Statement of Robert DeYoung, Capitol Federal Distinguished Professor in Financial Markets and Institutions, University of Kansas School of Business. For presentation to the Senate Committee on Banking, Housing and Urban Affairs, July 23, 2015.

Thank you for the opportunity to address the committee. The Chairman has asked me to share my perspective on which factors are important for determining the systemic risk of bank holding companies. I am pleased to do so.

Bank size is the most immediate consideration. Larger banking companies tend to have more volatile earnings, tend to be less liquid, tend to be more interconnected, and tend to be more difficult to value. The raw data shows that bank failure during and after the financial crisis was clearly correlated with bank asset size.

But by itself, a bank's size is neither a necessary nor a sufficient indicator of its systemic risk. Regulators currently treat all banking companies with more than $50 billion of assets as systemically important. But this single-factor, bright line approach will is far too simple. A good example is Washington Mutual, which held over $300 billion in assets at the time of its failure in 2008. The FDIC was able to resolve WAMU without systemic consequences and without government financial support. So resolvability is another important factor, in addition to bank size, for determining whether or not a banking company poses a systemic threat.

The Shelby bill would redraw the bright line at $500 billion in assets, and rely on the Federal Reserve and the Financial Stability Oversight Council to evaluate the systemic importance of banking companies below this asset size threshold. This approach would automatically define the six largest bank holding companies in the U.S. as systemically important—not coincidentally, on Monday of this week the Federal Reserve announced systemic risk capital surcharges for these same six firms. For smaller firms, the Fed and FSOC would be free to consider multiple indicators of systemic risk other than asset size, such as off-balance sheet positions, earnings volatility, interconnectedness, and cross-country exposures. Both sets of banks would be subject to enhanced regulatory and supervisory treatment.

A good example of this type of multi-factor approach can be found in a recent policy brief from the Office of Financial Research (OFR 15-01, February 12, 2015). While I am not in a position to endorse the exact formulations within the OFR method, I strongly endorse its general approach. It uses pre-defined weights to translate each bank's size, business activities, financial complexity, and interconnectedness into a quantitative score that represents each bank's relative systemic importance. This approach applies the same risk filters to every banking company, so human "discretion" plays no role in determining the relative outcomes. And while the calculations may appear complicated, both the results and the reasoning are transparent.

The natural concern is that one or more banks that pose systemic threats could be mistakenly left off the list, and to avoid this we should err on the side of caution and maintain the $50 billion threshold. I think this concern is unwarranted; and in any case, mistakenly putting non-systemic banks on the list imposes costs as well. The size of a banking company is just one potential indicator of systemic risk, it is an incomplete and sometimes misleading indicator.

For example, consider four U.S. bank holding companies, each with assets in the neighborhood of $300 to $400 billion: U.S. Bancorp, PNC, Bank of New York Mellon, and State Street. In the OFR's scoring exercise, U.S. Bancorp and PNC get relatively low systemic risk scores because they practice traditional banking: they hold diversified portfolios of loans, fully funded by stable deposits, have very little off-balance sheet exposures, and their clientele is almost completely domestic. In contrast, Bank of New York Mellon and State Street get relatively high systemic risk scores, because they hold very few loans, rely on relatively unstable deposit funding, have large cross-border exposures, and provide infrastructure and logistics that are essential for the smooth operations of securities markets.

Of course, the Fed and FSOC would still need to determine where to draw the line between SIFI and non-SIFI. I strongly suspect that these agencies will err on the side of caution when drawing this line. The designation of MetLife as a SIFI provides a case study.

In closing, I want to re-emphasize the importance of resolvability in determining a bank's systemic importance. If a bank holding company can be resolved without causing disruptions in financial markets or contagion to other banks—either through regular bankruptcy or via orderly liquidation authority—then such a bank should not be considered systemically important. It is not the job of bank regulators to prevent insolvencies at poorly run banking companies. I think we can all agree that poorly run banks should exit the market and stop wasting society's scarce resources. Our goal should be safe resolutions for these banks—not additional regulatory and supervisory safeguards that, by keeping poorly run banks out of trouble, keeps them operating and in business.

Thank you for your time this morning. I hope that my remarks have been useful. I look forward to your questions.