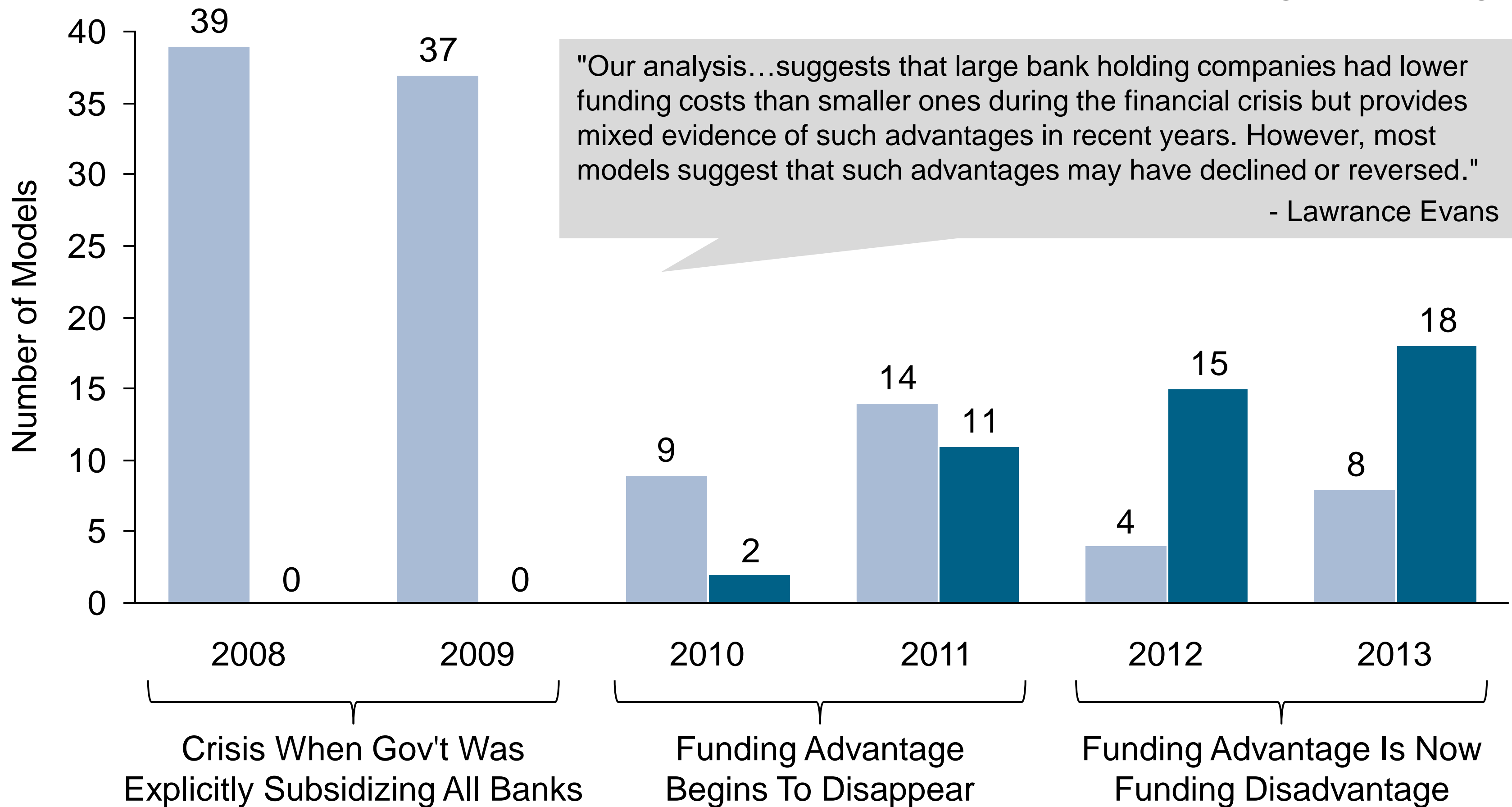
- The International Swaps and Derivatives Association and 18 global financial firms agreed to a 48-hour stay on derivative contracts for failing firms
- Stays apply to new and existing contracts
- More than 90 percent of derivatives contracts are held by institutions covered by the stay rule

Easier Resolution

- Delay gives regulators time to ensure that critical parts of a bank continue smoothly while the company is wound down in an orderly way
- "Regulators have said a pause in the collection of swaps collateral could give a bank enough time to re-capitalize and avoid the kind of panic that followed the 2008 failure of Lehman Brothers Holdings Inc."

Source: Reuters; Bloomberg

No "Subsidy": Any Funding Advantage Has Been Eliminated If Not Reversed Since The Crisis



Source: Lawrance Evans Testimony, Figure 1