Strengthening Our Financial System

DECEMBER 2012

Introduction

Our financial system is fundamentally stronger than it was four years ago, when we endured the worst financial crisis since the Great Depression. Our banks have added more than $440 billion of fresh capital, putting them on firmer footing to support lending to consumers and businesses. Our financial institutions today are also significantly less reliant on short-term financing from private investors, who fled during the crisis at the first signs of market stress.

Even as policymakers took the necessary steps to stabilize our financial system, they also recognized the precedent those actions might set. So they put in place a series of measures to help eliminate the perception that any institution is too big to fail and avoid a repeat of the Fall of 2008.

Regulators face new limitations on emergency authorities employed during the crisis. The Federal Reserve can no longer provide direct support to individual institutions, as it did with AIG. And the Federal Deposit Insurance Corporation's authority to guarantee the financing of bank holding companies was curtailed.

Meanwhile, Wall Street Reform gave regulators new legal powers to facilitate the orderly wind down of large, failing financial firms. If the government is forced to step in, equity holders will be wiped out, management will be replaced, and the institution will be dismantled. That way, taxpayers will never again have to bear the cost of financial firms' mistakes.

To be sure, our banking system has grown more consolidated in the aftermath of the financial crisis – a trend that has been taking hold over the last few decades. Yet, compared to its peers, the United States has the least concentrated banking system of any major advanced economy – and one of the smallest banking systems relative to the size of its economy.

Some early evidence also suggests that we are making progress addressing the perception that institutions can still be "too-big-to-fail" in the post-crisis marketplace. For example, investors are increasingly distinguishing between financial institutions, as measured by a wider variance in credit default swap spreads among the largest banks. Bank borrowing costs have also increased significantly for the largest, most complex institutions.

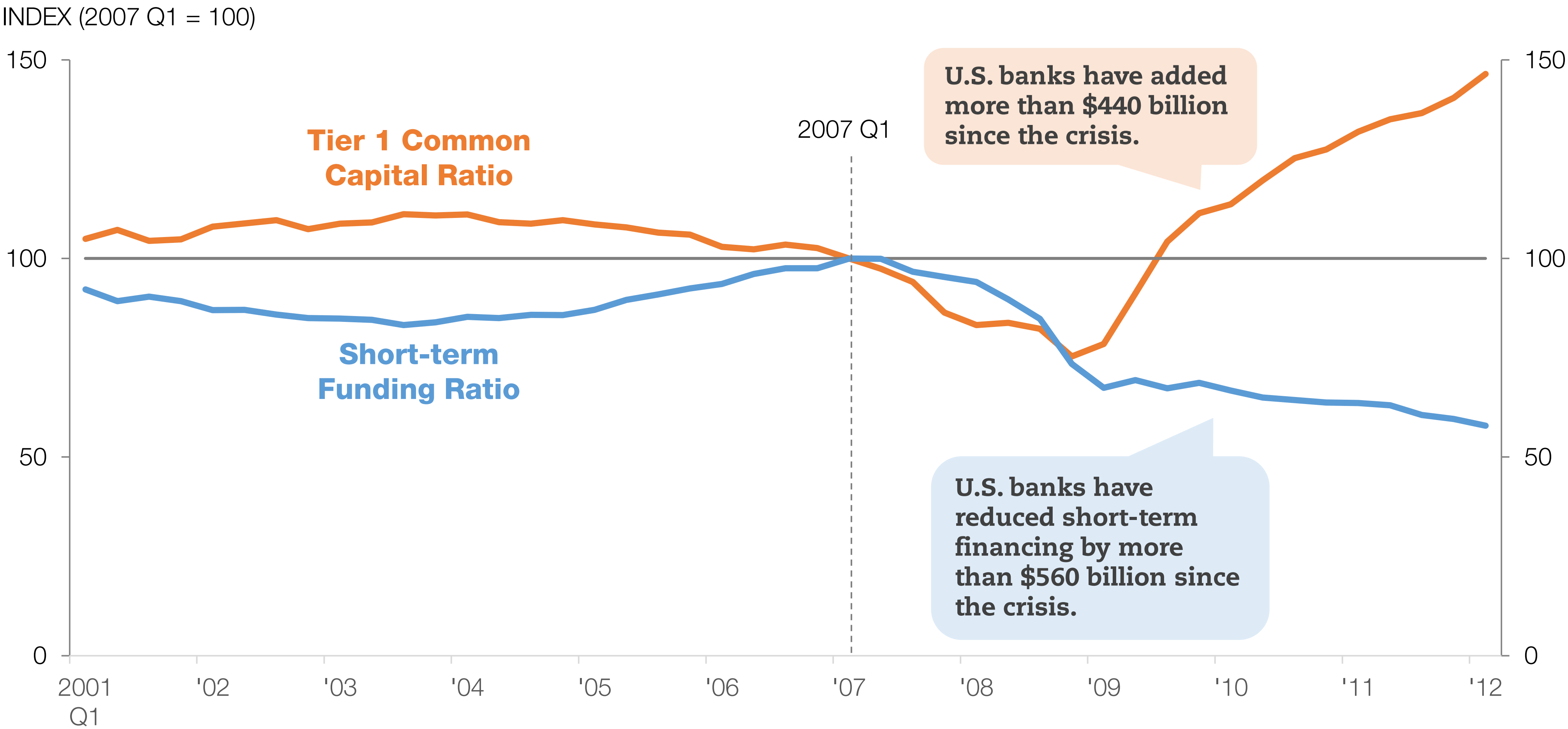
We still have more work to do, but all of this is welcome news for those of us who want a safer, fairer and stronger financial system.

