VIEWPOINTS

Designating Bank SIFIs: An Arbitrary Threshold for Risk

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November 2015

In response to the recent severe financial crisis and the worst recession since the Great Depression, the U.S. Congress enacted and President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) in July 2010. An important objective of DFA is to mitigate the threat to financial stability posed by systemically important financial institutions, or SIFIs. Should any of these institutions fail, the entire financial industry would be adversely affected and most likely the broader economy as well. The Financial Stability Oversight Council (FSOC) was established by DFA to identify any and all SIFIs, which are then subjected to enhanced prudential supervision by the Federal Reserve Board. Section 165 of DFA, however, requires that bank holding companies (BHCs) with $50 billion or more in consolidated assets must be designated as SIFIs.

Table 1 lists the BHCs that are currently designated SIFIs and identifies those also designated global systemically important banks (G-SIBs) by the Financial Stability Board (FSB). As of June 2015, the biggest SIFI is JPMorgan Chase, with $2.5 trillion in assets, while the smallest one is Zions, with $58 billion in assets. (See Figure 1 for a visualization of the striking differences in asset size among SIFIs.) Clearly, these two institutions pose different degrees of systemic risk, with one more than 40 times the size of the other. This disparity indicates the arbitrariness of designating SIFIs solely on the basis of whether a BHC has $50 billion in assets.

New York Community Bancorp, moreover, has total assets of $49 billion, which places it just below the threshold for the SIFI designation. The $9 billion difference between it and Zions can’t justify the identification of one, and not the other, as a SIFI based on risk concerns. In short, there is no evidence to support the use of a $50 billion threshold set by law to distinguish SIFIs from the rest. Such a static and arbitrary threshold incentivizes institutions just below the limit to curtail their growth, while those just above have a motive to increase their size to spread the additional costs imposed by being subject to enhanced supervision. Surely, this was not the intent of the law.

TABLE 1. U.S. Bank Holding Companies With Total Consolidated Assets Greater Than $50 Billion

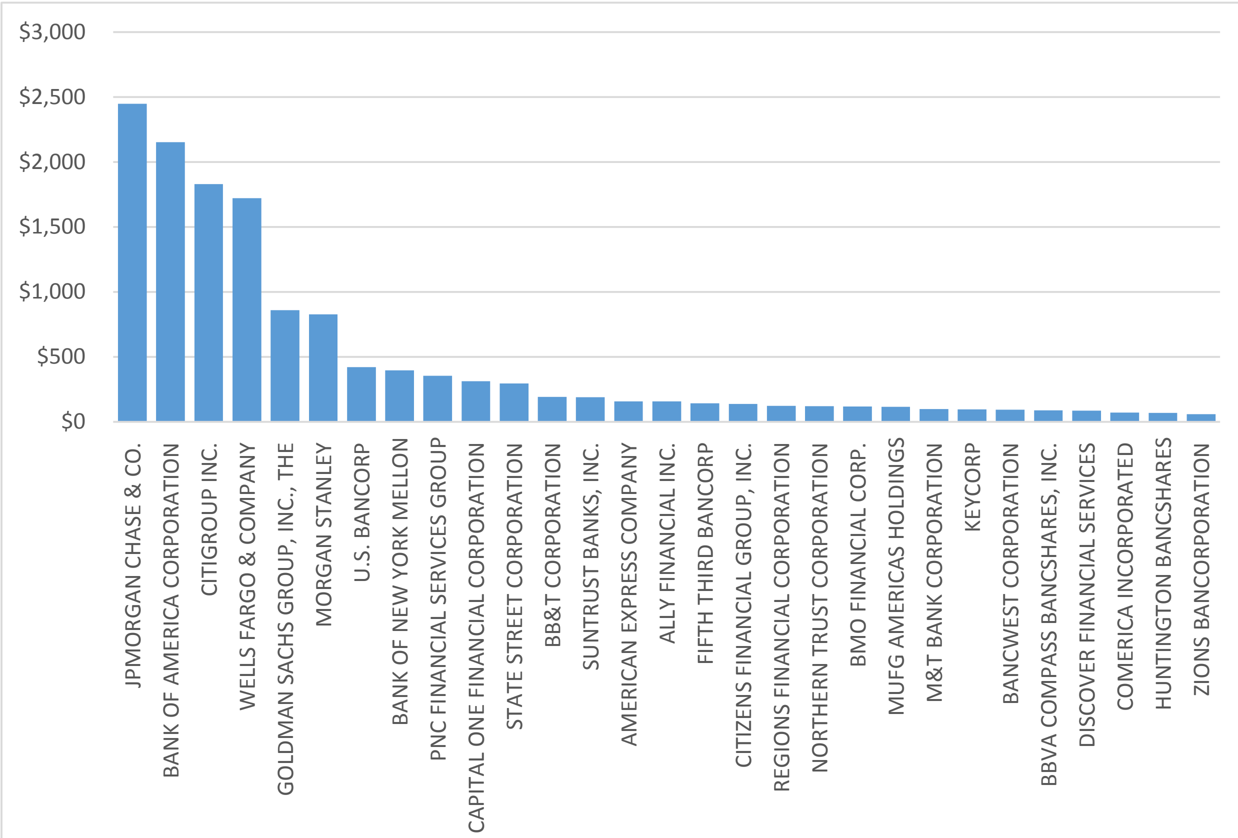
X denotes institutions that participated in DFA stress tests and/or were designated G-SIBs by the FSB (as of June 30, 2015)

