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FOSTERING ECONOMIC GROWTH: REGULATOR PERSPECTIVE

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

ON

RECEIVING LEGISLATIVE AND REGULATORY RECOMMENDATIONS FROM FINANCIAL REGULATORS ON FOSTERING ECONOMIC GROWTH

JUNE 22, 2017

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FOSTERING ECONOMIC GROWTH: REGULATOR PERSPECTIVE

THURSDAY, JUNE 22, 2017

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:19 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order. Welcome, everyone. I apologize that we had to set the hearing back a few minutes, and you will see there are no Republicans in the room right now. They are having a conference right now on health care, and——

Senator DONNELLY. Can we have a few Committee votes here?

[Laughter.]

Senator HEITKAMP. Where is the room?

[Laughter.]

Chairman CRAPO. I will tell you where. If you look at where almost every reporter in the complex is, it is right in the middle of that circle.

Senator BROWN. "Conference" would suggest "confer."

Chairman CRAPO. That is right. I figured we might get into that.

Senator BROWN. Sorry, Mr. Chairman.

Chairman CRAPO. But, anyway, thank you. They should be coming. I had to leave that conference early, and I expect that we will see more Republicans coming. You are going to the conference now?

Senator DONNELLY. I am, yeah.

[Laughter.]

Senator DONNELLY. And I am as well informed as the rest of them.

[Laughter.]

Senator TESTER. We are heading to the briefing, Mike.

Chairman CRAPO. All right. We do get along on this Committee.

Senator HEITKAMP. I am hanging with you.

Chairman CRAPO. Thank you, Heidi. You did well after Sherrod.

So now let me re-collect my thoughts. The hearing is already in order, and we will hear from our financial regulators today to receive legislative and regulatory recommendations that would foster economic growth.

Based on conversations I have had with current and former regulators, recommendations in Treasury's recent report, testimony at

hearings before this Committee, and the recent EGRPRA report, I am convinced that there is growing support for legislation that promotes economic growth.

I have had conversations with Members on both sides of the aisle who have told me that they are committed to pursuing bipartisan improvements.

One of my key priorities in this Congress is passing bipartisan legislation to improve the bank regulatory framework and promote economic growth.

In March, Senator Brown and I began our process to receive and consider proposals to help foster economic growth, and I appreciate the valuable insights and recommendations we have received.

Most recently, we heard from small financial institutions and from midsize and regional banks about the need to tailor existing regulations and laws to ensure that they are proportional and appropriate. For example, something that witnesses highlighted that has bipartisan agreement is that the regulatory regime for small lenders is unnecessarily burdensome.

There also seems to be genuine interest by Members in assessing whether certain rules applied based on asset threshold alone reflect the underlying systemic risk of financial institutions.

Specifically, there is interest in finding bipartisan solutions aimed at: tailoring regulation based on the complexity of banking organizations; changing the $50 billion threshold for SIFIs; exempting more banks from stress testing; simplifying the Volcker rule; and simplifying small-bank capital rules.

These are just a few of the many issues that the Committee is reviewing.

Today I look forward to hearing recommendations from our financial regulators on these issues. And as this process continues, I will be working with all Members of the Committee from both sides of the aisle to bring strong, robust bipartisan legislation forward.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman, for holding today's hearing. I would like to welcome our five witnesses. Thank you for joining us, those who have been here a while and done this and those who are new to this Committee and to this process.

I am guessing that none of our witnesses today had their homes foreclosed on in the last decade. I would make the assumption that none of you lost your jobs because of what happened because your company went out of business. I would bet that none of you saw almost your entire savings, retirement savings, disappear. But perhaps you know someone that did. Perhaps, as Lincoln said, we all need to get out and get our public opinion baths more than we do as elected officials and as regulators, or as Pope Francis said, admonished his parish priests, "Go out and smell like the flock." Perhaps we all need to do that better than we do.

Wall Street greed, the resulting financial crisis, what it did to millions of Ohioans and so many of our constituents is a lesson, collective amnesia in this body notwithstanding, is a lesson we need

to learn, to remember, and to act on. We must never forget those stories.

Many of you have heard, my colleagues have, my wife and I live in Cleveland, Ohio, ZIP Code 44105. Ten years ago right now, they had more foreclosures in my ZIP Code, 44105, Cleveland, than any ZIP Code in the United States of America.

Wall Street reform created a more stable financial sector by strengthening the capital position of the Nation's largest banks. American consumers have recovered $12 billion of their hard-earned money because we now have an independent agency, the CFPB, protecting them from scams and abuse. Senator Reed, the most senior Democrat on this Committee, is working on legislation particularly aimed at the work and to expand the work Holly Petraeus did at CFPB on behalf of servicemembers, and if we have military bases in our States, we all know what kind of characters hang right outside these military bases—payday lenders, other predators scamming these servicemen- and -women who are often vulnerable in their economic situation. It is a question, as Ms. Petraeus and Senator Reed said yesterday, when they have their financial security so challenged by scam artists.

That is why the report that the Treasury Department released last week is just misguided. Their report is a Wall Street wish list specifically targeting the capital and liquidity rules for the largest banks and seeking to undermine the CFPB. The report takes as gospel that more lending and leverage is the best way to create economic growth. Data shows that lending has, in fact, been healthy and at sustainable levels since the crisis. The last thing we should advocate for is going back to the levels of 2001 and 2002 and 2003 which led to the subprime crisis, a time period which the Treasury report holds up as an example.

There is no evidence that relaxing rules will lead banks to lend more. It is just as likely that bank executives will pass any savings, if history is an indication, it just as likely they will pass any savings along to themselves, shockingly, and their shareholders. I am concerned that many of Treasury's recommendations will undermine or delay the effectiveness of bank supervision, something that was severely lacking leading up to the crisis. These misguided ideas include additional layers of cost-benefit analysis, more obstacles to supervisory actions, weakened leverage rules, changes to stress tests that will allow the banks to game the stress tests, and changes to living wills. These recommendations would make the watchdogs' jobs harder and prevent them from spotting risks before they again balloon out of control. They would make our system less stable. They would leave consumers more vulnerable.

The Treasury report missed an opportunity to put forth an agenda that actually does create real economic growth for our country. At every turn, the Administration has advocated for an agenda that hurts average Americans, more handouts for Wall Street, more tax cuts for millionaires and billionaires, less health care for working people, cuts to programs that help those who need it the most.

There are ideas worth considering in the Treasury report, as evidenced by the overlap with some of the recommendations in the agency's EGRPRA review for small institutions. But many of

Treasury's recommendations seem like a steep price to pay for our country after the 2008 financial crisis. We have seen the damage that happens when the Administration pushes financial watchdogs to prioritize special interests over working people. It is pretty telling that Treasury met with 17 representatives for every one advocate for ordinary Americans—17 representatives for every one advocate for ordinary Americans—and that 31 out of 40 requests made by those representing the biggest banks were included in the reports.

The five of you have a very, very important job. I hope that you do not have that same bias that this Treasury Department does. Again, 31 out of the 40 requests put forward by the largest banks were included in this report. I hope this Committee can focus on the issues that will reduce burdens for small institutions and struggling communities, will help consumers, and in the end will create long, sustainable economic growth.

Mr. Chairman, I look forward to working with you and our colleagues, but it would be a shame if we forgot so soon in less than a decade, or in about a decade, the lessons of the Great Recession.

Chairman CRAPO. Thank you, Senator Brown.

Now we will turn to oral testimony, and first we will receive testimony from Governor Jay Powell, a Member of the Board of Governors of the Federal Reserve System.

Next we will hear from Chairman Martin Gruenberg, Chairman of the Federal Deposit Insurance Corporation.

Then we will hear from Acting Chairman Mark McWatters, Acting Chairman of the National Credit Union Administration.

Next we will hear from Acting Comptroller Keith Noreika—did I get that right?

Mr. NOREIKA. Close enough.

Chairman CRAPO. Thank you—who is Acting Comptroller of the Office of the Comptroller of the Currency.

And, finally, we will hear from Commissioner Charles Cooper, Commissioner of the Texas Department of Banking, on behalf of the Conference of State Bank Supervisors.

Each witness is recognized for 5 minutes. Mr. Powell, you may proceed.

STATEMENT OF JEROME H. POWELL, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. POWELL. Thank you, Chairman Crapo, Ranking Member Brown, and Members of the Committee. I appreciate the opportunity to testify here today on the relationship between regulation and economic growth. We need a resilient, well-capitalized, well-regulated financial system that is strong enough to withstand even severe shocks and support economic growth by lending through the economic cycle. And the Federal Reserve has approached the post-crisis regulatory and supervisory reforms with that outcome in mind.

There is little doubt that the U.S. financial system is stronger today than it was a decade ago. As I discuss in significantly more detail in my written testimony, loss-absorbing capacity among banks is substantially higher as a result of both regulatory requirements and stress testing exercises.

The banking industry, and the largest banks in particular, face far less liquidity risk than before the crisis, and progress in resolution planning by the largest firms has reduced the threat that their failure would pose. These efforts have made U.S. banking firms both more robust and more resolvable.

Turning to the subject of today's hearing, evidence overwhelmingly shows that financial crises can cause severe and lasting damage to the economy's productive capacity and growth potential. Post-crisis reforms to financial sector regulation and supervision have been designed to significantly reduce the likelihood and severity of future financial crises, and we have sought to accomplish this goal in significant part by reducing both the probability of the failure of a large banking firm and the consequences of such a failure were it to occur.

As I mentioned, we substantially increased the capital, liquidity, and other prudential requirements for large banking firms. These measures are not free. Higher capital requirements increase bank costs, and at least some of those costs will be passed along to bank customers and shareholders. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth through the cycle.

Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through-the-cycle credit availability, and economic growth. And to accomplish that goal, it is essential that we protect the core elements of these reforms for our most systemic firms in capital, liquidity, stress testing, and resolution.

With that in mind, I will highlight briefly five key areas of focus for regulatory reform.

The first is simplification and recalibration of regulation of small- and medium-sized banks. We are working to build on the relief that we have provided in the areas of call reports and exam cycles, by developing a proposal to simplify the generally applicable capital framework that applies to community bank organizations.

The second area is resolution plans. The Fed and the FDIC believe that it is worthwhile to consider extending the cycle for living will submissions from annual to once every 2 years and focusing every other of these filings on topics of interest and material changes from the prior submission. We are also considering other changes as detailed in my written testimony.

Third, the Fed and others are looking at the Volcker rule implementing regulation and asking whether it most efficiently achieves its policy objectives, and we look forward to working with all four other Volcker agencies to find ways to improve that regulation. In our view, there is room for eliminating or relaxing aspects of the implementing regulation in ways that do not undermine the Volcker rule's main policy goals.

Fourth, we will continue to enhance the transparency of stress testing and CCAR. We will soon seek public feedback concerning possible forms of enhanced disclosure, including a range of indicative loss rates predicted by our models for various loan and securities portfolios, and information about risk characteristics that

contribute to the loss estimate ranges. We will also provide more detail on the qualitative aspects of stress testing in next week's CCAR announcement.

Finally, the Federal Reserve is taking a fresh look at the enhanced supplementary leverage ratio. We believe that the ratio is an important backstop to the risk-based capital framework, but that it is important to get the relative calibrations of the leverage ratio and the risk-based capital requirements right.

In conclusion, U.S. banks today are as strong as any in the world. As we consider the progress that has been achieved in improving the resiliency and resolvability of our banking industry, it is important for us to look for ways to reduce unnecessary burden. We also have to be vigilant against new risks that develop. In all of our efforts, our goal is to establish a regulatory framework that helps ensure the resiliency of our system, the availability of credit, economic growth, and financial market efficiency, and we look forward to working with our fellow agencies and with Congress to achieve these goals.

Thank you.

Chairman CRAPO. Thank you, Mr. Powell.

Mr. Gruenberg.

STATEMENT OF MARTIN J. GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Mr. Chairman.

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify today on legislative and regulatory relief recommendations.

It has been nearly a decade since the onset of the worst financial crisis since the 1930s. In that time, the U.S. banking industry has experienced a gradual but steady recovery that has put it in a strong position to support the credit needs of the economy.

The economic expansion that began in 2009 is now approaching its ninth year, making it the third longest expansion on record. While this expansion has been marked by the slowest pace of economic growth and the lowest short-term interest rates of any expansion of the past 70 years, the sustained period over which it has occurred, combined with the regulatory changes implemented in the post-crisis period, have enabled FDIC-insured institutions to make substantial progress in strengthening their capital and liquidity, improving their asset quality, and in raising their net income to record highs.

The improvements have occurred across the industry, including at community banks, which have outpaced noncommunity banks by a number of measures during this post-crisis period.

The experience of the crisis and its aftermath suggests that a strong and well-capitalized banking system is a source of strength and support to our national economy. The reforms implemented in the post-crisis period, particularly in regard to large institutions, have been aimed at making the system more resilient to the effects of future crises or recessions and better able to sustain credit availability throughout the business cycle.

Nonetheless, the FDIC remains cognizant of the costs imposed by regulatory requirements, particularly for smaller institutions,

which operate with fewer staff and other resources than their larger counterparts.

In March, the FDIC, along with the OCC and the Federal Reserve, submitted a report to Congress pursuant to the Economic Growth and Regulatory Paperwork Reduction Act, or EGRPRA. The agencies jointly have taken or are in the process of taking a number of actions to address comments received during the EGRPRA process.

In addition to actions already taken to reduce examination frequency, reduce reporting requirements, and ease appraisal requirements, the agencies are developing a proposal to simplify the generally applicable capital framework for small banks.

Additionally, the FDIC would support three legislative reforms raised by EGRPRA commenters.

First, the FDIC would support raising the $10 billion in total assets threshold to $50 billion for conducting annual stress tests required by statute, while retaining supervisory authority to require stress testing if warranted by a banking organization's risk profile or condition.