A SAFER FINANCIAL SYSTEM

Stronger Balance Sheets

U.S. banks have nearly doubled their capital levels since the lows during the financial crisis in order to cushion against unexpected losses, while supporting lending and economic growth. Meanwhile, banks have almost cut in half their dependence on short-term financing, establishing a more stable funding base.

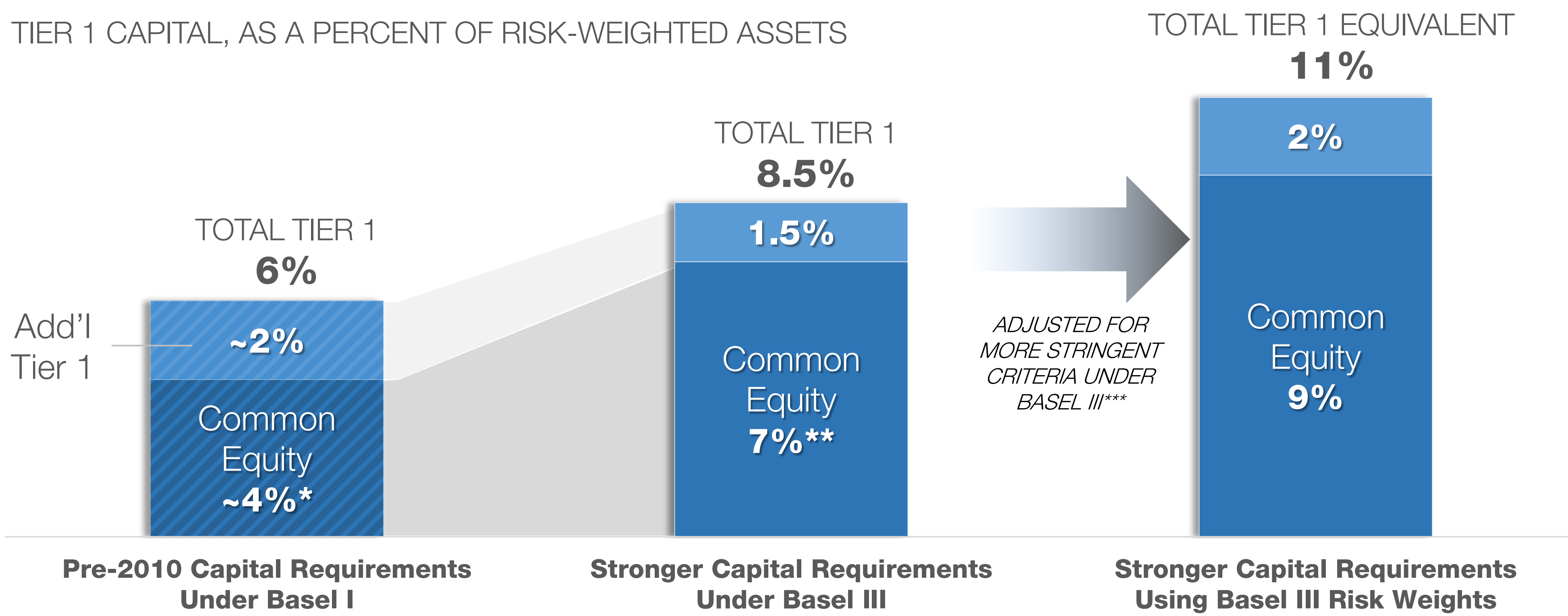
Tier 1 Capital Ratios and Short-term Funding for the U.S. Banking Industry



SOURCE: FEDERAL RESERVE (Y-9C, FLOW OF FUNDS), HAVER ANALYTICS, TREASURY/FSOC ANALYSIS.

Bolstering Bank Capital I

Tougher new capital standards would require more loss-absorbing capital and, in effect, would nearly double the amount of capital all banks are required to hold.



Basel I required that for banks to be "well-capitalized," they had to set aside a preponderance of their Tier 1 capital in the form of common equity, which more effectively absorbs losses.

Basel III would require banks to hold more Tier 1 capital overall, and more of that capital in the form of common equity.

U.S. regulators have proposed more stringent risk-weights, which would require banks to hold more capital against their assets. Combined with the heightened Basel III standards, banks would, in effect, nearly double the amount of capital they hold.