Rank	Institution	Location	Total Assets ($ billions)	Participated in Stress Test (March 2015)	G-SIBs (November 2014)
1	JPMORGAN CHASE & CO.	NEW YORK, NY	$2,448	X	X
2	BANK OF AMERICA CORPORATION	CHARLOTTE, NC	$2,152	X	X
3	CITIGROUP INC.	NEW YORK, NY	$1,829	X	X
4	WELLS FARGO & COMPANY	SAN FRANCISCO, CA	$1,721	X	X
5	GOLDMAN SACHS GROUP, INC.,	NEW YORK, NY	$860	X	X
6	MORGAN STANLEY	NEW YORK, NY	$826	X	X
7	U.S. BANCORP	MINNEAPOLIS, MN	$419	X	
8	BANK OF NEW YORK MELLON CORPORATION	NEW YORK, NY	$395	X	X
9	PNC FINANCIAL SERVICES GROUP, INC.,	PITTSBURGH, PA	$354	X	
10	CAPITAL ONE FINANCIAL CORPORATION	MCLEAN, VA	$311	X	
11	STATE STREET CORPORATION	BOSTON, MA	$295	X	X
12	BB&T CORPORATION	WINSTON SALEM, NC	$191	X	
13	SUNTRUST BANKS, INC.	ATLANTA, GA	$189	X	
14	AMERICAN EXPRESS COMPANY	NEW YORK, NY	$157	X	
15	ALLY FINANCIAL INC.	DETROIT, MI	$156	X	
16	FIFTH THIRD BANCORP	CINCINNATI, OH	$142	X	
17	CITIZENS FINANCIAL GROUP, INC.	PROVIDENCE, RI	$138	X	
18	REGIONS FINANCIAL CORPORATION	BIRMINGHAM, AL	$122	X	
19	NORTHERN TRUST CORPORATION	CHICAGO, IL	$120	X	
20	BMO FINANCIAL CORP.	WILMINGTON, DE	$118	X	
21	MUFG AMERICAS HOLDINGS CORPORATION	NEW YORK, NY	$114	X	
22	M&T BANK CORPORATION	BUFFALO, NY	$97	X	
23	KEYCORP	CLEVELAND, OH	$95	X	
24	BANCWEST CORPORATION	HONOLULU, HI	$91		
25	BBVA COMPASS BANCSHARES, INC.	HOUSTON, TX	$88	X	
26	DISCOVER FINANCIAL SERVICES	RIVERWOODS, IL	$85	X	
27	COMERICA INCORPORATED	DALLAS, TX	$70	X	
28	HUNTINGTON BANCSHARES INCORPORATED	COLUMBUS, OH	$69	X	
29	ZIONS BANCORPORATION	SALT LAKE CITY, UT	$58	X	

Note: Savings and loan holding companies and foreign bank holding companies are excluded. Also, BancWest Corporation will be subject to Dodd-Frank Act stress testing beginning January 1, 2016.

