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Fed's New Rule Aims To Stop "Too Big To Fail" Banks

By Xiaolin Ma, LL.M. Candidate 2016 | November 12, 2015

On October 30, 2015, the Federal Reserve Board announced a new proposal to change banking requirements for certain banks. The proposal requires domestic global systemically important banks (GSIBs) and the U.S. operations of foreign GSIBs to meet a new long-term debt requirement, as well as a new "total loss-absorbing capacity," or TLAC, requirement. Janet Yellen, the Federal Reserve chairwoman, said, "This is an important step toward ending the market perception that any banking firm is 'too big to fail."

"Too big to fail" refers to the notion that the government has to bail out the largest banks in economic catastrophes, since allowing them to fail would create a negative domino effect on the remainder of the economy. In the last financial crisis in 2008, the U.S. government dropped their oppositions to bailout soon after the Lehman Brothers collapsed and the global financial system was seriously affected. Such bailouts ultimately impose losses on the taxpayers rather than allocating responsibility for risky banking practices on the organizations themselves. Therefore, the post-crisis regulations, including but not limited to the Dodd-Frank Act, are aimed at making it safer to let a big bank die.

This new proposal is a key part of this endeavor. Mainly eight banks will be affected by the new rule, namely Citigroup, JPMorgan Chase, Goldman Sachs, Morgan Stanley, State Street, Bank of New York Mellon, Bank of America, and Wells Fargo. According to the Fed, these eight largest banks are estimated to need a total of $120 billion in debt to meet the requirement in the new rule. It is likely that most banks will be able to meet this requirement by refinancing already existing debt.

This proposal is open to comments until February 1, 2016, and is expected to take full effect in 2022.