* FOR ILLUSTRATIVE PURPOSES. THE 2009 SUPERVISORY CAPITAL ASSESSMENT PROGRAM (SCAP) STRESS TEST REQUIRED COVERED FIRMS TO MEET A QUANTITATIVE 4 PERCENT TIER 1 COMMON CAPITAL RATIO. PREVIOUSLY, REGULATIONS REQUIRED THAT FIRMS' TIER 1 CAPITAL BE PREDOMINANTLY MADE OF COMMON EQUITY, BUT DID NOT SPECIFY REQUIRED LEVELS. ** INCLUDES BOTH A 4.5% MINIMUM AND A 2.5% CAPITAL CONSERVATION BUFFER. *** INCLUDING BOTH CHANGES IN RISK-WEIGHTS AND INCREASED DEDUCTIONS. THE ADJUSTMENT FOR RISK WEIGHTED ASSETS REFLECTS THE AVERAGE OF DISCLOSED BASEL I AND BASEL III RISK WEIGHTED ASSETS FOR BANK OF AMERICA, WELLS FARGO, CITIGROUP AND JPMORGAN AS OF SEPTEMBER 2012. OTHER BANKS MAY SEE DIFFERENT CHANGES.

SOURCE: COMPANY FILINGS AND TREASURY ANALYSIS.

