THE NEW ENGLAND COUNCIL

Committee Update

July 31, 2014

GAO Releases Report on Too-Big-To-Fail

TOPLINE SUMMARY: Senators Sherrod Brown (D-OH) and David Vitter (R-LA) requested the Government Accountability Office (GAO) "conduct a study of the economic benefits that bank holding companies (BHCs) with more than $500 billion in consolidated assets receive as a result of actual or perceived government support" in order to determine whether too-big-to-fail (TBTF) had been eliminated.

Today, at a Senate Banking Subcommittee on Financial Institutions and Consumer Protection hearing, the Senators released a second GAO report based on their request (the GAO previously issued one in November 2013), titled *Large Bank Holding Companies: Expectations of Government Support*.

The report found that, among market participants the agency interviewed, including credit rating agencies and large investors, many believe that recent regulations, including those promulgated as a result of the Dodd-Frank Act, ***"have reduced but not eliminated the likelihood the federal government would prevent the failure of one of the largest bank holding companies."*** Member agencies of the Financial Stability Oversight Council (FSOC) also believe that "financial reforms have not completely removed too-big-to-fail perceptions but have made significant progress toward doing so."

The authors also noted that, ***"[r]emaining market assumptions about government support can give rise to advantages for the largest bank holding companies*** in three broad categories to the extent these assumptions affect decisions by investors, counterparties, and customers of these firms….[namely:] funding costs, financial contracts that reference ratings, and ability to attract customers."

The report also found that funding cost differences between large bank holding companies and smaller ones "may have declined or reversed" in recent years, but noted that this may be due to improvements in their financial conditions as well as low borrowing costs.

INITIAL REACTION: Senator Brown, who chairs the Banking Subcommittee that held today's hearing, and Senator Vitter cited the report as evidence that "Wall Street megabanks have not only received more support from government bailout programs, but enjoy a taxpayer-funded advantage – over community and regional banks – that widens during times of economic crisis." They previously introduced legislation called the *Terminating Bailouts for Taxpayer Fairness Act* (TBTF Act), to:

- Set reasonable capital standards that would vary depending on the size and complexity of the institution;
- Limit the government safety net to traditional banking operations; and
- Provide regulatory relief for community banks.

At the hearing, Subcommittee Ranking Member Pat Toomey (R-PA) said the greater question to ask if whether or not Dodd-Frank has been effective in ending TBTF. He said Congress should look to create a system where companies can fail without a taxpayer bailout by enacting a properly functioning bankruptcy process. Toomey also discussed his legislation to repeal Title II (Orderly Liquidation Authority) of Dodd-Frank. Toomey said that the GAO report was inconclusive as to whether or not large BHCs enjoy an expectation of government support; Vitter disagreed, saying the report was clear that they do.

RESOURCES

To read today's full GAO report, click here.

To read the GAO's testimony from today's hearing summarizing the report, click here. You may also view the full hearing and read all of the witnesses' testimony here.

To read the first GAO report on the subject, issued in November 2013, click here.

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