Second, the FDIC would be receptive to legislation further increasing the asset threshold for banks eligible for an 18-month exam cycle from $1 billion to $2 billion.

Finally, the FDIC supports legislative changes that would create a new appraisal residential real estate threshold exemption that would minimize burden for many community banks.

In addition to these EGRPRA reforms, the FDIC and the Federal Reserve are exploring ways to improve the living will resolution planning process. We believe it is worthwhile to consider extending the cycle for living will submissions from annual to once every 2 years, and focusing every other filing on key topics of interest and the material changes from the prior full plan submission. In addition, there may be opportunities to reduce the submission requirements for a large number of firms due to their relatively small, simple, and domestically focused banking activities. Such an approach could limit full plan filing requirements to firms that are large, complex, or have a systemically critical operation.

Mr. Chairman, it is desirable that financial regulations be simple and straightforward, and that regulatory burdens and costs be minimized, particularly for smaller institutions. In considering ways to simplify or streamline regulations, however, it is important to preserve the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking system in the post-crisis period.

Mr. Chairman, that concludes my statement, and I would be glad to respond to questions.

Chairman CRAPO. Thank you, Mr. Gruenberg.

Mr. McWatters.

STATEMENT OF J. MARK MCWATTERS, ACTING BOARD CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Mr. MCWATTERS. Good morning, Chairman Crapo, Ranking Member Brown, and Members of the Committee. Thank you for the opportunity to participate in this important hearing on regulatory relief for financial institutions.

Since 1987, the NCUA has undertaken a rolling 3-year review of all of our rules, and although not required by law, the NCUA is an active participant in the EGRPRA process. After independent analysis, the agency has agreed to comply with the spirit of the recently issued Executive orders addressing the regulation of the financial services sector and the overall structure of the Federal financial regulators.

The NCUA is unique among Federal financial regulators because of its structure as a one-stop shop. The NCUA insures, regulates, examines, supervises, charters, and provides liquidity to credit unions. My mandate to staff is to make the NCUA even more efficient, effective, transparent, and fully accountable while protecting America's $1.3 trillion credit union community, its 108 million largely middle-class account holders, and the safety and soundness of the National Credit Union's Share Insurance Fund.

The NCUA is committed to promulgating targeted regulation accompanied by a thoughtfully tailored supervisory and examination programs as ill-considered, scattershot rules and compliance protocols stifle innovation and the ability of credit unions to offer appropriately priced services to their members. The agency endeavors to identify emerging adverse trends in a timely manner and remains mindful that regulators should learn from the past, yet focus on the future. Fighting the last battle gave us the S&L, leveraged buyout, dot-com crises and laid the foundation for the near collapse of our economy in September 2008. A prudently regulated credit union community grows, thrives, and prospers and, as such, protects the taxpayers from bailout risk. This approach is consistent with the theme of the report recently issued by the U.S. Treasury Department and the view that well-capitalized and appropriately managed financial institutions warrant a reduced regulatory burden.

Along these lines, within the past 18 months, the NCUA has: one, implemented a broad-based change to our member business lending rule; two, modernized our field of membership rule; three, revised our entire examination approach; four, worked to enhance the due process rights of credit unions and their members; five, issued a proposed regulation requiring the disclosure of compensation payments related to a voluntary merger; six, developed an approach to streamline and modernize the rules for corporate credit unions and the stress testing of the largest credit unions; seven, issued an ANPR requesting comments on the issuance of supplemental capital for risk-based net worth purposes; eight, invited comments and revisions on our call report; nine, implemented our enterprise solutions modernization program; ten, undertaken the development of a credit union advisory council; and, eleven, initiated a full review of the NCUA's operations and management.

In addition to these actions, I intend to consider revisions to the agency's risk-based net worth rule before its effective date in 2019.

The recent EGRPRA report also highlights three beneficial legislative measures that would: one, provide the NCUA with greater flexibility in designing capital standards for credit unions; two, permit all credit unions to add underserved areas to expand access to financial services for the unbanked and the underbanked; three,

provide credit unions with more flexibility to extend credit to small businesses to fuel economic growth.

In closing, the NCUA remains committed to providing regulatory relief for the credit union community in compliance with the Federal Credit Union Act and streamlining and modernizing the operations of the agency while focusing on our prime role as a prudential regulator. We also stand ready to work with you and your colleagues on your legislative priorities.

I look forward to your questions. Thank you.

Chairman CRAPO. Thank you, Mr. McWatters.

Mr. Noreika.

STATEMENT OF KEITH A. NOREIKA, ACTING COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. NOREIKA. Thank you, Mr. Chairman.

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify. We all share the goal of a strong national economy. Since becoming the Acting Comptroller, I have worked with staff and colleagues to promote economic growth and opportunity. I am honored to serve in this role until the Senate confirms the 31st Comptroller.

During my service, the OCC will carry out its mission to maintain the safety and soundness of our Federal banking system and will do so consistently with the President's Executive Order on Core Financial Principles and the recent Treasury report.

Our country has the world's most respected banking system. When running well, it powers economic growth and prosperity. To run well, we must balance prudent regulations with sound opportunities for expansion. It has been 10 years since the Great Recession began. It is time again for a constructive, bipartisan conversation about how to recalibrate our regulatory framework. In doing so, we must carefully consider the cumulative effects of our actions, especially on community and midsize banks.

When I arrived at the OCC 6 weeks ago, I sought the views of all affected parties on the issues facing the agency and the industry. I sought ideas from our boots on the ground to reduce unnecessary regulatory requirements and encourage economic growth. Our staff has submitted more than 400 suggestions and are excited to use our collective expertise to contribute to more efficient and effective regulation.

I also sought the views of colleagues at the Federal and State levels, bankers, trades, scholars, community groups, and others on what we can do to make our regulatory framework better for everyone. The response has been overwhelming. People from all sectors have accumulated 10 years of experience and want to share it so that we can continue to have the strongest banking system in the world.

My testimony offers legislative options for your consideration that address two general issues that have become apparent in my canvassing of affected parties.

First, I repeatedly hear about regulatory redundancy. My support of legislative action to rationalize our regulatory framework relies on our organically developed decentralization of authority and responsibility. Independent regulators for different and unique

financial sectors ensure multiple points of view and important checks and balances. But we must be mindful that as our system has evolved, it has created unnecessary regulatory burden and overlap. The need now is to recalibrate roles and responsibilities to maximize efficiency and eliminate growth-inhibiting redundancy.

Second, it has become apparent that we need a right-sizing of regulation to eliminate inflexible, one-size-fits-all requirements that result in banking regulation that simultaneously under- and over-regulates bank activities. I want to highlight four ideas from my written testimony that respond to these issues.

First, Congress could streamline the regulation of smaller, less complex bank holding companies by amending the law so that when a small depository institution constitutes the majority of its holding company's assets, the Federal regulator of the depository institution would have sole examination and enforcement authority for the holding company as well.

Second, Congress could eliminate 19th century impediments for smaller, less complex national banks to operate without a holding company by allowing these banks to have the same access as State banks to the publicly traded markets.

Third, Congress could eliminate a statutory barrier to entry for new community banks by allowing *de novo* banks to obtain deposit insurance automatically when chartered by the OCC.

Finally, a bipartisan consensus is emerging that the Volcker rule needs clarification and recalibration to eliminate burden on banks that do not engage in covered activities and do not present systemic risks. Various options exist that can be pursued at both the congressional and agency levels. I hope that we, the agencies, can move forward on seeking public comment on this topic soon.

My testimony provides a summary of the EGRPRA report as well as other ideas to consider. Today's conversation is a healthy one, and I look forward to working with the Committee as we move ahead.

Thank you, and I look forward to answering your questions.

Chairman CRAPO. Thank you, Mr. Noreika.

Mr. Cooper.

STATEMENT OF CHARLES G. COOPER, BANKING COMMISSIONER, TEXAS DEPARTMENT OF BANKING, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. COOPER. Good morning, Chairman Crapo, Ranking Member Brown, and Members of the Committee. My name is Charles Cooper. I am the Commissioner of the Texas Department of Banking, and I serve as the immediate past Chair of the Conference of State Bank Supervisors. It is my pleasure today to testify on behalf of CSBS.

We applaud the Committee's focus on economic growth and banking. I have more than 47 years in the financial service industry, both as a banker and as a State and Federal regulator. Over these years, few things have become more evident than the value of community banks. They are vital to our economy and our financial stability.

Also over these years, I have seen many swings in the regulatory pendulum. Extreme swings to either side are wrong. We must all seek ways to ensure a balanced approach.

State banking regulators charter and supervise over 78 percent of our Nation's banks. We continue to see firsthand that community banks are disproportionately burdened by oversight that is not tailored to their business model or activities.

Looking beyond the industry's aggregate performance data, we have lost 2,156 banks over the last 8 years. That is 300 banks a year, nearly a community bank every day. And we have had only five new banks coming in.

This consolidation cannot continue if we are to have a robust banking sector. There are many factors to blame for this consolidation, but regulatory burden is certainly one of them.

We may have the best opportunity in years to appropriately calibrate our regulatory approach, especially for community-based institutions. I believe that this can be done while maintaining strong and effective regulation that ensures safety and soundness, protects our consumers, and meets the economic needs of our communities.

State regulators were part the EGRPRA process, and we engaged with the Treasury Department in their recent work. With nearly 100 recommendations in the Treasury report and 440 pages of comments and recommendations in the EGRPRA report, there is no denying that we have a problem with the volume, complexity, and overall approach of the regulatory framework.

I would like to point out that the sheer volume of regulations confounds the best of our bankers, but the issue of regulatory burden goes well beyond the laws and regulations. It includes the interpretations and supervisory techniques that are utilized. How we operate our agencies can contribute to regulatory burden. How or why we got to this point is not as important at the opportunity we have to come together to address it. There are tangible recommendations in these reports that present opportunities for both Congress and regulators to have a positive impact on the banking industry and our citizens.

My written testimony makes several recommendations for right-sizing bank regulation.

Number one, reducing the complexity of the capital rules for smaller banks;

Two, mortgage rule relief for community banks holding loans in portfolio;

Three, greater transparency and timeliness in fair lending supervision for community banks;

And, number four, an activities-based approach to defining community banks for regulatory relief.

Our community banks need the relief to do what they do best, and that is to serve their communities and their customers. Regardless of the charter or agency, we are all in this together. We must ensure that sound judgment and appropriate flexibility are central to our supervisory approach.

Thank you for the opportunity to testify today, and I look forward to your questions.

Chairman CRAPO. Thank you, Mr. Cooper. And I want to also thank all of you for the work you do and for the excellent testimony you have just provided. You each provided some significant insights and some significant suggestions for how we could improve. I appreciate that.

My first question I would like to have each one of you answer, and when we do this, it sometimes takes up our whole time if we get long answers. So if you could, I would appreciate the panel being as concise as you can be so that I can get through a few questions.

The first question is: Over the past few years, Congress has been working with the regulations to change the $50 billion SIFI threshold. I appreciate your willingness to work with me on this issue. Do you agree that changing the $50 billion SIFI threshold would be appropriate? And I will start with you, Governor Powell.

Mr. POWELL. Yes.

Chairman CRAPO. That is a good, short answer.

Mr. Gruenberg.

Mr. GRUENBERG. Chairman, I would have some caution in regard to that. I would not argue that a $50 billion institution is necessarily systemic. On the other hand, from the perspective of the deposit insurer, I would note that the most expensive bank failure in this crisis and in the history of the FDIC was the failure of a $30 billion thrift institution, IndyMac, which ultimately cost the Deposit Insurance Fund over $12 billion. So I would just note that even though an institution of that size might not raise systemic implications, it could still have significant consequences certainly for the Deposit Insurance Fund.

Chairman CRAPO. So are you saying you do not believe we should address the $50 billion threshold or that we should have some tailoring and adequate ability to analyze the risks?

Mr. GRUENBERG. I would be more inclined toward tailoring, Senator.

Chairman CRAPO. All right. Thank you.

Mr. MCWATTERS.

Mr. MCWATTERS. Yes, but when it comes to the credit union community itself, and concepts of increasing that number to $50 billion for stress testing, I think we need to be thoughtful on the range between $10 and $50 billion. A $30 billion credit union loss to the Share Insurance Fund would be quite a bit more dramatic than a $30 billion loss to the FDIC Fund.

Thank you.

Chairman CRAPO. Thank you.

Mr. Noreika.

Mr. NOREIKA. Thank you, Chairman Crapo. Yes, we believe the $50 billion threshold needs to be changed or reevaluated. What concerns us is that it is being used as a competitive barrier to entry because the costs of regulation increase dramatically as you cross that $50 billion threshold. For the largest banks, the gap is about 33 times that of smaller banks. The largest banks get a competitive advantage off that. And we have only ever seen one or two banks cross that threshold. That is not good for the competitive environment or consumers.

Chairman CRAPO. Thank you.

Mr. Cooper.

Mr. COOPER. Yes, subject to risk profiling.

Chairman CRAPO. All right. Thank you. And my next question is also one that I am going to ask each of you to address. It is a more general question, but, again, if you could be very concise, I would appreciate it.

I would just like to ask each of you to identify one area that we should examine—and you may have already done so in your testimony, if that is what you want to pick—of where tailoring of our regulation is needed. Governor Powell?

Mr. POWELL. I will start with Volcker. Volcker was designed to address proprietary trading, and the insight that that should not happen in a depository institution probably could have been limited to a handful of firms. But the law applies to all banks. So, you know, we probably have some authority under the statute to do this, but I think we would support a significant tailoring of the application of Volcker so that really it falls on the banks that have big trading books, and it falls much more lightly as you go down. It is very important that, you know, the intensity of regulation be tailored appropriately for the risks that the institutions present.