Sources: National Information Center, http://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx; Board of Governors of the Federal Reserve System, http://www.federalreserve.gov/bankinforeg/dfa-stress-tests.htm; Financial Stability Board, http://www.financialstabilityboard.org/wp-content/uploads/r_141106b.pdf.

FIGURE 1. U.S. Bank Holding Companies With Total Consolidated Assets Greater Than $50 Billion
($ billions)

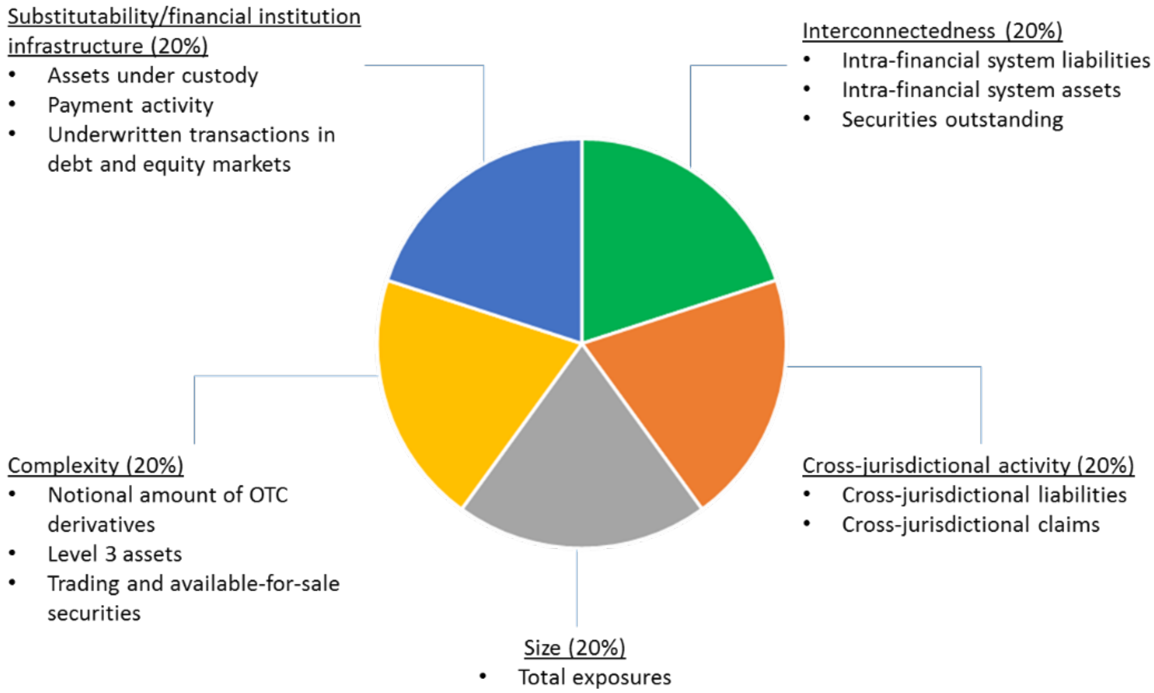


If such a static threshold is to be used, it should be much higher. A $500 billion threshold would include only the top six BHCs in Table 1, which accounted for 61 percent of total BHC assets as of June 30, 2015. Alternatively, a threshold of $250 billion would include only the top 11 BHCs, which accounted for 73 percent of BHC assets. These two figures, moreover, are free of a key problem associated with the $50 billion threshold: The institutions on either side of a $250 billion or $500 billion threshold will have far greater differences in assets. Of course, if either of these figures were used to designate SIFIs, the threshold should change over time, perhaps by linking them to GDP growth.