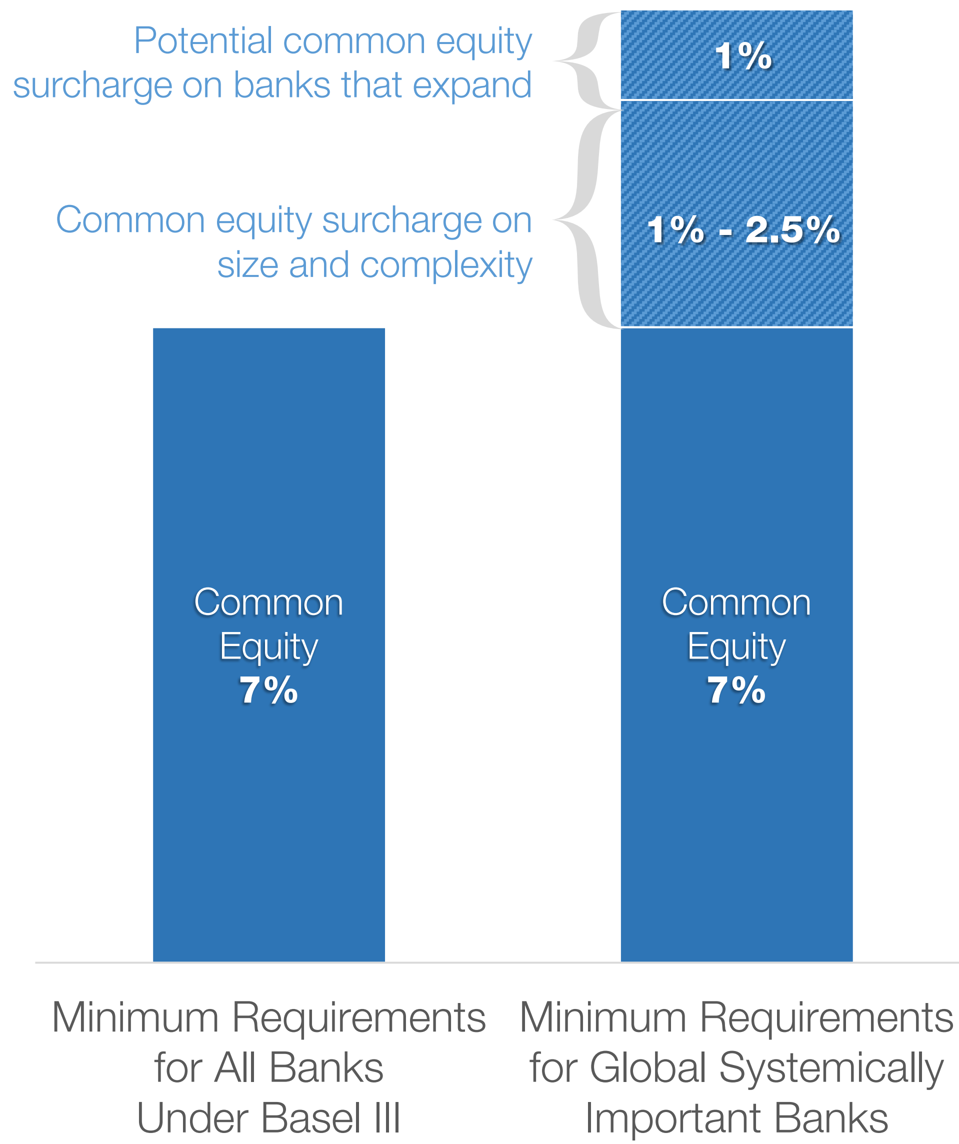
A SAFER FINANCIAL SYSTEM

Bolstering Bank Capital II

- On top of the more-stringent Basel III requirements, the largest internationally-active banks must hold an additional capital cushion so that they can:
  - Better withstand financial stress.
  - Bear the costs of the risks they create.
  - Allow smaller banks that pose less risk to compete on a more level playing field.
- Additional capital surcharges discourage banks from becoming big and complex in the first place.
  - Large banks will face a surcharge of between 1 percent and 2.5 percent based on their size and complexity.
  - To curb further growth, large banks could face an additional 1 percent surcharge if they increase in size and complexity.
- Going forward, banks around the world will also be required to adhere to a new international leverage ratio that:
  - Sets a floor on the amount of capital a bank must hold against all of its assets, regardless of their risk.
  - Brings overseas firms more in line with a tougher leverage ratio that has long been applied to U.S. banks.

2012 Bank Capital Standards

Tier 1 Common Stock, as a Percent of Risk-Weighted Assets



A SAFER FINANCIAL SYSTEM

Ruling Out Extraordinary Support

To help end the perception of "too-big-to-fail," new rules have significantly curtailed or eliminated many of the powers used to stabilize the financial system during the crisis…

Program	Description	Changes under Regulatory Reform
Money Market Fund Guarantee Program	Guaranteed more than $3 trillion of money market mutual fund shares when faced with a broad-based run; guarantee backed by Exchange Stabilization Fund (ESF).	TARP legislation prohibits use of the ESF for the establishment of any future guarantee programs for the United States money market mutual fund industry.
Federal Reserve Act §13(3) lending	Provided liquidity facilities for both specific institutions (e.g., AIG, Bear Stearns) and financing markets (e.g., CPFF, TALF).	Dodd-Frank prohibits §13(3) lending to insolvent borrowers and requires "broad-based" program eligibility. A program structured for a single and specific company is prohibited.
FDIC Systemic Risk Determination	Provided open bank assistance, including the use of federal guarantees on asset pools and bank debt to support term unsecured financing.	Open bank assistance and guarantees not permitted except for widely-available guarantee programs pursuant to "Liquidity Event Determination," which require joint resolution of approval by Congress.

… and many of the key crisis response programs are being wound down.

Program	Description	Expiration
Troubled Asset Relief Program (TARP)	Up to $700 billion troubled asset purchase authority to support financial system.	TARP purchase authority terminated in 2010.
Housing and Economic Recovery Act (HERA)	Provided authority to purchase GSE obligations and securities to support GSEs and the housing market.	HERA purchase authority terminated at end of 2009.
FDIC Bank Debt Guarantee Program (TLGP)	Provided federal guarantees on nearly $350 billion of bank debt to support term unsecured financing during the crisis.	TLGP guarantees on bank debt will expire at the end of 2012.

New Tools to Mitigate Financial Threats

Meanwhile, Wall Street Reform gave regulators new powers to support financial stability, so that taxpayers do not bear the burden of the firms' mistakes.