Chairman CRAPO. All right. Thank you.

Mr. Gruenberg.

Mr. GRUENBERG. Mr. Chairman, I think I would focus on the issues relating to small-bank capital compliance, particularly risk-based capital. I do think there is an opportunity there for smaller institutions, say under $10 billion, that are strongly capitalized on the leverage ratio to provide some relief in regard to risk-based capital, particularly if they are not engaged in a limited set of specified activities.

Chairman CRAPO. Thank you.

Mr. McWatters.

Mr. MCWATTERS. I would like to see the Federal Credit Union Act amended to give all credit unions the ability to add underserved areas to their field of membership. Currently, that is limited, believe it or not. So people who are unbanked and underbanked, where there may be a credit union within a specific field of membership, simply cannot join that credit union.

Chairman CRAPO. Thank you.

Mr. Noreika and Mr. Cooper, I have 22 seconds.

Mr. NOREIKA. Thank you. I would just refer you to our testimony where we talk about a regulatory traffic light system so that where there are overlapping jurisdictions between the regulators, we have a system where one regulator can take the lead and the others then can join or be foreclosed.

Chairman CRAPO. Thank you.

Mr. Cooper.

Mr. COOPER. Reduce the complexity of capital rules for smaller banks.

Chairman CRAPO. Thank you, and I appreciate you working with me on the timeframe.

Senator Brown.

Senator BROWN. Well done.

Last week, Treasury, as I mentioned in my opening statement, put out a report suggesting changes to the regulatory structure. We

know the impact of deregulatory policies advocated by Departments of Treasury in past Administrations, and following the Chairman's construct, I would like to as a series of questions, and I think you can do these with "yes" or "no." I would ask you if you would.

All five of your represent independent agencies. And starting with you, Governor Powell, do you commit to being independent from the Administration?

Mr. POWELL. Yes.

Mr. GRUENBERG. Yes

Mr. MCWATTERS. Yes.

Mr. NOREIKA. Yes.

Mr. COOPER. Yes.

Senator BROWN. OK. Thank you. Again, do you commit to speaking out if you think a legislative or regulatory recommendation threatens the financial stability of our economy or the safety and soundness of our banking system? Governor?

Mr. POWELL. Yes, sure.

Mr. GRUENBERG. Yes.

Mr. MCWATTERS. Yes.

Mr. NOREIKA. Yes.

Mr. COOPER. Of course.

Senator BROWN. And, last, do you commit to make consumer protection a priority?

Mr. POWELL. Absolutely.

Mr. GRUENBERG. Yes.

Mr. MCWATTERS. Absolutely.

Mr. NOREIKA. Yes.

Mr. COOPER. Yes.

Senator BROWN. OK. Thank you.

Last year, the Fed—and this is for Governor Powell. Thank you. And thanks for your years of service and your work with this Committee over the years. And, Mr. Gruenberg, you, too.

Governor Powell, last year the Fed proposed adding capital surcharges into the biggest banks' stress tests. Governor Tarullo last week said the biggest banks' capital requirements "are still somewhat below where they should be," and that incorporating the surcharges into CCAR will protect against contagion from one of these banks infecting, spreading to the rest of the financial system. By your testimony, you suggest that the Fed will integrate the stress test into the banks' regulatory requirements. I assume that means the Fed is moving forward with adding the capital surcharge into the stress tests?

Mr. POWELL. That is the plan, yes. We have asked staff to work up some options on that. We are working on it. There is no specific data upon which we bring that forward, but we would like to have it in place.

Senator BROWN. I would like to encourage you to do that as quickly as possible. Is there a reason you cannot move quickly?

Mr. POWELL. No; just we want to get it right.

Senator BROWN. And you do not plan to wait until new Board members on the Fed are nominated and confirmed? That is not part of the delay?

Mr. POWELL. No. We have ongoing things; we are doing stuff all the time. We are announcing CCAR results this afternoon. This is

another thing that is in the pipeline, and we will get to it when we need to get to it.

Senator BROWN. OK. Thank you, Governor.

Mr. Gruenberg, there have been recent press reports that any additional profits that the money center banks make from deregulation will go to stock buybacks and dividends up, to $30 billion in one estimate. Is that what banks will do with their profits if we relax the stress tests?

Mr. GRUENBERG. I do not know that we have evidence to the contrary in regard to that, Senator.

Senator BROWN. Governor Powell, your comments on that?

Mr. POWELL. What banks would do with the profits?

Senator BROWN. Yeah.

Mr. POWELL. I think it is hard to know. Some of it would go to shareholders; some of it would go to management; some of it would go in pricing and customers, I suppose.

Senator BROWN. Shouldn't we want to know whether a decreased regulatory burden on banks will lend to more lending and economic growth if the money goes to stock buy—certainly an imperfect analogy, but what happened with the bank holiday of—or the tax holiday on overseas—money kept overseas from corporations brought back, it did not exactly work because there were no strings attached the way a lot of policyholders thought. So shouldn't we know if banks are going to save money because of a decreased regulatory burden that it will, in fact, lend to more lending and economic growth or just increase dividends?

Mr. POWELL. I guess I would look at it from the other end, which is we should make sure that we do not impose unnecessary costs through regulation. Regulation should not cost any more than it needs to. It does not make the economy any better to raise banks' costs. If we can cut those costs without affecting safety and soundness, we cut them. And I think that, you know, that funding will help the economy, and it should help the economy in a very general way, but in a broad way I would think.

Senator BROWN. So, to the two of you, Mr. Gruenberg and Mr. Powell, what do you think of the idea that if money—if banks do better, are more profitable because of deregulation, that maybe the best way to increase economic growth would be to ban buybacks and limit dividends in order to ensure the banks increase lending and contribute to economic growth? Mr. Gruenberg first.

Mr. GRUENBERG. Senator, let me say I think in terms of reducing regulatory burden, the biggest bang for the buck is to reduce burden on smaller institutions that serve their communities and will either strengthen those institutions or strengthen their ability to serve their communities. I would be cautious in terms of making changes, particularly for the large systemic institutions. I think there we really need to preserve the prudential standards that we have established.

Senator BROWN. Thank you, Chairman Gruenberg.

Governor Powell, if you would just answer that, and I am done.

Mr. POWELL. I would be wary of prescriptive things like limiting dividends and that sort of thing. And, again, I would just go back to this. I do not think what we are talking about here amounts to deregulation or broad deregulation. I think it amounts to making

regulation more efficient, protecting the important gains that we have made. We are not really talking about some massive program here.

Senator BROWN. OK.

Chairman CRAPO. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

One of the main tenets all of you know of the recently released Treasury Department report regarding core principles for financial regulation is calling for Federal financial regulators to conduct cost-benefit analysis for all economically significant regulations. That is something I have long advocated for right here in this Committee.

I will start with you, Governor Powell. Do you believe that conducting cost-benefit analysis when you are determining or considering financial regulations is very important not only to the regulatory body itself but to the consumer, to the bank system, all of it?

Mr. POWELL. Yes, I do, and we have always tried to implement regulations in the way that is faithful to what Congress has asked us to do in the least costly and least burdensome way. More recently, we have actually tried to up our game more and take a more analytical approach to that. We are doing more on that front. We actually are planning on hiring a few people, but we are waiting until the hiring freeze rolls off to do that.

Senator SHELBY. But that could be very important to the whole banking system and to the American people, could it not?

Mr. POWELL. I think it is our obligation, and it is an important obligation.

Senator SHELBY. Marty?

Mr. GRUENBERG. I agree with that, Senator. I think doing cost-benefit analysis has value, and particularly including it in proposed rulemakings to give the industry an opportunity to comment and get their feedback. And evaluating both the impact of the proposed rule as well as alternatives to the rule does have value, and that is something we are doing in the preamble of every rulemaking that we do.

Senator SHELBY. Mr. McWatters?

Mr. MCWATTERS. Yes, Senator, I do, but we have to be thoughtful about this. It is an art more than a science, and it would be helpful if all of us had a consistent methodology as to how to compute and conduct the cost-benefit analysis across the board. So the NCUA is not doing one on an ad hoc basis, or the FDIC, the Fed, or the OCC. But we had some consistency and well thought out, bring some economists in, work through this, come up with a protocol that can be implemented in a transparent way that people will take a step back and say, yeah, that is fair.

Senator SHELBY. Yes, sir?

Mr. NOREIKA. Thank you, Senator. My own view is in regulating a dynamic industry, we must always look at the costs and benefits not only of the new regulations but of the existing ones as well, and, importantly, what we are doing here, looking at the statutory basis as well.

Senator SHELBY. Mr. Cooper?

Mr. COOPER. Senator Shelby, I certainly agree with cost-benefit analysis on the regulations. I do feel very strongly that it has to go beyond just regulations. It has to include the way we operate our agencies. We have to be efficient, and not only efficient in the use of our time but efficient in the use of our banks' time.

Senator SHELBY. I will direct this to the Comptroller's office. In your testimony, Mr. Noreika, you stated that financial institutions' risk should not be determined strictly by their size. I agree with that. In your view, what should be considered when tailoring regulations for small- and mid-sized banks? And could you elaborate on what specific regulations should be further tailored through administrative or congressional action?

Mr. NOREIKA. Sure. Thank you.

Senator SHELBY. That is a lot of work.

[Laughter.]

Mr. NOREIKA. I think we have many options on how to gauge the risk of institutions. Size is one of them, but it is not the only one of them. There are risk profiles as well. Just because you are bigger does not mean you are riskier. Just because you are smaller does not mean you are less risky all the time. So I think we have to make both a quantitative and a qualitative judgment before determining what we impose, and then those regulations that follow are based on the riskiness of the institution. Controls would include capital requirements, liquidity requirements, perhaps activity restrictions as well. So I think all of those would go into that calculus, Senator.

Senator SHELBY. Mr. Powell, I think the word "redundancy" was brought up earlier, and that is important. There are a lot of overlapping regulations in the banking field. What could be done to do away with some of the redundancy which costs money for banks to comply with?

Mr. POWELL. I think that is part of the exercise now we are undergoing to try to identify those and limit them or eliminate them, if possible. And I would say if you think about Volcker, to come back to that, the insight of not wanting proprietary trading in these big firms probably makes sense. But before the crisis, we did not have strong capital requirements, and under the trading book we did not have liquidity requirements. We did not have the stress tests, which are very tough on those things. So trading by the big banks is supported by several other policy initiatives, it gives us a little more freedom to think about how we can draw back the scope of Volcker and make it less burdensome.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. And thank you all for your testimony.

Chair McWatters, let me ask you, there are more than 300 credit unions that have been certified as CDFIs. Community development credit unions like the North Jersey Federal Credit Union in Totowa, New Jersey, have stepped up to supply banking services in underserved neighborhoods and communities across the country, the very communities that President Trump said he wanted to

help. And in terms of doing that, the CDFI Fund is critical to those credit unions that work in low-income communities.

So do you believe that Congress should eliminate the CDFI Fund as proposed in the President's budget?

Mr. MCWATTERS. No, I do not.

Senator MENENDEZ. I appreciate that because the Treasury Department released a report just a few weeks ago that said, "CDFIs are often the only source of credit and financial services in impoverished urban and rural low- and moderate-income areas with limited access to the banking system." So it defies their own logic, and I am glad to see you share the view that it is critical to maintain the fund.

Chairman Gruenberg, the Treasury report includes recommendations to reform the Community Reinvestment Act examination process and ratings system. The report argues that the CRA examinations play a role in preventing certain banks from merging and opening new branches. What is your view of this argument?

Mr. GRUENBERG. First of all, Senator, CRA is an important statute that encourages banks to meet the credit and basic banking services needs of all of their communities. So the function it performs is a very important one. Most institutions, as you know, get satisfactory or better ratings under the CRA. There are opportunities for local organizations to raise issues when an institution files an application for a merger or other activity as part of the statute. That happens in relatively few cases. So as a general proposition, I do not think it is a significant impediment.

Senator MENENDEZ. So most of them receive satisfactory ratings; therefore, it should not impede mergers of those who desire a merger.

Mr. GRUENBERG. The local organizations still have an opportunity to raise the issue, but in terms of actually impacting significant activity, I do not think it does.

Senator MENENDEZ. I appreciate that response because it seems to me that the Administration should be focused on ensuring that the evaluation and ratings system is holding institutions accountable in providing equitable access to credit rather than focusing its efforts on weakening the Community Reinvestment Act. And, frankly, it is a little difficult to take seriously the recommendation of the Treasury Secretary when his only experience on the matter is running a bank that so struggled to meet its obligations to provide equitable access to credit in and of itself.

Governor Powell, let me ask you, just shy of 9 years ago, Lehman Brothers filed for a bankruptcy, the largest bankruptcy in history, one that sent shock waves throughout the entire financial system. In short order, numerous other entities failed, leading to unprecedented support from the U.S. Government and taxpayers to bail out the institutions that had been playing fast and loose without guard rails and subjecting Americans' hard-earned savings to unjustifiable risk. It became abundantly clear in that moment that we needed a process to deal with the adverse market effects of the failure of a large, complex, and interconnected financial firm.

In response, we created the Orderly Liquidation Authority in Title II of Dodd-Frank. This process, thankfully, has not been needed. But if it were to be utilized, it is designed to protect taxpayers

and the market at large by ensuring that the burden of the failure falls on the owners and managers of the firm, that you do not privatize profit and collectivize risk.

Do you agree, Governor, that this authority to resolve firms whose failure would present a threat to U.S. financial stability is critically important?

Mr. POWELL. I do, Senator. Working with the FDIC, we have made a lot of progress under Title I, but I think it is absolutely essential that we keep Title II as a backup.

Senator MENENDEZ. Chair Gruenberg, do you have anything to add to that?