Table 1 also shows the eight BHCs that have been designated G-SIBs by the Financial Stability Board. Each has total assets greater than $250 billion. More importantly, the G-SIB designation is not based solely on asset size. As Figure 2 shows, five factors are used in the designation process, a far more appropriate basis for designating a BHC as a SIFI. Indeed, the size factor only accounts for 20 percent in calculating the final score that captures the global systemic risk presented by an institution.

It should also be noted that the list of G-SIBs is not static but can change over time depending on the extent to which the business model of an institution evolves. For example, Banco Bilbao Vizcaya Argentaria was added to the list in 2012, the Industrial and Commercial Bank of China Ltd. was added in 2013, and Agricultural Bank of China was added in 2014. Importantly, an institution's score relating to global systemic risk may even be adjusted based on the FSB's supervisory judgment. In a similar manner, if the threshold for designating a SIFI were increased to $250 billion or $500 billion, the Federal Reserve Board could use its judgment to determine whether a BHC with less should nevertheless be so designated.

FIGURE 2. Factors for Designating G-SIBs



Source: Basel Committee on Banking Supervision, "The G-SIB Assessment Methodology – Score Calculation," November 2014.

It is important to point out that the Office of Financial Research (OFR), housed within the U.S. Treasury Department, recently issued a report evaluating the systemic importance of the largest BHCs based on size, interconnectedness, complexity, global activity, and substitutability.[1] These are the same factors used to designate G-SIBs (see Figure 2). The report found that the eight BHCs designated as G-SIBs had the highest systemic importance scores, ranging from a low of 1.72 percent for Wells Fargo to a high of 5.05 percent for JPMorgan Chase. In sharp contrast, however, the other 25 BHCs had an average score of just 0.14 percent. On the basis of their findings, it was concluded that "the largest banks tend to dominate all indicators of systemic importance."

The authors' use of more than just a size measure to evaluate the systemic importance of BHCs is consistent with another report issued by the Bank of Canada.[2] The report concluded with the statement, "While regulators take different approaches in assessing systemic importance, all of them look beyond size to evaluate the importance of each institution for the financial system."

1. Meraj Allahrakha, Paul Glasserman, and H. Peyton Young, "Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data," Office of Financial Research Brief Series, February 12, 2015.
2. Éric Chouinard and Erik Ens, "Assessing the Systemic Importance of Financial Institutions," Bank of Canada, *Financial System Review*, December 2013.

It is also interesting to note that a recently published paper[3] by three economists—one of whom received the Nobel Prize for economics—at the New York University Stern School of Business reached a similar conclusion to that of the OFR paper. The authors implemented a model based on publicly available data to compute systemic risk (SRISK%), which is a measure of the percentage of the capital an institution is expected to need if there is another financial crisis. The results of their analysis for most of the BHCs listed in Table 1 are reported in Table 2, noting the BHCs' assets and risk levels. Bank of America has the highest score at 18.83 percent, while all of the BHCs with fewer than $500 billion have scores equal to or less than 0.7 percent, with the exception of Bank of New York Mellon and State Street Corp., which are designated G-SIBs and have scores of 1.79 percent and 1.67 percent respectively.

TABLE 2. U.S. Bank Holding Companies With Total Consolidated Assets Greater Than $50 Billion