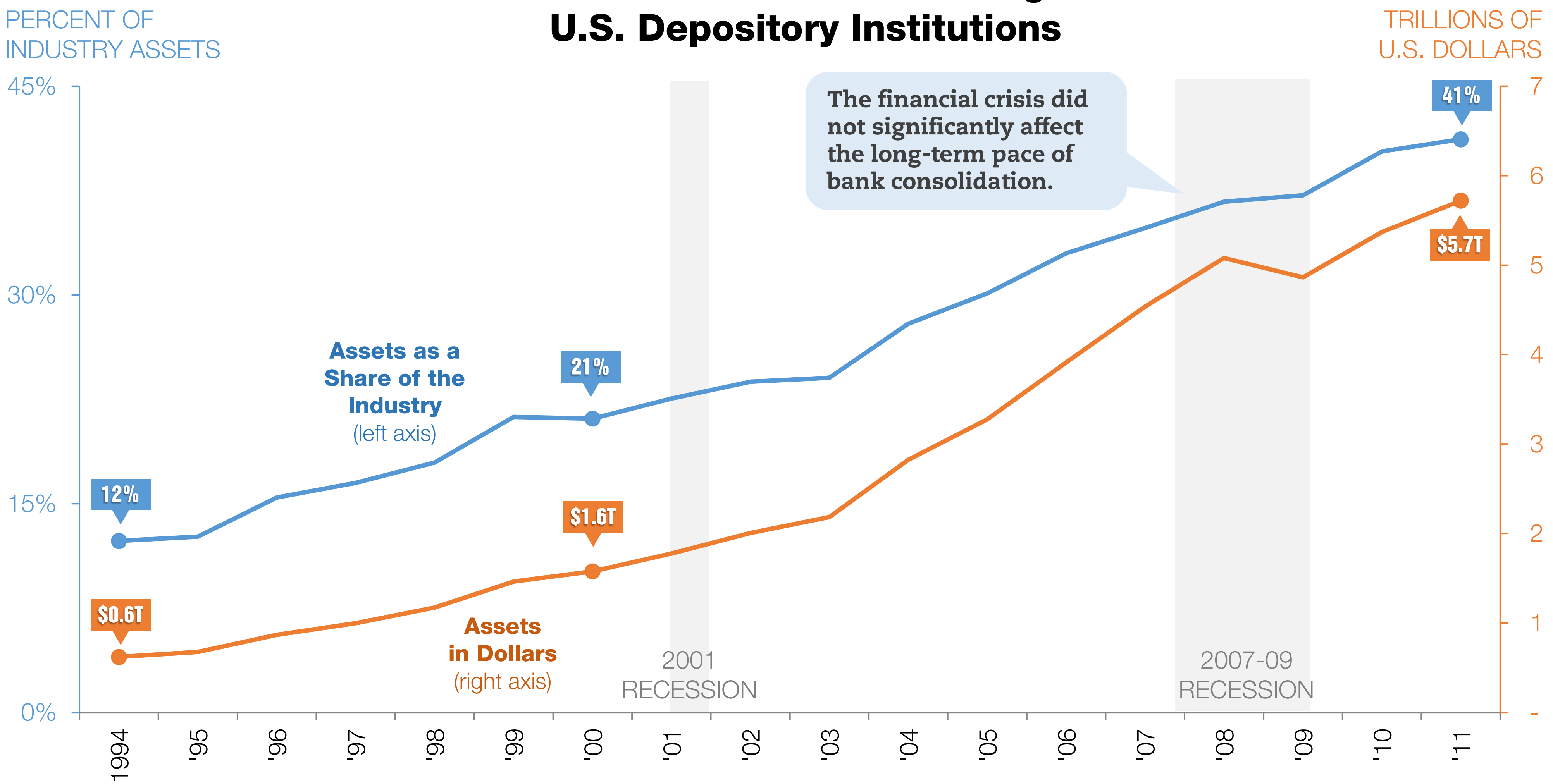
	Pre-Crisis	Post-Wall Street Reform
Capital	Banks were required to effectively meet a Tier 1 capital standard of 6% of their risk-weighted assets, without a clearly-defined amount of higher-quality common equity.	Today, the largest, most complex banks and designated nonbanks will be required to hold up to 9.5% of their risk-weighted assets in the form of higher-quality Tier 1 common equity.
M&A Limits on Size	10% nationwide deposit limit.	In addition, no financial firm can grow through acquisition in excess of 10% of all financial firm liabilities.
Supervision of Nonbanks	Voluntary SEC program for supervising securities firms on a consolidated basis.	Ability to subject any nonbank financial firm whose failure could pose a threat to U.S. financial stability to enhanced supervision.
Counterparty Limits	Lending limits for banks (not including derivative exposures).	Exposure limits on largest bank holding companies and designated nonbanks across all types of exposures.
Securities Activity Limits	Limits only on certain holdings of banks.	Volcker Rule prohibits proprietary trading by banks and their affiliates.
Derivatives	A largely unregulated derivatives market lacked transparency and posed significant risk management challenges for firms and regulators.	Mandatory central clearing, exchange trading and trade reporting improve transparency and risk management. New capital and margin requirements makes derivatives trading safer.
Resolution Authority and Living Wills	Limited ability to wind down systemically important financial institutions.	Firms must submit living wills documenting how they will be wound down without leaving taxpayers on the hook. Regulators have new authorities to wind down systemically important financial institutions without putting the economy or taxpayers at risk.

CONCENTRATION IN CONTEXT

A Consolidating Banking Industry I

The U.S. banking industry has been consolidating at roughly the same pace over the last few decades, even after factoring in that several large banks acquired weaker competitors during the financial crisis.