Mr. GRUENBERG. I strongly agree with that. The Orderly Liquidation Authority really is the last recourse but a critically important backstop to assure an orderly failure, even of a systemic firm. And as you point out, Senator, to assure that the stakeholders in the firm—the shareholders, the creditors, the management of the firm—are held accountable.

Senator MENENDEZ. Finally, the Federal Reserve Bank of New York highlighted in November that there has been an uptick in delinquency rates on auto loans made to borrowers with subprime credit scores. I would like to hear from each of you your thoughts regarding this trend. Is this something that you are concerned about? I see it going—since 2013, 90-day delinquency rates made to borrowers with subprime credit scores have risen by more than 40 percent. Is that an early bird warning here?

Mr. NOREIKA. Our agency has been tracking this since about 2014, and we do notice an uptick, and it is something that we are certainly making our regulated entities aware of to keep track of.

Senator MENENDEZ. Is there something we should be doing?

Mr. NOREIKA. Our job as regulators is to watch and monitor credit risk and to flag where we are seeing increased risks. This is one of those areas.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

A couple quick questions because I know the Chairman wants everyone to keep this brief. I just want to associate myself with the comments on the Volcker rule. When you look, many current and former regulators also publicly state that the Volcker rule is way too complicated. It is my experience when a rule is too complicated, there is not much compliance, so it does not really get you what you need.

I think that what I am hearing today is no one wants to go back, but everybody wants to tailor a rule or find a rule that can, in fact, accomplish the purpose without overly burdening, you know, all manners of banks and certainly something that makes common sense. So I want to just kind of put that on the record, and thank you all for your comments.

My questions are to Governor Powell. Are you aware of the bills that have been introduced, bipartisan bills that have been introduced at this Committee regarding relieving midsize banks from Dodd-Frank stress tests and exempting community banks from the requirements of the Volcker rule and the qualified mortgage rule?

Mr. POWELL. Generally, yes, aware.

Senator HEITKAMP. Have you had a chance to review those proposals?

Mr. POWELL. Our staff has. I have not had a chance to review them carefully, but I am generally aware that they are there.

Senator HEITKAMP. OK. I think it is critically important that we get your input moving forward. We obviously think there is broad bipartisan support for these kinds of changes and would love to see the Banking Committee produce some bills that would fulfill the commitment that we all privately have made to not only our small community banks but also our midsize banks. I think the time for talking is over and the time for doing is now.

Marty, I am really concerned about what is happening right now at ag lending in my State, and I think you guys frequently can be on the tip of the spear, the leading indicator of challenges that we are going to have. I obviously have argued before for flexibility in these kinds of cyclical environments, especially in agriculture. And so just a couple questions.

Have you experienced or observed meaningful changes in terms of the risk in the ag economy? And how is the FDIC approaching ag lenders who continue to provide credit, absolutely essential credit, to our producers who now are being squeezed by low commodity prices?

Mr. GRUENBERG. So, Senator, we do have a changing environment, as you know well, in the ag sector. We are seeing low commodity prices and some decline in land values in the agricultural areas. And we are starting to see some pressure in regard to the banks that are focused on agricultural lending.

So from a supervisory standpoint, the institutions are still as a general matter in pretty good shape, but they are under some pressures, and the trend seems to be toward increasing pressure. So from a supervisory standpoint, this is something we are paying close attention to.

Senator HEITKAMP. I think it is critical that we be aware of what those indicators are and that we work together with the private lending industry to make sure that we do not let cyclical changes in agriculture shut down especially our small family farmers, who struggle the most in this kind of environment. And so I think before we see widespread pressure from the examiners to do things in that space that would, in fact, cutoff liquidity for farmers, we need to have a conversation here, because what you do will have ripple effects in the ag economy. Can I have your commitment that you will stay on top of this and let us know?

Mr. GRUENBERG. You do, Senator.

Senator HEITKAMP. OK. I want to just close out with a question on appraisals. As part of the EGRPRA process, regulators identified access to timely appraisals, especially in rural America, as a major challenge for small lenders. Yet the report itself did little to address residential appraisal requirements.

Governor Powell, do you share my concerns that the appraisal system in rural America really does not work and that we need to have special attention paid to how we can make those changes?

Mr. POWELL. Yes, Senator, I think we are sensitive to the problem and would like to do more.

Senator HEITKAMP. Right, and have you had any discussions about what that "do more" would look like?

Mr. POWELL. Not recently, but this is something we are going to come back to.

Senator HEITKAMP. Well, we will follow up because most of you know I come from a small town of 90 people. People say you want to, you know, see kind of the average sale, good luck getting that. It is not going to happen. And it is a huge challenge in terms of mortgage lending for our small community banks, and so this appraisal issue is not going away. I want you to come up with solutions to this and cut our small community banks some slack. OK?

Chairman CRAPO. Thank you.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. And I want to thank all the members of our panel today for your service and for being here.

I want to talk about flood insurance, which, of course, is extraordinarily important to my State, Louisiana, but, frankly, most States. The current National Flood Insurance Program expires September 30th. We have to renew it. This Committee will be working hard to do so under the leadership of our Chairman and our Ranking Member. But here is a question that I think goes to what undermines the entire program.

About 53 percent of the people that should carry—excuse me—are required to carry flood insurance carry it. What do we do about that? I am sorry. Excuse me. What do you think we should do about that?

Let me put it another way. Let me ask our FDIC Chairman—before I choke to death.

[Laughter.]

Senator KENNEDY. I am just so overwhelmed with emotion at that health insurance bill that I am almost speechless.

Mr. Chairman, do you think it would be a good idea to ask FEMA to compile a list of mortgages in high-risk flood areas so we will know who is supposed to carry insurance and who does not?

Mr. GRUENBERG. Senator, actually I think that is a good idea. One of the challenges in this area is a lack of reliable data——

Senator KENNEDY. Yes, sir.

Mr. GRUENBERG.——really to assess the extent of compliance with the flood insurance requirement. Getting better data would have real value here, and I think FEMA as the agency responsible for the National Flood Insurance Program would probably be the appropriate agency to do that.

Senator KENNEDY. How do we get FEMA to do that, other than just asking pretty please?

Mr. GRUENBERG. Well, on that score, Senator, you probably would have a better feel for that than we would.

Senator KENNEDY. OK. Governor Powell, I saw where we recently had a bank—Sun Trust Bank was fined $1.5 million for violations regarding mandatory compliance with the National Flood Insurance Act. How did the Fed determine that they had a pattern and practice of noncompliance? What is a pattern and practice?

Mr. POWELL. Senator, I remember that case. I do not remember the specifics of that case, though, to be honest. A pattern or

practice would be I think what it sounds like, which is something that happens repeatedly.

Senator KENNEDY. Well, what triggered the review?

Mr. POWELL. I should not talk about a particular enforcement action, and I am actually not deeply familiar with the individual facts of that case. I could get back to you on that.

Senator KENNEDY. Would you? That would be very helpful.

Mr. POWELL. I would be glad to.

Senator KENNEDY. Let me open this up to anyone. I do not want to add to the regulatory burden on our community banks. I do not. But at the same time, when somebody does not carry flood insurance who is required to carry flood insurance and they flood, somebody else has to help them recover. And that is not fair to the American taxpayer, and it is not really fair to the people who do the right thing and carry the flood insurance.

I am going to go to each of you. I only have a minute, but give me your thoughts about what we can do to increase participation from 53 percent. That is embarrassing.

Mr. POWELL. This is for flood insurance?

Senator KENNEDY. Yes, sir.

Mr. POWELL. Well, I cannot improve on your idea of FEMA.

Senator KENNEDY. How about Mr. Cooper?

Mr. COOPER. Senator, obviously knowing a little bit about what happened in your State, I would agree with your recommendation. One of the concerns that I have is that, I believe, in several places in your State, several of the places never flooded before flooded this time. And so——

Senator KENNEDY. That is true.

Mr. COOPER. It is hard, these lines of who floods and who does not flood, they blur, and, quite frankly, we have to deal with that. And I am not sure how to do that.

Senator KENNEDY. OK.

Mr. NOREIKA. Senator, certainly this is something that is a very high priority for our agency, and we take very seriously our supervisory obligations to examine our banks to make sure that loans have the proper flood insurance for those areas. So while I do not know the percentages off the top of my head, this is something that I know our supervisors and our examiners in our institutions take very seriously, and there are mandatory penalties that come if they do not——

Senator KENNEDY. Well, I am out of time, but I will be contacting you individually to talk about what we can do to help get the compliance right. We need to do a better job.

Mr. NOREIKA. Thank you.

Senator KENNEDY. And we need to start with our friends at FEMA.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. Thank you all for being here today.

So last week, the Treasury Secretary issued a report that included about 100 recommendations for changing our financial rules, and these recommendations were basically cut and pasted

from the banking industry's lobbying priorities. In fact, one bank lobbyist was brutally honest, saying, "The report is basically our entire wish list."

Now, most of these changes do not require any congressional action. Federal agencies can make the changes all by themselves, and that means all of you at the banking regulatory agencies have a lot of power to decide whether to hold the line on financial rules or to make every wish come true for giant banks.

So, Governor Powell, the Federal Reserve is responsible for many of the rules governing the country's biggest banks, and you are now the point person at the Fed for regulatory issues. You are also on record as being a fan of cost-benefit analysis, so let us do that here. The potential cost of implementing recommendations in the EGRPRA report seems pretty clear to me. It could increase the risk of another financial crisis and another bailout.

So I want to ask about what the potential benefit is letting banks add to the already record profits they have generated in the past several quarters. Where is the benefit side?

Mr. POWELL. Well, Senator, I guess I see it as a mixed bag. There are some ideas in the report that make sense, maybe not exactly as expressed there, but that would enable us to reduce the cost of regulation without affecting safety and soundness. There are some ideas, of course, that I would not support, that we would not support as well. But I guess I see it as mixed.

Senator WARREN. Well, I get your point about mixed. The only benefit you see then is just cost reduction?

Mr. POWELL. I think we have an obligation to make our regulation no more costly than it need be.

Senator WARREN. Fair enough. Fair enough. But I am just asking about any other benefits because I was—the Treasury report, actually I want to read a direct quote from it about our financial rules on capital and liquidity, and it explained the rules on capital and liquidity saying that these can decrease the resources—the current rules can decrease the resources a bank has available for customer loans.

So let me ask it that way since that is what the Treasury Department claims is the reason for reducing capital. Do you agree with that, Mr. Powell?

Mr. POWELL. Let me say this: I do not support and we do not support reducing risk-based capital requirements. So that is not the idea. But I think of it a little bit differently. Capital is more expensive than debt, so if we raise capital standards, you are raising costs. Some of those costs will be passed through to customers. The question is: Where is the cost-benefit analysis? And I happen to think we have got it about right today.

Senator WARREN. You know, because I am really worried about this, because the big banks obviously would like to see capital requirements reduced. And I started looking at what happened recently with JPMorgan Chase. The biggest bank in the country spent $26 billion in the last 5 years on stock buybacks. They had $26 billion they could have spent on anything they wanted to spend it on, and they could have spent it on lending to customers, but, no, what they decided to do with the money is to spend $26 billion to pump up their share price. And, in fact, every one of the big

banks in the country has spent billions and billions of dollars in the past 5 years on stock buybacks.

So it sounds like to me that these banks have plenty of capital available to them. Governor Powell?

Mr. POWELL. Well, I think their obligation is to meet their minimum capital standards and even more relevant for the biggest banks to meet their CCAR requirements. And once they do that, you know, they are entitled to pay dividends or buy back stock as long as post-stress and post-minimums—you know, as long as they meet those capital requirements.

Senator WARREN. But what I am hearing you say——

Mr. POWELL. They do have plenty of capital.

Senator WARREN. That is right, that they have plenty of capital and there is no reason to reduce their capital standards here.

Mr. POWELL. We are not in favor of that.

Senator WARREN. All right. I think that is very helpful because, you know, the team at Goldman Sachs that is running financial policy for this Administration really wants to boost profits for the Wall Street banks, and I think that is what the Treasury report is all about. And here is what is going to happen if regulators make the changes for the big banks that they want, and that is that bank stock prices will go up, bonuses for bankers will go up, bank stock buybacks will go up, and the risk of another financial crisis and bailout will go up.

You know, I recognize that the bank lobbyists will be thrilled by this report and be thrilled if that happens. CEOs will be thrilled. But we will not see any increase in lending, and I do not think we are going to see a boost to our economy from it.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Cotton.

Senator COTTON. Thank you. And thank you, gentlemen.

You know, since that Treasury report came out, I have heard a lot of complaints, like Senator Warren's complaint today but many others, not just from Senators and Congressmen in the Congress but outside observers as well, about how many of those changes could be made without congressional action. I think I have heard something like two-thirds of the proposed changes could be made without congressional action. That may be the case. It may not. I do not know. But I would suggest that that would counsel us to stop giving so much power to unelected regulators in Washington, DC—not just in the financial services arena but in every single area.

All you gentlemen are extremely capable professionals. We may have our disagreements here or there. But none of you are in Washington because you won an election and are, therefore, accountable to the American people. We are on this dais. There are 537 people who are. They should be making the rules that govern the conduct of the American people so they can be held accountable at the next election.

I have got to break the news to everyone watching at home. I am sorry that I have to bring the scales down from your eyes. Many Congressmen and Senators like to punt the ball to regulators like these gentlemen. They like to pass laws like Dodd-Frank or

Obamacare or anything else that does not require them to make a hard choice and be held accountable. Because what do they do? They declare victory when the law passes, and then 2 or 3 years later when the CFPB or the SEC or the Department of Labor or the EPA makes the regulation, they declare victory a second time by denouncing the unelected bureaucrats who make the rules that do not implement their guidance. That is not the way we should govern ourselves in this country.