Rank	Institution	Total Assets ($ billions)	SRISK% (September 18, 2015)
1	JPMORGAN CHASE & CO.	$2,448	16.4
2	BANK OF AMERICA CORPORATION	$2,152	18.83
3	CITIGROUP INC.	$1,829	13.95
4	WELLS FARGO & COMPANY	$1,721	≤ 0.10
5	GOLDMAN SACHS GROUP, INC.	$860	4.95
6	MORGAN STANLEY	$826	7.44
7	U.S. BANCORP	$419	≤ 0.10
8	BANK OF NEW YORK MELLON CORPORATION	$395	1.79
9	PNC FINANCIAL SERVICES GROUP, INC.	$354	0.2
10	CAPITAL ONE FINANCIAL CORPORATION	$311	≤ 0.10
11	STATE STREET CORPORATION	$295	1.67
12	BB&T CORPORATION	$191	≤ 0.10
13	SUNTRUST BANKS, INC.	$189	0.83
14	AMERICAN EXPRESS COMPANY	$157	≤ 0.10
15	ALLY FINANCIAL INC.	$156	N/A
16	FIFTH THIRD BANCORP	$142	0.55
17	CITIZENS FINANCIAL GROUP, INC.	$138	N/A
18	REGIONS FINANCIAL CORPORATION	$122	0.61
19	NORTHERN TRUST CORPORATION	$120	0.19
20	BMO FINANCIAL CORP.	$118	N/A
21	MUFG AMERICAS HOLDINGS CORPORATION	$114	N/A
22	M&T BANK CORPORATION	$97	≤ 0.10
23	KEYCORP	$95	0.36
24	BANCWEST CORPORATION	$91	N/A
25	BBVA COMPASS BANCSHARES, INC.	$88	N/A
26	DISCOVER FINANCIAL SERVICES	$85	N/A
27	COMERICA INCORPORATED	$70	0.34
28	HUNTINGTON BANCSHARES INCORPORATED	$69	0.16
29	ZIONS BANCORPORATION	$58	0.26

Source: http://vlab.stern.nyu.edu/analysis/RISK.USFIN-MR.MES#risk-graph

3. Viral Acharya, Robert Engle, and Matthew Richardson, "Capital Shortfall: A New Approach to Ranking and Regulating Systemic Risks," *American Economic Review: Papers & Proceedings*, 2012.

Once again, there are substantial differences in the evaluation of the systemic risk posed by the BHCs with $50 billion or more in assets, with the evidence indicating that the number of SIFIs is quite limited. In a study examining individual bank risk, moreover, it was found that "among large banks only (over US$50 billion in assets), size per se ceases to be an independent risk factor."[4] Such studies further emphasize the need to base the SIFI designation on factors beyond asset size or at least raise the threshold substantially above $50 billion. Even with a much higher threshold, the DFA specifies that "when differentiating among companies for purposes of applying standards established under section 165, the Board may consider the companies' size, capital structure, riskiness, complexity, financial activities, and any other risk-related factors the Board deems appropriate." [5] The Federal Reserve Board could exercise this same discretion to identify BHCs that fall below a new, higher threshold as SIFIs, if it so desired.

Some may argue that the $50 billion threshold is fine because it is better to err on the side of caution when designating a BHC as a SIFI. However, this view ignores the fact that a BHC that is incorrectly designated a SIFI is subject to unnecessary costs without offsetting benefits. Some of these costs are associated with the following supervisory and regulatory requirements. SIFIs are subject to higher capital, greater liquidity, and lower leverage requirements. They are also subject to annual stress tests conducted by the Federal Reserve and required to conduct their own semiannual stress tests. The Federal Reserve, moreover, conducts an annual Comprehensive Capital Analysis and Review to assess whether SIFIs have sufficient capital to continue operations through times of economic and financial stress and that they have robust, forward-looking capital planning processes that account for their unique risks. Furthermore, SIFIs are subject to an enhanced supervision framework, and fees may be assessed on them to finance that supervision as well as the OFR's budget.

The costs imposed on BHCs due to being inappropriately designated SIFIs result in the provision of fewer and more costly services to the communities they serve. Regulatory authorities are also forced to spend more time dealing with these BHCs. The bottom line: Economic resources are being misallocated based on the arbitrary and static $50 billion legal threshold.

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4. Luc Laeven, Lev Ratnovski, and Hui Tong, "Bank Size and Systemic Risk", *IMF Staff Discussion Note*, May 2014.
5. Federal Register, Vol. 79, No. 84, May 1, 2014, P. 24529.

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