Total Assets of the Four Largest U.S. Depository Institutions



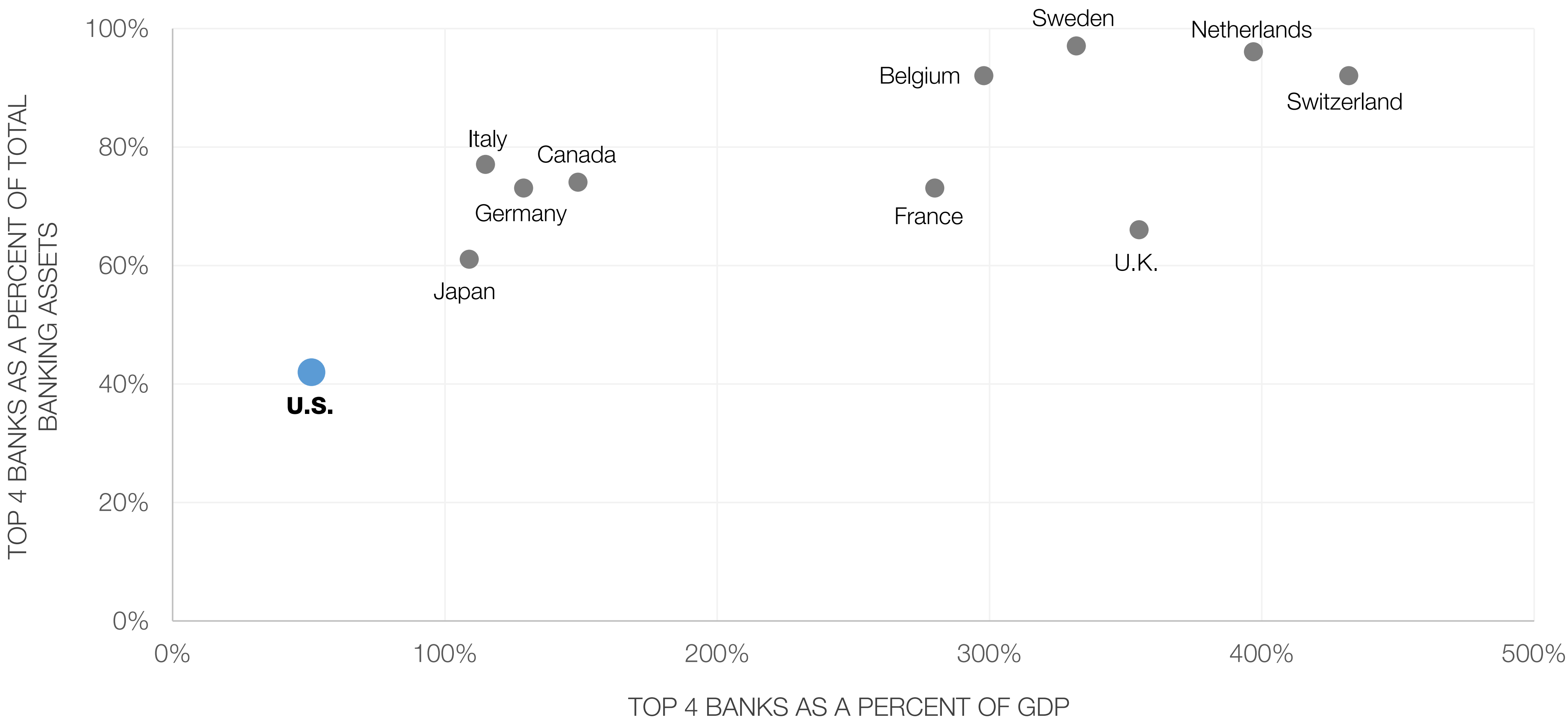
SOURCE: SNL FINANCIAL, FEDERAL RESERVE, FDIC, IMF, BANKSCOPE, EUROSTAT, Y-9 BHC.

CONCENTRATION IN CONTEXT

A Consolidating Banking Industry II

However, the United States is among the least concentrated banking system of any major economy and among the smallest banking system relative to the size of its economy.

Bank Concentration, 2011*



* NOTE: THESE NUMBERS REFLECT LOCAL ACCOUNTING CONVENTIONS (E.G., U.S. GAAP, IFRS) AND THEREFORE MAY NOT BE DIRECTLY COMPARABLE.

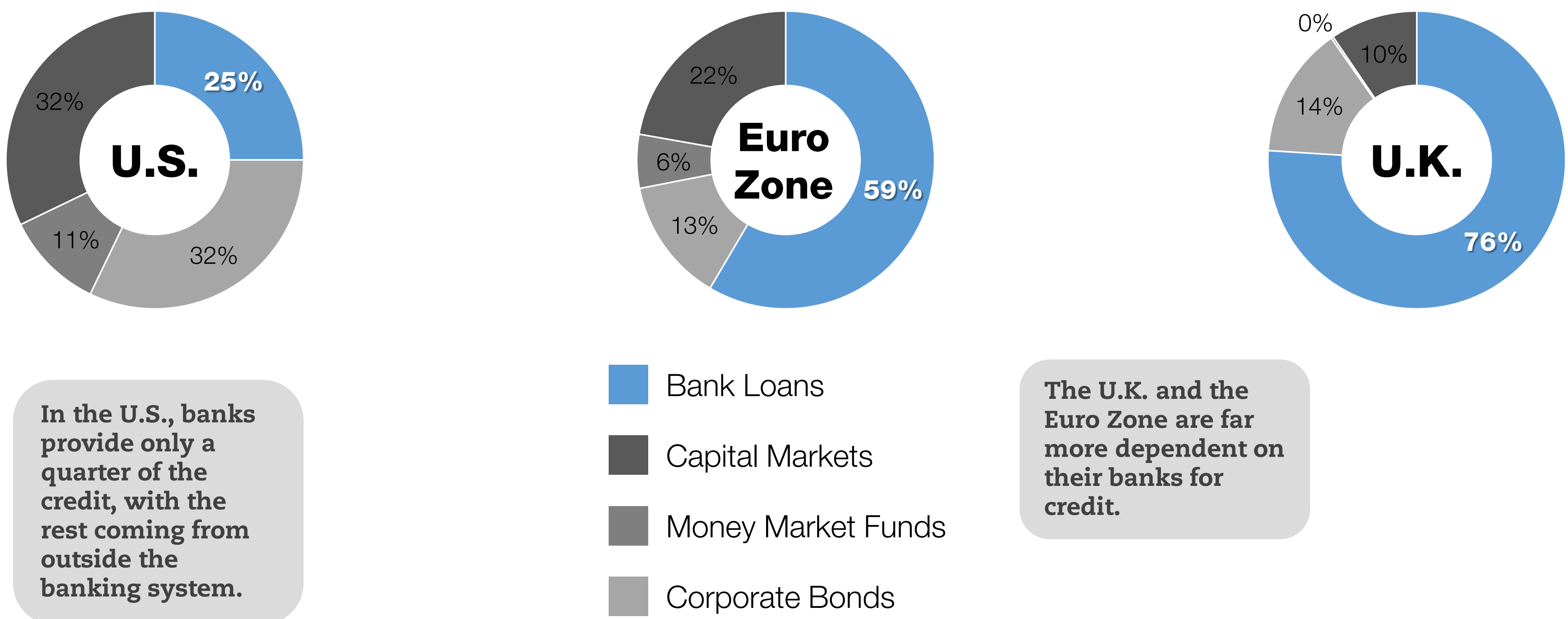
SOURCE: SNL FINANCIAL, FEDERAL RESERVE, FDIC, IMF, BANKSCOPE, Y-9 BHC.