A second point. We are having a hearing today about financial regulators, and we have five gentlemen here at the table—four from the Federal Government, one representing a consortium of State regulators. That is a lot of people to look to. On the Armed Services Committee, when we have a hearing about strategy in Afghanistan or the Islamic State, there is one person sitting at the table: the Secretary of Defense. Why is that? Because the military believes in the unity of chain of command, and if you are a private in Nangarhar Province today or outside Mosul, you know exactly who is in your chain of command from your squad leader all the way up to the President of the United States. And one of the most common complaints I hear from our bankers in Arkansas is that they have to answer to multiple masters who, if they do not issue conflicting rules, they at least give conflicting interpretations or guidance or even attitudes. And I think that is something that we need to address.

So, Mr. Noreika, of all the banking agencies, you were the only one that provided what Bloomberg News called a "sweeping list of recommendations to streamline oversight." My question about this multiplicity of regulators is this: In the context of today's meeting, how do you think we ought to approach your recommendations and how should we prioritize them, given how difficult it has been to get anything done in Washington, DC, lately?

Mr. NOREIKA. Thank you, Senator, and thank you for the question. As you point out, there is a real risk, actually and in practice of regulatory redundancy happening here in Washington with respect to the financial services industry. And one of the things that we are proposing is having a statutory traffic light system among the Federal regulators so that when one regulator acts to effectuate regulation, others will be foreclosed. And what we are seeing in practice is both under- and over-regulation at the same time. And the CFPB is a great example. When we consider banks $10 to $50 billion where the CFPB has exclusive jurisdiction, we do not see much activity of the CFPB regulating those institutions at all. So they have actually in many ways gotten less regulation since Dodd-Frank has passed.

And yet if we go in and we examine them with our backup authority, as we do, if there is an issue, you may see the CFPB come. And so while they are underregulated until we regulate them, then they become overregulated.

So I think what we are trying to do in our testimony with the long list of regulatory suggestions for consideration is to start a dialogue and identify what the problems are, and you have put your finger on one of the biggest problems, and to start a bipartisan, constructive conversation about how we recalibrate our regulation of this dynamic industry.

Senator COTTON. Thank you. My time is almost expired. I just want to suggest to the Members of this Committee and the Chairman and the Ranking Member, who I know have been working together very carefully to try to craft some bipartisan compromises, that this is something we should look at. I do not see any reason why we could not have bipartisan agreement on an effort to put more accountability in our own hands, since we are the ones elected to make these decisions and the only ones accountable to the American people; and, second, to streamline somewhat the multiplicity of regulators that our bankers, especially our small bankers, who do not have the capital base to respond to multiple requests from multiple regulators, to give them a little bit of an eased burden.

Chairman CRAPO. Thank you.

Senator CORTEZ MASTO.

Senator CORTEZ MASTO. Thank you, Mr. Chair. Thank you, gentlemen, for your testimony today. It has been very helpful, enlightening, and I really appreciate it.

I, however, would like to start with Mr. Noreika. Your testimony, including your written testimony, includes a lot of ideas about how to restructure our financial regulatory system. I want to focus on your recommendations related to the Consumer Financial Protection Bureau, and let me put this in perspective. I am a new Senator. I was not here——

Mr. NOREIKA. I am new, too, Senator.

Senator CORTEZ MASTO. Well, and I recognize that. But where I was previously was the Attorney General of the State of Nevada during the worst crisis we have ever seen. And I will tell you this: I supported the CFPB after what I had seen, and I know the CFPB was created because before the crisis, we in our States trusted the safety and soundness regulators like the OCC to oversee consumer protection, and they failed to do so, threatening both the homeowners in my State and across this country. In fact, one former State prosecutor who tried to stop the banks' predatory lending said about the OCC, and I quote, "Not only were they negligent, they were aggressive players attempting to stop any enforcement action. Those guys should have been on our side." In that particular case, you were actually representing the bank that was being sued. Yet in your testimony you suggest that we return examination and supervision authority for all depository institutions back to their primary banking or credit union regulator.

In other words, this would strip the CFPB of its ability to go in and routinely supervise big banks for noncompliance with the laws that protect consumers, seniors, students, and servicemembers. This represents a return to the bad old days and would undermine an essential pillar of the Wall Street reform.

You come to the OCC, as you said, on an interim basis from a prominent law firm where you represented big banks. Under special hiring authority, you can serve for only 130 days. But, in exchange, you get to avoid Senate confirmation, and you do not have to sign the typical ethics pledge. And here we get a recommendation from you to roll back the regulations for CFPB. That concerns me. And how is the CFPB supposed to catch wrongdoing and

enforce the law if they are not able to examine and supervise the largest banks?

As a former law enforcement official, I know how difficult it is to identify fraud as it is happening. It seems like it would be more difficult for the Bureau to quickly stop the mortgage servicing debt collection and credit card abuses if it is not inside the big banks monitoring them. How do we address that?

Mr. NOREIKA. Thank you, Senator, and thank you for the opportunity to respond to your question. As I responded to Senator Cotton earlier, this is a big concern of ours to actually increase the consumer compliance and monitoring at the smaller banks within the CFPB's exclusive jurisdiction to ensure compliance with the relevant consumer protection laws.

Since Dodd-Frank, we have a CFPB that writes rules, and as you will see from my written testimony, that is something we support them doing. The real question now is the correct allocation of scarce regulatory resources to enforce those rules. And what we are seeing in practice is that the CFPB is not enforcing those rules against the midsize banks, the large small banks to the small big banks. And so we do have a problem of both over- and under-inclusion. When we get up to the bigger banks, we have a little bit of overlap and overkill there. So we need some better system of coordination.

Now, whether that involves taking that responsibility and putting it back with the prudential bank regulators who can balance, as they traditionally have, the supervisory priorities of the bank or adopting, as I have said twice before, a statutory traffic light system, I think both of those are options. And yet we have to talk about what the problems are first.

Senator CORTEZ MASTO. I appreciate the comments. I do not understand them. Quite frankly, in one breath you are saying that there are scarce regulatory resources with the CFPB so that means that we should give them the resources they need to supervise, and in other breath giving it back to the same regulators who were not there when I was in my State trying to help homeowners who were not enforcing the laws. It does not make sense to me.

Chairman Gruenberg——

Mr. NOREIKA. I am happy to meet with you to discuss it more.

Senator CORTEZ MASTO. Chairman Gruenberg, as a banking regulator, would you say that having the independent Consumer Bureau has been successful? And do you think that the CFPB's existence is a threat to the FDIC?

Mr. GRUENBERG. Yes to the first, and no to the second, Senator.

Senator CORTEZ MASTO. Thank you.

Chairman CRAPO. Thank you.

Senator CORTEZ MASTO. Let me just say this, finally, Mr. Chair, and thank you. The CFPB has returned $12 billion to 29 million consumers. I really do not understand the motivation behind stripping the Bureau of its powers. And I will tell you this: As somebody who has focused for 8 years on consumer protection, there is a need for the CFPB. And to roll back any regulations and say that we cannot find a balance somehow and still look at how we address the regulatory burdens that are happening right now with our banks, and particularly with our community banks and our credit

unions, I think we need to calibrate there. There is no doubt about it. I think we need to work in that space. But we need to find this balance, and the balance is not doing away with consumer protection completely, because it is working. And that is all I am looking for, in this day and age, is somebody reasonable to come up and figure out how we find that balance. I am not for rolling back any of those regulations because that is going to continue to harm the homeowners that I fought for for 8 years in my State. And I am concerned about the future.

Chairman CRAPO. Thank you.

Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman. That is one of the nice things in the Banking Committee: you get to hear some diverse points of view. Rest assured when it comes to the CFPB, I think there is a group of us out here that feel that they are flat out out of control and that there are no controls on them that Congress can come in, bring them in and ask questions. Their budget is not part of the budget that we authorize. And we think that there most certainly is room to be able to allow for consumer protection based upon the original agencies who had the responsibility, and if you were not living up to those responsibilities, I think it would have been more appropriate for Congress to have come back and demanded that or to provide you with the tools in order to do that as opposed to creating a new behemoth type of an agency there that is just flat out, in my opinion, out of control. If I could repeal it, I would. And if I cannot do that, the least we ought to do is put it under the control of the appropriations process up here. But it is always interesting to hear the different points of view when it comes to something as controversial as the CFPB.

I did want to spend just a few minutes and talk about the TAILOR Act. We have reintroduced it again this year. The idea behind it is to allow for the regulatory entities within the banking systems to be able to look at the individual types of business models that individual banks have. Community banks have a different business model than some of those that do international banking and so forth.

It looks to me like if you had the appropriate direction from Congress that you most certainly in almost every phase of the regulatory process you could really do a better job of tailoring the regulatory approach based upon the size and business model, specifically the business model of the individual banks themselves.

I would just like, if you could, can you just very, very briefly suggest whether or not the introduction of the TAILOR Act or the adoption of the TAILOR Act would be of benefit in giving direction to you as agencies that oversee these financial institutions?

Mr. POWELL. Senator, I have not looked at the TAILOR Act in a few months, but just in general, I would say I agree with what you are suggesting. You know, what Dodd-Frank did was it put these numerical cliffs in, and those are nondiscretionary. They are sort of arbitrary in a way. And that was a choice that Congress made for that.

A different choice would have been to let us think about the size and business model, and I think we can work with either. In fact, for the largest institutions there is more discretion in who got

designated. So Congress really did both. I think if you wanted to change the way the thresholds worked and put us in a situation of being more discretionary and looking at size and business model, we could certainly work with that, and it would help us.

Senator ROUNDS. Mr. Gruenberg?

Mr. GRUENBERG. Senator, I would want to look more closely at the statutory language. The issue you raise is a critical one. Appropriately tailoring regulation to the size and complexity and business model of the particular institution in some ways is the core challenge for us as bank regulators. So I think you are certainly focusing our attention on the right issue. I am glad to engage with you on it, but I would want to look at the specific statutory language.

Senator ROUNDS. Fair enough.

Mr. McWatters?

Mr. MCWATTERS. Regulations should be targeted with a laser. Shotguns do not work. Shotgun regulation creates collateral damage, unintended consequences. But in order to target a regulation to the real problem that is out there, the future problem that is out there, you have to understand the business that you are regulating. You have to understand the business model. You have to understand how they make money. You have to understand their ambitions. So focusing in on that will allow me to target regulations and stay away from the scattershot approach with unintended consequences and collateral damage.

Senator ROUNDS. Thank you.

Mr. Noreika?

Mr. NOREIKA. Thank you, Senator. Certainly, as I mentioned earlier in my testimony, we are concerned about under- and over-inclusiveness of regulation to make sure it is most efficient and effective. And certainly the idea of tailoring regulation is very important.

With respect to your bill, we are happy to work with you.

Senator ROUNDS. Thank you.

Mr. Cooper?

Mr. COOPER. Senator, I cannot remember all the provisions of your bill, but obviously the thought process behind it we would support.

The one thing I would like to say is, again, I have been around this for a long time. We have been talking about this for a long time, and we need to start working toward making some solutions.

Senator ROUNDS. Thank you.

I have one real quick one, and I am just going to ask this of Governor Powell and Mr. Gruenberg. The SLR and the ESLR, you have diverging points of view regarding that. I am concerned about mutual funds and where they place their accountable. Right now it looks to me like we have got a real problem between European banks, which have one capital requirement, versus the American banks with the ESLR makes them less competitive when it comes to the costs of providing those custodial services. Shouldn't we be trying to address the costs for mutual funds? When it comes to these custodial banks—there are not a lot of them—shouldn't we be able to make our American banks as competitive as those in other parts of the country regarding custodial accounts? Can you

explain to me the reason why you have divergent points of view as to why we have not done something about the—at least allowing for the accounts that are being held where we are placing deposits with the central bank. It looks to me like we ought to be able to help these folks out a little bit and bring down the cost of what it is for a custodial bank to bring in and maintain mutual fund relationships.

Mr. POWELL. Senator, briefly, we look at the leverage ratio as a backup to binding risk-based capital, and the leverage ratio sees a junk bond the same as a bank deposit, the same as a Treasury, and makes it uneconomic for banks that have a model, a business model that involves having a lot of deposits in cash and puts that money, for example, at a reserve bank. So we want it to be a binding backstop so that banks cannot game the risk-based capital, but we feel it is time to rethink the calibration.

Senator ROUNDS. Mr. Gruenberg, you had kind of a differing point of view.

Mr. GRUENBERG. Yes, Senator. We do see the strengthening of the leverage ratio as one of the core reforms that have been put in place with the large systemic institutions to deal with one of the important lessons of the crisis. The lesson was that in that stressed environment, leverage capital had credibility with the financial markets as opposed to risk-based capital. So we think it is really quite important from a safety and soundness and systemic risk standpoint to have rough comparability between risk-based capital and leverage capital. Prior to the crisis, the leverage capital requirements were lower. The changes we made were really designed to produce that comparability because both measures of capital—and I will keep this brief—both measures of capital have strengths and issues.

Risk-based capital has the strength of being linked to the risk of the activities taken by the institution. It has the downside of being subject to manipulation and, frankly, we saw some of that during the crisis.

Leverage capital has the strength of being a simple, loss-absorbing measure of capital that is not manipulatable. It has the downside of not being risk-sensitive.

The two together, roughly comparable, we think, make the strongest basis for a capital system.

Senator ROUNDS. Mr. Chairman, thank you for your patience. It just seems as though we have really got an issue with regard to deposits that are central bank deposits and whether or not we should be not giving some leniency for folks that are depositing with the central bank and making them very uncompetitive with other banks around the world.

Thank you, Mr. Chairman.

Chairman CRAPO. Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman. I thank all of you for your testimony today.

Mr. Noreika, as you know, many of us were troubled by the mechanism procedure that was used to put you in your current position because it kind of short-circuited the advice and consent process. I know it is not a permanent position, but it is a position

of incredible public trust. I think you would agree with that, would you not?

