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United States Senate
Washington, DC 20510

Dear Senator:

Demos is a national, non-partisan, non-profit research and advocacy organization. As part of our research into policies to promote broadly shared prosperity, we have investigated the role that financial services deregulation has played in undermining the American middle class. For a century, government regulation of finance was the public structure responsible for protecting consumers, preventing and containing financial crises, and ensuring a dynamic, competitive financial sector. Thirty years ago, however, these essential structures began to be dismantled. The culmination of this radical deregulatory experiment was a banking meltdown that has cost Americans $14 trillion in household wealth, 8 million jobs, nearly 200 community bank closures and upwards of $14 trillion in taxpayer bailouts and subsidies. Bank lending has declined at its sharpest rate since 1942, and America's wealthiest banks are increasingly looking to Wall Street, not Main Street, for investment.

The policy shifts that created this situation are recent, and – given their enormous cost – must be reconsidered. Interstate regulations that limited bank size were loosened in 1994; the first credit default swap was in 1997; banks were allowed to engage in risky trading in 1999; derivatives were taken off exchanges in 2000; and the SEC lifted leverage limits for investment banks in 2004.

Congress now has the opportunity to erect new public structures guaranteeing stability, transparency and competition in banking. One critical structure would be a new, targeted limit on the size and leverage of our largest banks, as proposed by Senator Sherrod Brown and Senator Ted Kaufman in the SAFE Banking Act. The new limits would give financial institutions the opportunity to transform themselves into more manageable and sustainable firms – through a market process, maximizing shareholder value and ideally divesting riskier business lines from core banking.

The SAFE Banking Act would:

- **Ensure that no bank or thrift can hold more than 10 percent of the nation's deposits.** The current 10 percent cap applies only to mergers and acquisitions, not organic growth, allowing three banks to exceed the cap. Increased consolidation means less consumer choice for families and small businesses. Small banks and credit unions—which are disadvantaged by the government and market subsidies to "Too Big to Fail" banks – have lower consumer fees and are responsible for the majority of small business lending.

- **Give bank and thrift holding companies three years to comply with a new 2 percent GDP non-deposit liability cap.** Limiting non-deposit liabilities will both address overall bank size and target banks' unsustainable dependence on volatile capital market funding. Traditionally, banks have used stable deposits for funding; the pre-crisis boom flooded the market with highly liquid sources such as repurchase "repo" agreements, exposing banks to liquidity crises. Bank of America currently has about 7 percent of GDP in non-deposit liabilities, but the figure was around 2 percent most recently in 2003.

- **Limit the liabilities of any systemically risky non-bank financial institution to 3 percent of GDP within three years**. Non-bank financial companies like AIG, hedge funds and investment banks have become "shadow banks": speculative and loosely regulated, but deeply intertwined with our banking system. Size limits on these institutions (combined with the new safety and soundness regulations and resolution authority proposed in S. 3217, the Restoring American Financial Stability Act of 2010) will prevent risky shadow banks from threatening the larger system.

- **Institute a statutory leverage ratio.** Irresponsibly high levels of leverage, or debt held per dollar of actual capital, were a hallmark of the boom that led to the crisis. The bill would require banks and systemically risky non-bank financial companies to hold $1 of Tier 1 capital for every $16.67 of debt. The current Federal Reserve limit for banks is $25 to $1.

In several recent policy research reports, Demos has examined the rapid increase in the size and complexity of American financial firms, and the way in which these trends relate to the factors (skewed incentives, excessive risk-taking, conflicts of interest, and opaque accounting, among them) that lay at the heart of the financial meltdown. In the U.S. today, six financial firms - Goldman Sachs, Morgan Stanley, JPMorgan Chase, Citigroup, Bank of America, and Wells Fargo – have combined assets equal to 60 percent of GDP. That is three times the holdings of these and their antecedent institutions fifteen years ago. The SAFE Banking Act -- as part of strong, comprehensive financial reform – is a critical measure that will restore balance to our economy.

Sincerely,

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