CONCENTRATION IN CONTEXT

Credit Sources in International Context

The United States has a diversified financial system that is less dependent on banks as a source of credit than in many other countries. Here, markets play a much larger role, which means businesses and families are less reliant on large institutions to provide financing.

Where Does Credit Come From in Different Countries?



In the U.S., banks provide only a quarter of the credit, with the rest coming from outside the banking system.

The U.K. and the Euro Zone are far more dependent on their banks for credit.

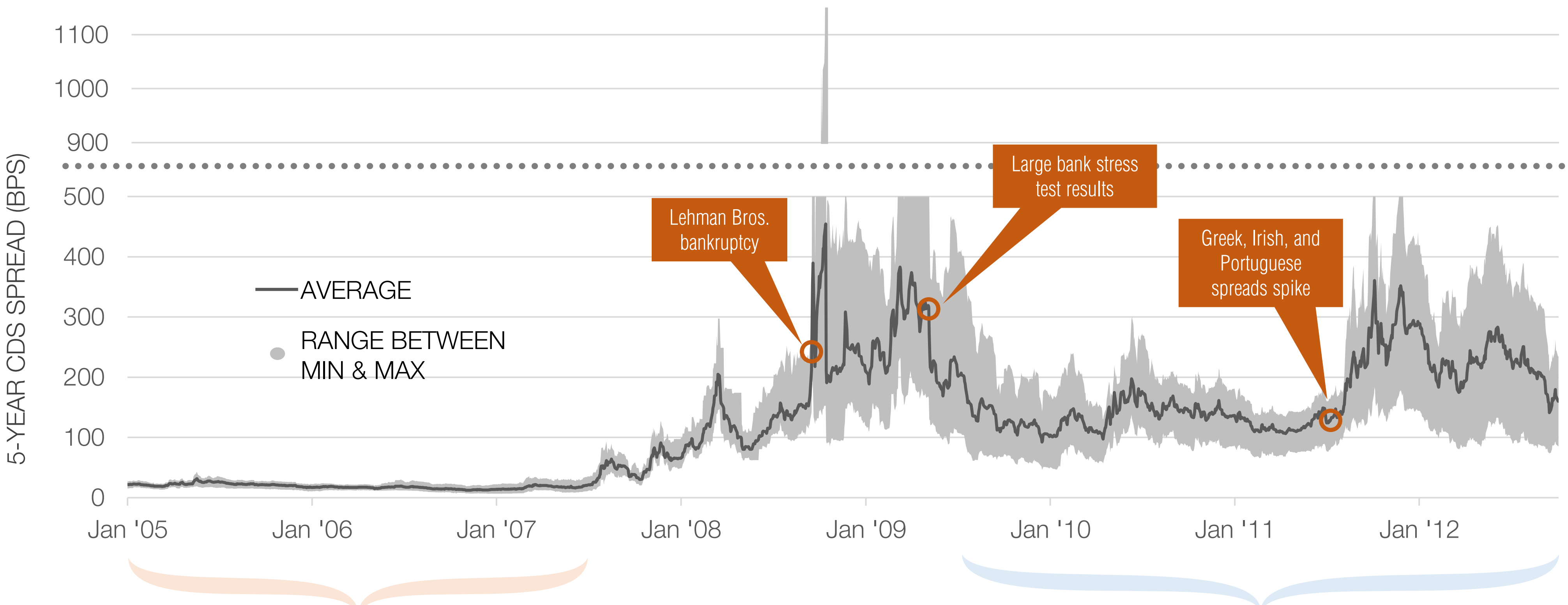
SOURCE: TREASURY ANALYSIS AND JPMORGAN.