Mr. NOREIKA. Yes, Senator.

Senator VAN HOLLEN. And barring that process, one of the things that the Trump administration has touted as a mechanism for upholding the public trust has been their ethics pledge. So my question to you today is: Will you uphold or sign that Trump administration ethics pledge?

Mr. NOREIKA. Well, Senator, I do not have a position that is subject to the ethics pledge.

Senator VAN HOLLEN. So even though you have got the top position in the department, in OCC, you are saying that the Trump administration did not write its ethics protections in a way that would cover that position?

Mr. NOREIKA. It was President Obama who wrote that policy and the Trump administration——

Senator VAN HOLLEN. No, I am talking——

Mr. NOREIKA. Senator, it is President Obama's policy that the Trump administration is following with respect to special Government employees. So I think when you make the characterization of President Trump writing the policy, I think that is the wrong characterization.

Senator VAN HOLLEN. Well, OK. But I think you know that President Trump tried to sell his ethics pledge as much more robust than that of the Obama administration. I am going to go on.

And I would like to ask you, Governor Powell, about the issue of the foreign banking organizations, and specifically Deutsche Bank, but the others as well. As you know, during the financial crisis the Fed provided about $538 billion in emergency loans to European banks, and as part of that, we also provided some oversight. Recently, the Department of Treasury has suggested rolling back some of those provisions. I think all of us on this Committee want to look for ways to provide relief for community banks and want to make sure that all our regulations are tailored to accomplish their purpose. We are talking here about major foreign banks. I want to ask you if you support their proposal that would loosen or weaken the requirements for loss-absorbing long-term debt. Are you familiar with that particular recommendation?

Mr. POWELL. For foreign banks?

Senator VAN HOLLEN. Yeah. They want to scale back——

Mr. POWELL. This is from the Treasury report?

Senator VAN HOLLEN. This is the Treasury report.

Mr. POWELL. I would have to look at it, Senator. I mean, it is a lot of recommendations.

Senator VAN HOLLEN. OK. And I would appreciate it if you could get back to us on that.

How about their other recommendations regarding foreign banking organizations? Have you had a chance to look at the other ones?

Mr. POWELL. Yes, our view at the beginning was that we should look to the U.S. assets rather than the global assets in designating these companies for purposes of Section 165, and it went the other way. So we would actually be comfortable with that change. But I will come back to you on the other ones.

Senator VAN HOLLEN. I appreciate that. And I want to thank you and Mr. Gruenberg for your service.

And, Chairman Gruenberg, if you could please comment both on that proposal that was made by the Treasury Department regarding the long-term debt, the loss-absorbing long-term debt, but also this issue of just looking at U.S.-based assets. On the one hand, I understand that. On the other hand, these are major multinational banking organizations, and my sense is that if they melt down in their operations outside the United States, it is going to have a dramatic impact here in the United States. If you could comment on those?

Mr. GRUENBERG. So I would want to look at the specifics in regard to foreign institutions. As a general proposition, one of the important rules that the Federal Reserve has adopted is to require a minimum level of loss-absorbing debt for large institutions, which includes some of the foreign banking organizations. It is an important resource to have so that if one of these institutions gets into difficulty and begins to fail, that resource can be utilized in a resolution to recapitalize the bank, imposing the costs of the recapitalization on the creditors of the institution and protecting the taxpayer. We view it as one of the key changes that have been made, and we are highly supportive of the Federal Reserve rule that has been adopted. We think it has been properly calibrated to allow an appropriate level of debt to ensure that these institutions in resolution could be recapitalized in a way that would be credible with the markets and allow for the orderly failure of the institution. So it is quite important.

Senator VAN HOLLEN. And the other provision, if I could——

Mr. GRUENBERG. The other thing we do think is important in evaluating the U.S. operations of these institutions is that certainly the foreign operations can impact them. But in looking at their U.S. operations, we should not and have not allowed them to rely on an expectation of support from the foreign parent. One of the lessons we learned during the crisis is that support may not be forthcoming, so they need to have the appropriate standards here to protect the U.S. operations based on the U.S. requirement——

Senator VAN HOLLEN. On a stand-alone basis. Yeah, OK. Thank you.

Chairman CRAPO. Thank you.

Senator Tillis.

Senator TILLIS. Thank you, Mr. Chair. Gentlemen, thank you all for being here.

Governor Powell, I know that a couple of the former regulators appointed by the Obama administration have either called for a reduction in the complexity of Volcker; I think at least one of them has called for its outright repeal. Can you give me an idea of where you think we need to be? On that spectrum of just changes, can you talk a little bit about specific things that we should be looking at or expecting in terms of regulatory relief as it relates to Volcker?

Mr. POWELL. Yes, Senator. What we have been focusing on is laying the statute side by side with the rule and looking at the degrees of freedom we have to make the rule less burdensome consistent with both the letter and the spirit of the law. And I would say our—and it is complicated, down-in-the-weeds stuff, but I think

we have a significant amount of freedom—we do—to tailor for large institutions versus small institutions, those with big trading books in particular.

Senator TILLIS. Can you give me an idea of some of those weeds that would get whacked?

Mr. POWELL. I would. I would be delighted to. I think in general, we believe we have the authority to draw a line below those with the big trading books—maybe $10 billion and up—and have sort of that group regulated in one way, and then everybody else regulated a lot less. A lot less.

I think we also believe we can change the definition of "trading account," which I think that some of the choices that were made in the regulation go well beyond what is in the statute, for example, the rebuttable presumption, the definition of a covered fund when you get to the fund side. Quite a lot of those things—not all of them, but quite a lot of those were drafting choices made in the regulation, and so we believe, really based on 2 ½ years of experience and 5 years of discussion, that we can go back and revisit those and do a lot.

I would say Congress could play a role here. It, in effect, could exempt banks below a certain level, just completely exempt them from this. There would be no loss to safety and soundness and an appreciable gain to cost-effectiveness.

Senator TILLIS. That is a point I want to make. I think it was Senator Warren that brought it up. I do not see how those sorts of changes create any significant risk. I see how it makes the regulations leaner. But I do not really understand. What would be the argument for saying that considering those signs of changes are going to create a greater risk?

Mr. POWELL. We are committed to not doing things that create a significantly——

Senator TILLIS. That is a bad thing——

Mr. POWELL.——greater risk. The whole idea is to preserve—in my view, and I think our view, the important core reforms that we have made, but to go back and clean up our work. I think our obligation is to do that. I think Volcker is a very, very difficult statute to implement, and I think if you look at it, it is implemented in a way that is too costly. I think it is on us to address that as supervisors and regulators. So that is how I see it.

Senator TILLIS. Anybody else have a comment on that?

Mr. GRUENBERG. I would just add, Senator, I think the basic premise of the Volcker rule, which is that risky proprietary trading should not be supported by insured deposits, by the public safety net, is a premise that is generally accepted. I think the issue is the implementation of the Volcker rule. I think there is a general view that there are opportunities to simplify compliance while achieving the purposes of the rule. And I think there will be an effort among the regulators to do that.

I think obviously here the key is to strike a balance between trying to simplify compliance while being sure that we are achieving the purpose of the rulemaking.

I would say on the exemption side, I would be more inclined toward a regulatory safe harbor for institutions, smaller institutions that engage in traditional banking activities rather than trying to

have a flat exemption because then that would capture the vast number of institutions, say, below $10 billion. But you do not want to create a vehicle for a small number of those institutions to be used for the proprietary trading activity. So striking a balance there seems to me would make some sense.

Mr. NOREIKA. And as the third Volcker agency at this table, we strongly support a full review of the Volcker rule, putting it out for comment to get the views of the affected parties as far as what we can do, what works, what does not work. Where the costs vastly exceed the benefits, we need to, revise it and streamline it.

Senator TILLIS. Mr. Chair, I am not going to go to far over, even though I am the last person here, because I have another commitment. But I really believe that we have to go through the process of regulatory reform, and I think it was Mr. McWatters that said something about we should not be using a shotgun as a method for rightfully going in and making sure that financial institutions are complying with regulations that expose our economy to risk or financial sector to a risk. But I think we have got some pretty dumb ways for doing that today. I think that we have to take a look at the risk profiles of banking institutions, get away from arbitrary thresholds so that we are actually making sure that the green light and the red light is being driven by common-sense assessments of the risk that a given institution represents, and it goes far beyond many of the regulations that I think that are driving our agencies today. And I look forward to a lot of recommendations that we can fast-track to get to that point, to get to the minimum amount of regulation to cover the risk and to free up financial services institutions, free up market makers, do the kind of things that we know we need to do if we are going to be serious about getting to the kind of economic growth we need to get to in this country.

Thank you all for being here. I will have several questions for the record.

Senator TILLIS. Thank you, Mr. Chair.

Chairman CRAPO. Thank you very much, and that does conclude the questioning. I again want to thank our witnesses for not only your time and effort to appear here today, but the work that you do in helping us to administer the financial governance of our system in the United States.

I also appreciate the fact that each of you provided very helpful suggestions to the process that we are going through. And I will be quick, too, in wrapping up, in line with what Senator Tillis was just talking about.

We are, as you know, engaged in an effort to identify where statutorily we can make things better. I do not think that it necessarily always does—in fact, it often does not come down to trying to figure out how to analyze the cost and benefit of allowing risk to go up in return for some kind of efficiency in the system. There are many efficiencies in the system that we can achieve that will not cause increase in risk and, in fact, might even reduce risk. And it is those kinds of efforts that I think we are primarily focused on today.

We need to get the right balance in our system so that we can have the strongest economic engine that we possibly can in our country. That is what will provide the kind of strength and reduce

risk in maybe the biggest way possible, in my opinion. But you are literally on the front lines, and the advice that you provide is tremendously helpful to this Committee, and I appreciate it.

You will receive some additional questions from Senators, as Senator Tillis just indicated. For the Senators, their questions will be due within 7 days, which will be next Thursday. I ask you to be very prompt in your responses because we are literally actively engaged right now in moving forward with developing this legislation.

With that, thank you again for coming today, and this hearing is adjourned.

[Whereupon, at 12:04 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF JEROME H. POWELL

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JUNE 22, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify at today's hearing on the relationship between regulation and economic growth. We need a resilient, well-capitalized, well-regulated financial system that is strong enough to withstand even severe shocks and support economic growth by lending through the economic cycle. The Federal Reserve has approached the post-crisis regulatory and supervisory reforms with that outcome in mind.

As a result of an improving economy and actions taken by both the Federal regulators and the industry, the U.S. financial system is substantially stronger and more stable than it was before the financial crisis erupted nearly a decade ago. In this testimony, I will highlight the considerable gains made since the crisis and reflect on the principles that should guide us in the next phase. I will also discuss some specific actions that align with these principles that we have recently taken or expect to take that are designed to reduce regulatory burden without compromising safety and soundness and financial stability.

Post-Crisis Regulatory and Supervisory Reform

There is little doubt that the U.S. financial system is stronger today than it was a decade ago. As I will discuss, loss-absorbing capacity among banks is substantially higher. The banking industry, and the largest banking firms in particular, face far less liquidity risk than before the crisis. And progress in resolution planning by the largest firms has reduced the threat that their failure would pose. These efforts have made U.S. banking firms both more robust and more resolvable. And history shows that when U.S. banking firms are financially strong, they are able to better serve their customers.

Today I will highlight developments in the four key regulatory areas designed to improve and maintain the resiliency of the banking industry: capital, stress testing, liquidity, and resolution planning.

Regulatory capital reforms

The U.S. banking agencies have substantially strengthened regulatory capital requirements for large banking firms, improving the quality and increasing the amount of capital in the banking system. High-quality common equity tier I capital (CETI) is important because it is available under all circumstances to absorb losses.

Since the financial crisis, U.S. banks have been required to meet new minimum requirements for CETI to ensure a base of protection against losses. U.S. banks also have been required to meet capital conservation buffers that incentivize banking firms to keep their capital levels well above the minimums in order to maintain full flexibility to allocate profits to shareholders and employees. For the U.S. global systemically important banks (G–SIBs), we have also imposed an additional capital surcharge designed to reduce the threat that a failure of any of these firms would pose to financial stability.

Stress testing

The Federal Reserve also conducts the Comprehensive Capital Analysis and Review (CCAR), a stress test that assesses whether large banking firms have enough capital to withstand severely adverse macroeconomic and financial market stress. We also use this process to assess the quality of the capital planning processes of large banking firms. The U.S. bank holding companies (BHCs) subject to CCAR have more than doubled the dollar amount of their CETI from around $500 billion in 2009 to $1.2 trillion in the first quarter of 2017, and have more than doubled their CETI risk-based capital ratios from 5.5 percent to 12.4 percent over that period.

Liquidity regulation reforms

The banking agencies have also required large banking firms to substantially reduce their liquidity risk. Our key reforms in this area include a liquidity coverage ratio (LCR) that requires large banking firms to keep enough high-quality liquid assets (HQLA) to meet net stressed cash outflows over a 30-day period. The Federal Reserve has also adopted the Comprehensive Liquidity Analysis and Review (CLAR) supervisory program for evaluating the liquidity of the most systemic banking firms. In addition, the banking agencies have proposed a net stable funding ratio (NSFR) regulation that would help ensure that large banking firms maintain a stable funding profile over a 1-year horizon.

Liquidity positions within the U.S. banking system have improved substantially since the financial crisis. The U.S. G–SIBs increased their holdings of HQLA from about $1.5 trillion to about $2.3 trillion between 2011 and the first quarter of 2017. The same institutions have also reduced their reliance on short-term wholesale funding from approximately 35 percent of assets in 2006 to about 15 percent of assets today.

Large bank resolvability reforms

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Federal Reserve has been working with the Federal Deposit Insurance Corporation (FDIC) to improve resolution planning by banks. Through thoughtful resolution planning, firms can reduce the risk that their failure would have disruptive effects on the financial system and the economy. The resolution planning process has caused the largest U.S. banking firms to substantially improve their internal structures, governance, information collection systems, and allocation of capital and liquidity in ways that both promote resolvability. The Federal Reserve also has helped improve the resolvability of the largest banking firms by requiring U.S. G–SIBs and the U.S. intermediate holding companies of foreign G–SIBs to meet long-term debt and total loss absorbing capacity (TLAC) requirements.

Effect of regulation on U.S. banks

Evidence overwhelmingly shows that financial crises can cause severe and lasting damage to the economy's productive capacity and growth potential.[1] Post-crisis reforms to financial sector regulation and supervision have been designed to significantly reduce the likelihood and severity of future financial crises. We have sought to accomplish this goal in significant part by reducing both the probability of failure of a large banking firm and the consequences of such a failure were it to occur. We have substantially increased the capital, liquidity, and other prudential requirements for large banking firms, and these increases are not free. Stronger capital requirements increase bank costs, and at least some of those costs are passed along to bank customers. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth. Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through-the-cycle credit availability and economic growth.

Guiding Principles to Simplify and Reduce Regulatory Burden

As we near completion of the major post-crisis regulatory reforms, this is a good time to assess the effectiveness and efficiency of these reforms. Several principles are guiding us in this effort. First, we should protect the core elements of the reforms for our largest banking firms in capital regulation, stress testing, liquidity regulation, and resolvability. Second, we should continue to tailor our requirements to the size, risk, and complexity of the firms subject to those requirements. In particular, we should always be aware that community banks face higher costs to meet complex requirements. Third, we should assess whether we can adjust regulation in common-sense ways that will simplify rules and reduce unnecessary regulatory burden without compromising safety and soundness. And finally, we should strive to provide appropriate transparency to supervised firms and the public regarding our expectations.

Areas of Focus for Recalibration and Simplification

Small- and medium-bank regulatory simplification

Over the course of the last year, the Federal Reserve and the other U.S. banking agencies finalized significant burden-reducing measures for smaller banks. The banking agencies significantly streamlined Call Report requirements for banks with less than $1 billion in total assets. This streamlined Call Report resulted in 24 fewer pages than the previous total of 85, and reduced data items required to be reported by small banks by 40 percent. The banking agencies also increased the number of institutions eligible for 18-month, rather than 12-month, cycles for safety and soundness and Bank Secrecy Act exams. And the Federal Reserve implemented

[1] See, for example, Robert F. Martin, Teyanna Munyan, and Beth Anne Wilson (2014), "Potential Output and Recessions: Are We Fooling Ourselves?" IFDP Notes (Washington: Board of Governors of the Federal Reserve System, November 12), *www.federalreserve.gov/econresdata/notes/ifdp-notes/2014/potential-output-and-recessions-are-we-fooling-ourselves-20141112.html;* and Olivier Blanchard, Eugenio Cerutti, and Lawrence Summers (2015), "Inflation and Activity—Two Explorations and Their Monetary Policy Implications, IMF Working Paper WP/15/230 (Washington: International Monetary Fund, November), *https://www.imf.org/external/pubs/ft/wp/2015/wp15230.pdf.*

a desirable statutory change to raise the threshold of its Small Bank Holding Company Policy Statement from $500 million to $1 billion in assets.

In addition, earlier this year, the U.S. banking agencies issued a report under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) that outlined additional measures that the agencies committed to completing to reduce regulatory burden. Perhaps most notably, the agencies committed to developing a proposal to simplify the generally applicable capital framework that applies to community banking organizations. Among other things, this proposal is being designed to simplify the current regulatory capital treatment of commercial real estate exposures, mortgage-servicing assets, and deferred tax assets. The agencies would seek industry comment on the proposal through the normal notice and comment process. The agencies also expect to further reduce burden on small banks by additional streamlining of Call Reports.

The Federal Reserve has also supported increases in various statutory thresholds in the Dodd-Frank Act to more narrowly focus financial stability reforms on larger banking firms. For example, we believe that small banking organizations could be exempted from the Volcker rule and from the incentive compensation requirements of the Dodd-Frank Act. We also would support an increase in the $10 billion Dodd-Frank Act asset threshold for company-run stress tests and risk committee requirements, and in the $50 billion threshold for enhanced prudential standards under section 165 of the Dodd-Frank Act.

Resolution plans

The U.S. G–SIBs have made substantial progress in improving their resolvability and have taken concrete steps to implement important organizational, governance, and operational measures developed in the course of their resolution planning exercises. These firms will be filing new plans on July 1 that should incorporate agency feedback and guidance. The Federal Reserve and FDIC will engage in a full review of these plans.

We are exploring with the FDIC ways to improve the resolution planning process. We believe it is worthwhile to consider extending the cycle for living will submissions from annual to once every 2 years, and focusing every other of these filings on key topics of interest and material changes from the prior full plan submission. In addition, there may be opportunities to greatly reduce the submission requirements for a large number of firms due to their relatively small, simple, and domestically focused activities. Such an approach could limit full plan filing requirements to firms that are large, complex, or have systemically critical operations.

Volcker rule

The Federal Reserve is reassessing whether the Volcker rule implementing regulation most efficiently achieves its policy objectives, and we look forward to working with the other four Volcker rule agencies to find ways to improve the regulation. In our view, there is room for eliminating or relaxing aspects of the implementing regulation that do not directly bear on the Volcker rule's main policy goals. We also believe it would be constructive for Congress to consider focusing the Volcker rule on entities with significant trading books and eliminating the requirement that smaller firms be subject to the rule. In the meantime, we believe that it is worthwhile for the agencies to consider further tailoring of the implementing rule as it applies to smaller firms and firms with small trading books, and to consider ways to streamline or reduce the paperwork and reporting burden associated with the rule.

Enhancements to stress testing and CCAR

The Federal Reserve is committed to increasing the transparency of the stress testing and CCAR processes. We will soon seek public feedback concerning possible forms of enhanced disclosure. One such disclosure would be a range of indicative loss rates predicted by the Federal Reserve's models for various loan and securities portfolios. We would also disclose more information about risk characteristics that contribute to the loss-estimate ranges.

When we release CCAR results next week, we will disclose more detailed information on CCAR's qualitative assessment. We will also publish a document later this year summarizing the performance of the industry on qualitative matters. Many of our largest banking firms have made substantial progress toward meeting supervisory expectations for capital planning. If that progress continues, I believe it will be appropriate to consider removing the qualitative objection from CCAR for those firms that achieve and sustain high-quality capital planning capabilities. We would continue to assess the capital planning practices of these firms as part of our ongoing supervisory processes. I would also see it as appropriate to adjust CCAR's assumptions regarding the balance sheet and capital distributions. These adjustments

would take place in conjunction with the integration of the stress test into a firm's regulatory capital requirements.

Leverage ratio

In light of the substantial progress in the build-out of our overall regulatory capital and stress testing frameworks over the past few years, the Federal Reserve is taking a fresh look at the enhanced supplementary leverage ratio. We believe that the leverage ratio is an important backstop to the risk-based capital framework, but that it is important to get the relative calibrations of the leverage ratio and the risk-based capital requirements right. Doing so is critical to mitigating any perverse incentives and preventing distortions in money markets and other safe asset markets. Changes along these lines also could address concerns of custody banks that their business model is disproportionately affected by the leverage ratio.

Conclusion

U.S. banks today are as strong as any in the world, as shown by their solid profitability and healthy lending over recent years. As we consider the progress that has been achieved in improving the resiliency and resolvability of our banking industry, it is important for us to look for ways to reduce unnecessary burden. We must also be vigilant against new risks that may develop. In all of our efforts, our goal is to establish a regulatory framework that helps ensure the resiliency of our financial system, the availability of credit, economic growth, and financial market efficiency. We look forward to working with our fellow regulatory agencies and with Congress to achieve these important goals.

STATEMENT OF

MARTIN J. GRUENBERG
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

Fostering Economic Growth: Regulator Perspective

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

June 22, 2017
534 Dirksen Senate Office Building
Washington, DC

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify today on legislative and regulatory relief recommendations. My written testimony will begin with an overview of the banking industry's recovery since the financial crisis and its current condition. I will then discuss the FDIC's efforts to streamline and simplify banking regulations and supervisory programs to reduce regulatory burden, particularly for community banks, while preserving the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking industry. That includes a discussion of the federal banking agencies' recently completed review pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) of 1996. Next, I will discuss the FDIC's recommendations for legislative changes to reduce unnecessary regulatory burden on financial institutions. Finally, I will conclude with comments on the recently released Treasury report on financial regulation.

State of the Banking Industry

Nearly a decade after the onset of the worst financial crisis since the 1930s, the U.S. banking industry has experienced a steady recovery that has put it in a strong position to support the credit needs of the economy.

Financial Crisis and Recession

The crisis itself originated in nontraditional mortgage lending, large banking organizations, and investment banks that became critically short of capital and liquidity. The acute disruption of financial markets that began in 2008, and the severe economic downturn that ensued, took a heavy toll on the financial condition of banks of all sizes and on their borrowers.

The U.S. economy lost 8.7 million jobs during and just after the recession. Home foreclosures exceeded two million in each year between 2008 and 2011. Estimates vary as to the total cumulative loss in gross domestic product (GDP) compared to potential output, but these estimates generally exceed $10 trillion.[1]

Banking industry indicators soon followed suit. The quarterly number of problem institutions rose from fewer than 50 in 2006 to a peak of 888 in 2011. Almost 1,800 institutions, or more than one-fifth of all insured depository institutions at the time, were on the problem bank list at some point during or in the aftermath of the crisis. In all, 520 FDIC-insured institutions failed between 2008 and 2016. The balance of the FDIC's Deposit Insurance Fund fell to a low of nearly $21 billion in the red at the end of 2009.

During the crisis and the deep recession that followed, many banks were in critical condition and many borrowers found themselves unable to service debt or unwilling to take on new loans. FDIC-insured institutions held nearly $400 billion in noncurrent loans at the end of 2009 (more than 5 percent of total loans), and charged off more than $300 billion in loans over the next two years.[2] With both the supply of and the demand for credit diminished, the year-over-year change in total loans and leases held by FDIC-insured institutions was negative in 11 out of 12 consecutive quarters starting at the end of 2008.

[1] See Atkinson, Tyler, David Luttrel and Harvey Rosenblum "How Bad Was It? The Costs and Consequences of the 2007-09 Financial Crisis" Federal Reserve Bank of Dallas, Staff Paper No. 20, July 2013. https://www.dallasfed.org/assets/documents/research/staff/staff1301.pdf

[2] Noncurrent loans are the sum of loans and leases 90 days or more past due, and loans and leases in nonaccrual status.

Recovery

The economic expansion that began in 2009 is now approaching its ninth year, making it the third longest expansion on record. The expansion, however, has been marked by the slowest pace of economic growth and the lowest short-term interest rates of any expansion of the past 70 years. In spite of these headwinds, FDIC-insured institutions have made substantial progress in strengthening their capital and asset quality, and in raising their net income to record highs.

The industry's equity capital-to-assets ratio had never exceeded 11 percent prior to the second quarter of 2010. Since mid-2010, it has never failed to exceed 11 percent. The percent of loans considered noncurrent reached a peak of 5.42 percent in the first quarter of 2010. Since then, the noncurrent loan ratio has declined in all but one quarter, and reached a new post-crisis low of 1.34 percent in March of this year. The quarterly ratio of net charge-offs to average loan balances has also fallen to pre-crisis levels below 0.50 percent.

Consistent with these improvements in credit quality, the annual number of failed institutions fell to single digits in both 2015 and 2016, and the number of problem banks fell to a nine-year low of 112 as of March 2017. The Deposit Insurance Fund also steadily recovered, growing to just under $85 billion as of March of this year.

After posting a loss in 2009, annual increases in industry net income have averaged 7.8 percent per year since 2011. FDIC-insured institutions reported a record $171.3 billion in net income for 2016, marking a net increase of 44 percent over the past five years. Only 4.2 percent of all banks failed to post a profit during the year, the lowest share in any year since 1995.

Profitability ratios – that is, return on assets and return on equity – have improved substantially, but not completely, from crisis lows. The most important factor holding back further improvement in bank profitability ratios has been the tight net interest margins (NIMs) banks have earned in the exceptionally low interest rate environment of the post-crisis period. While industry NIMs regularly ranged from 3.5 percent to 4 percent or higher between 1990 and 2005, they have failed to exceed 3.2 percent in any of the last 13 quarters. This squeeze on NIMs can be expected to ease once interest rates normalize and banks can earn wider spreads on their new loans.

As this long economic recovery has progressed, industry loan growth has strengthened in a gradual but sustained manner. Total loans held by FDIC-insured institutions grew by more than 5 percent in 2014, 2015, and 2016, exceeding the rate of growth in nominal GDP in all three years.[3] Year-over-year industry loan growth stood at 4 percent as of the end of the first quarter of 2017, a rate nearly equal to growth in nominal GDP.

Community banks have outpaced noncommunity banks by a number of measures. Their merger-adjusted loan growth has exceeded that of noncommunity banks in each of the past five years; they have increased lending by more than 8 percent in each of the past three years.[4]

Community bank loan growth has been broad-based, exceeding growth at noncommunity banks in each of the past four years in their holdings of one- to four-family mortgages,

[3] Appendix A, Figure 1.
[4] Appendix A, Figure 2.

commercial and industrial loans, and commercial real estate loans. The exception has been consumer loans to individuals – an area of relative strength for large banks. Yet even in that category, community banks have registered positive annual loan growth in each of the past five years.