MARKET RESPONSE

Distinguishing Financial Firms I

If investors still perceived large banks as "too-big-to-fail," we would expect to see persistently low credit spreads with little variation between firms. But in the aftermath of the crisis, investors are increasingly distinguishing between financial institutions, as measured by a wider variance in their credit default swap (CDS) spreads that markets use to assess credit risk.

Large U.S. Bank 5-Year CDS Spreads



PRE-CRISIS

Before the crisis, there was little differentiation between the CDS spreads of large financial firms and low responsiveness to external events.

POST-CRISIS

After the crisis, there was significant differentiation between the CDS spreads of large financial firms and higher responsiveness to external events.

NOTE: INCLUDES BANK OF AMERICA, CITIGROUP, GOLDMAN SACHS, JPMORGAN, MORGAN STANLEY, WELLS FARGO.

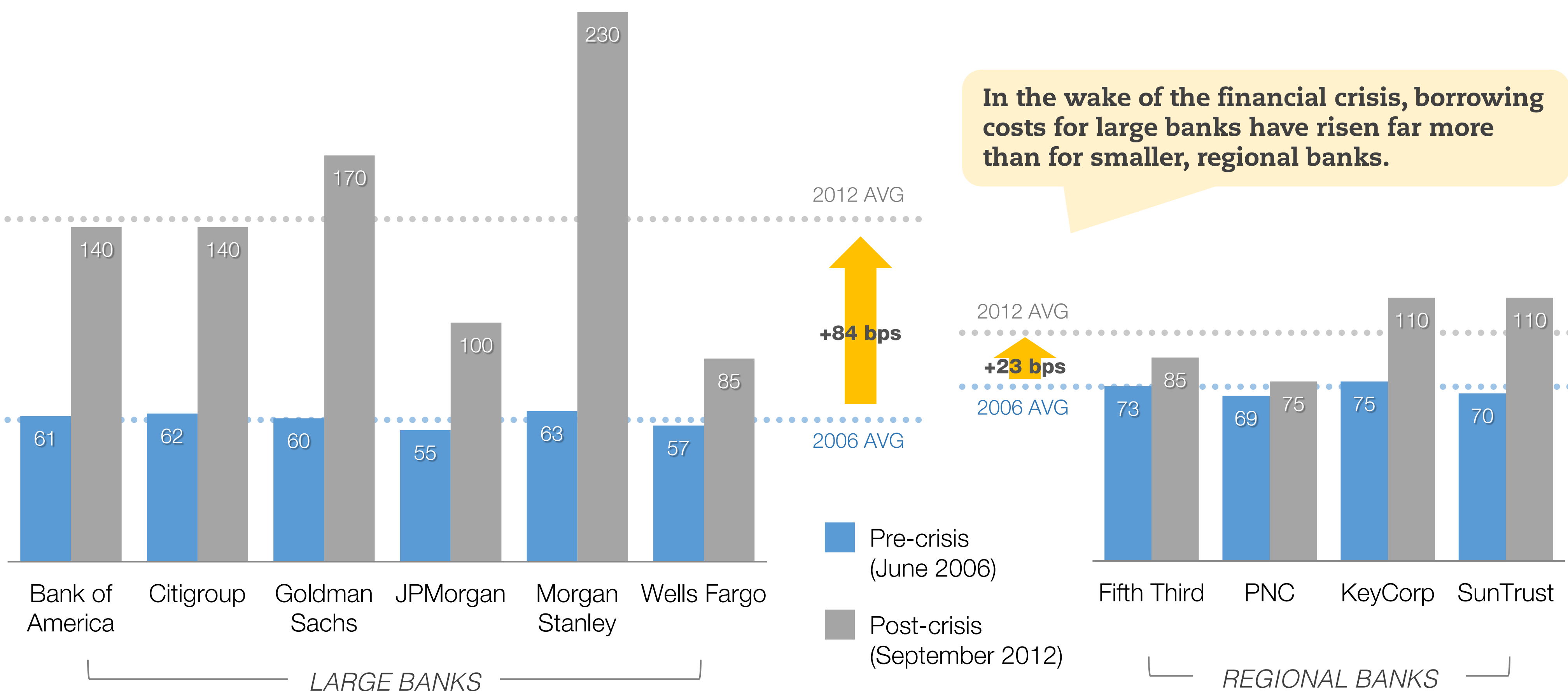
SOURCE: BLOOMBERG.

MARKET RESPONSE

Distinguishing Financial Firms II

If investors perceived large banks as "too-big-to-fail," we would expect their borrowing costs to be low and vary little by the size of the institution or its activities. That was the case before the crisis. But today, bank borrowing costs have increased significantly for the largest, most complex institutions.

Large and Regional U.S. Bank Five-Year Funding Spreads



SOURCE: BLOOMBERG AND TREASURY DEPARTMENT ANALYSIS.