This vigorous loan growth has translated into healthy increases in net income for community banks. In 2014 and 2016, community bank net income grew by 12.8 percent and 10.1 percent, respectively – far exceeding earnings growth at noncommunity banks during those years. In 2015, earnings growth was identical for both groups at 8 percent.

The state of the community banking sector is of particular importance because of the outsize influence these institutions have on their local economies. Based on the FDIC's research definition of a community bank, they made up 92 percent of all FDIC-insured institutions at the end of 2016.[5] Community lenders are disproportionately important in meeting the diverse credit needs of small businesses. At the end of last year, community banks held 43 percent of small loans to businesses and farms, a share that is more than three times higher than their 13 percent share of industry total assets.

A recent FDIC study showed that community banks held 100 percent of total deposits in 646 U.S. counties or county-equivalents, and more than 75 percent of deposits in another 598

[5] The FDIC's research definition of a community bank was introduced in the 2012 *FDIC Community Banking Study* (see Chapter 1 and Appendix A of the study). The purpose of this definition is to identify community banks according to their lending activity, reliance on core deposits, and limited geographic scope – and not to identify them purely in terms of asset size. The *FDIC Community Banking Study*, as well as historical data identifying community banks according to this definition, can also be found at: https://www.fdic.gov/regulations/resources/cbi/study.html

counties.[6] In all, community banks are the primary source of banking services in 40 percent of all U.S. counties, including rural areas, small towns, and urban neighborhoods across the nation.

An important measure of the effectiveness of our banking system is its ability to make new loans to creditworthy borrowers. As we saw in the crisis, inadequate levels of capital and liquidity at financial institutions can contribute to a collapse of the financial system that severely impairs credit creation and economic output for a protracted period. Conversely, as the capital and liquidity of the U.S. banking industry have recovered, so has the support it has provided to the current expansion.

As noted earlier in this testimony, loan growth at U.S. banks substantially outpaced nominal GDP growth from 2014 through 2016, a sign that banks are supporting economic growth. Bank loans outstanding also have grown faster than loans held by nonbank sources of credit in six of the last seven years. In international comparisons, large U.S. banking organizations as a group are better capitalized than their European counterparts, while economic growth and bank loan growth have been substantially stronger in the United States than in Europe.[7]

International comparisons of non-lending activity also are of interest. The top five investment banks in the world by fee income in 2016 and the first quarter of 2017 all were

[6] Eric Breitenstein and John McGee, "Brick-and-Mortar Banking Remains Prevalent in an Increasingly Virtual World," *FDIC Quarterly*, Vol 9, No. 1. 2015. https://www.fdic.gov/bank/analytical/quarterly/2015_vol9_1/fdic_4q2014_v9n1_brickandmortar.pdf

[7] From 2014 through 2016, real GDP grew by 6.7 percent in the U.S. compared to 5.3 percent in euro area. Over the same time period, loans to individuals/households grew by 17.4 percent in the U.S. compared to 3.5 percent in the euro area, and loans to businesses grew by 23.6 percent in the U.S. compared to 1.3 percent in the euro area. Source: FDIC, European Central Bank, European Commission. See Appendix A, Figures 3, 4, and 5.

investment banking subsidiaries of U.S. globally systemic banking organizations. This is broadly consistent with the fact that the volume of corporate bond trading in the United States has increased for several years, but has been flat in Europe.[8] Similarly, the market share of client derivatives cleared by large U.S. banking organizations has increased from roughly 50 percent to 70 percent during the past three years.

In short, the experience of the crisis and its aftermath suggests that a strong and well-capitalized banking system is a source of strength and support to our national economy. The reforms implemented in the post-crisis period have been aimed at making the system more resilient to the effects of future crises or recessions and better able to sustain credit availability throughout the business cycle.

Simplifying Regulation: The Economic Growth and Regulatory Paperwork Reduction Act

It is desirable that financial regulations be simple and straightforward, and that regulatory burdens and costs be minimized, particularly for smaller institutions. In considering ways to simplify or streamline regulations, it is important to preserve the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking industry. The next section of this testimony will discuss changes the FDIC has made, many of which were undertaken in collaboration with the other federal banking agencies, to its regulations or

[8] "Examination of the Liquidity of the Secondary Corporate Bond Markets: Final Report," International Organization of Securities Commissions (IOSCO), February 2017, Figure 8, page 26. See Appendix A, Figure 6.

supervisory programs in the interest of streamlining or simplifying processes, and in reducing regulatory requirements, particularly for community banks.[9]

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires the federal banking agencies (the Office of the Comptroller of the Currency, the Federal Reserve Board, and the FDIC), along with the Federal Financial Institutions Examination Council, to conduct a review of our rules at least every ten years to identify outdated or unnecessary regulations. To carry out the EGRPRA review, and to seek comment from bankers and other stakeholders, the agencies published four *Federal Register* notices, each addressing three categories[10] of rules and each providing a 90-day comment period.

In addition to seeking public comment through the *Federal Register* notices, the agencies held six public outreach meetings across the country to provide an opportunity for bankers, consumer and community groups, and other interested persons to present their views directly to agency senior management and staff on any of the regulations subject to EGRPRA review. One of the outreach sessions was specifically targeted toward rural bankers and issues important to them. Altogether, the agencies received more than 250 comment letters from financial institutions, trade associations, and consumer and community groups, as well as numerous

[9] In addition to these measures, the FDIC has also pursued a multi-year Community Banking Initiative. See Appendix A to this testimony.

[10] The agencies grouped their regulations into the following 12 regulatory categories [: (1) Applications and Reporting; (2) Banking Operations; (3) Capital; (4) CRA; (5) Consumer Protection;6 (6) Directors, Officers and Employees; (7) International Operations; (8) Money Laundering; (9) Powers and Activities; (10) Rules of Procedure; (11) Safety and Soundness; and (12) Securities.] During the review process the agencies announced their decision to expand the scope of the EGRPRA review to include recently issued rules, such as those issued pursuant to the Dodd-Frank Act and the recently promulgated domestic capital and liquidity rules. The agencies identified these rules, referred to as "Newly Listed Rules," on a chart included in the third Federal Register notice (see 80 FR 32046 (June 5, 2015), https://www.gpo.gov/fdsys/pkg/FR-2015-06-05/pdf/2015-13749.pdf.

comments from the outreach meetings. The banking agencies submitted our second EGRPRA report to Congress on March 21, 2017.[11]

Several themes emerged during our public outreach process and from the written comments. In particular, the complexity of the risk-based capital rules was cited as being a challenge for community bankers. Additionally, stakeholders suggested that longstanding thresholds set forth in legislation, regulations, or both, should be changed; e.g., dollar thresholds for transactions requiring an appraisal, and asset thresholds on the size of the institutions eligible for longer examination cycles. Commenters also asked that supervisory expectations intended for large banks not be applied to community banks – the so–called trickle-down effect – and that regulators have open and regular lines of communication with community bankers. We also heard concerns about burdens and costs related to Call Reports and suggestions for improving the Call Report preparation process, especially for community banks. Finally, we also heard that regulatory burden does not emanate only from statutes and regulations, but often comes from processes and procedures related to examinations and regulatory oversight.

Interagency Actions in Response to EGRPRA Comments

The agencies have taken, or are in the process of taking, actions to address comments received during the EGRPRA process, including but not limited to, the following:

Simplifying the Capital Rules. The agencies are developing a proposal to simplify the generally applicable capital framework, including: 1) replacing the framework's complex

[11] See 82 FR 15900 (March 30, 2017, https://www.gpo.gov/fdsys/pkg/FR-2017-03-30/pdf/2017-06131.pdf.

treatment of high-volatility commercial real estate exposures with a more straightforward treatment for most acquisition, development, or construction loans; (2) simplifying the current regulatory capital treatment for mortgage servicing assets, so-called timing difference deferred tax assets (DTAs), and holdings of regulatory capital instruments issued by financial institutions; and (3) simplifying the current limitations on minority interests in regulatory capital. The agencies will seek industry comment on the proposal through the normal notice-and-comment process.

Reduced Examination Frequency. Through the EGRPRA process, the agencies all indicated support for revisions to the statute governing examination frequency. Congress subsequently enacted the Fixing America's Surface Transportation Act that, among other things, gave the agencies discretion to raise the asset threshold for certain insured depository institutions qualifying for an 18-month examination cycle with an "outstanding" or "good" composite condition from less than $500 million in total assets to less than $1 billion in total assets. Shortly thereafter, the agencies exercised this discretion and issued a joint interim final rule, which we later finalized, to raise the asset threshold that, in general, makes qualifying institutions with less than $1 billion in total assets eligible for an 18-month (rather than a 12-month) examination cycle. As a result, approximately 611 more institutions potentially qualify for an extended 18-month examination cycle, increasing the share of potentially qualifying institutions to approximately 83 percent. In addition, the change in the examination cycle for certain qualifying institutions reduced the frequency of Bank Secrecy Act reviews that are typically conducted during safety and soundness examinations.

Reduced Regulatory Reporting Requirements. The agencies have worked together on a multi-phase plan to both simplify and reduce regulatory reporting requirements. First, in July 2016, the agencies finalized certain Call Report revisions, which included a number of burden-reducing and other reporting changes that took effect September 30, 2016, and March 31, 2017. Then in August 2016, the agencies proposed for comment a community bank Call Report and finalized it in December 2016. The new, streamlined Call Report for institutions with domestic offices only and less than $1 billion in total assets, reduced the length of the Call Report from 85 pages to 61 pages and removed approximately 40 percent of the data items that were previously included on the existing form. Additional measures proposed this week would remove, raise the reporting threshold for, or reduce the reporting frequency of approximately 8 percent of the data items on the Call Report for small institutions, and make other burden-reducing changes for larger institutions, while continuing to provide the agencies with the information needed to supervise the industry. Further Call Report streamlining is expected in future proposals.

Raising Appraisal Threshold. Community bankers in particular raised concerns that the thresholds for requiring appraisals pursuant to the banking agencies' regulations have not been changed in a number of years, and are particularly low for commercial transactions, effectively requiring an appraisal for most of these transactions. In response, the agencies are developing a proposal to increase the threshold for requiring an appraisal on commercial real estate loans from $250,000 to $400,000, which we believe will reduce regulatory burden in a manner consistent with safety and soundness.

Addressing Availability of Appraisers in Rural Areas. The agencies received a number of comments, particularly from community bankers that participated in the rural banking outreach session, regarding shortages of appraisers in rural areas. In response to these concerns, the agencies issued a statement in May 2017 to regulated entities informing them of the availability of two existing options that may help address appraiser shortages.[12] The first option, temporary practice permits, allows appraisers credentialed in one state to provide their services on a temporary basis in another state experiencing a shortage of appraisers, subject to state law. The advisory also discusses reciprocity, in which one state allows appraisers that are certified or licensed in another state to obtain certification or licensing without having to meet all of the state's certification or licensing standards.

The second option, temporary waivers, sets aside requirements relating to the certification or licensing of individuals to perform appraisals under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 in states or geographic political subdivisions where certain conditions are met. Temporary waivers may be granted when it is determined that there is a scarcity of state-certified or -licensed appraisers, leading to significant delays in obtaining an appraisal. At the FDIC, we intend to work to make sure that bankers and other stakeholders are aware of these options, and to encourage our regulated entities to use them when appropriate.

[12] As noted in the FFIEC's *Joint Report to Congress*, with respect to residential mortgage transactions, other federal government agencies that are involved in the residential mortgage market (such as the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, and the Rural Housing Service of the U.S. Department of Agriculture), and the government-sponsored enterprises, which are regulated by the Federal Housing Finance Agency, have the authority to set separate appraisal requirements for loans they originate, insure, acquire, or guarantee, and generally require an appraisal by a certified or licensed appraiser for residential mortgages regardless of the value of the loan (see page 29 of the *Joint Report to Congress*, https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf . However, residential real estate transactions that banks keep on their books and that do not involve these agencies would likely benefit from the existing options that help address appraisal shortages.

Also, some commenters, again primarily in rural areas, were uncertain about whether they were required to obtain appraisals performed by certified or licensed appraisers even when transactions fall below the dollar thresholds in the appraisal regulations. In response, in March 2016, the banking agencies clarified that evaluations may be used in lieu of appraisals when transactions fall below the dollar thresholds in the appraisal regulations.

Reviewing and Modernizing the Examination Process. A number of years ago, the FDIC and other agencies moved away from the one-size-fits-all, "surprise" examination model to a risk-focused examination model that is tailored to the size, complexity, risk profile, and business model of each individual bank. Risk-focused examinations involve significant ongoing communication with bankers and extensive pre-planning to tailor the on-site portion of the examination. That being said, the agencies recognize that regulatory burden does not emanate only from statutes and regulations, but often comes from processes and procedures related to examinations and supervisory oversight, and that we can review our examination processes to improve efficiencies and reduce burden, while maintaining the overall quality of supervision. Accordingly, the agencies are jointly reviewing the examination process, examination report format, and examination report preparation process to identify further opportunities to minimize burden to bank management where possible, principally by rethinking traditional processes and making better use of technology to allow more examination work to be performed off-site, reducing onsite examination hours and the number of examiners present in banks. In addition, the agencies plan to review interagency guidance, such as policy statements, to update and streamline guidance.

FDIC Actions Taken in Response to EGRPRA Comments

Promoting *De Novo* Institutions. Last year the FDIC rescinded its 2009 guidance on *de novo* supervision, FIL-50-2009, "Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Institutions," reducing from seven years to three years the period of enhanced supervisory monitoring of newly-formed insured depository institutions.[13] The FDIC also issued questions and answers on issues related to deposit insurance applications, clarifying the purpose and benefits of pre-filing meetings, processing timelines, initial capitalization requirements, and business plan requirements. Further, we conducted outreach meetings in all six FDIC regional offices around the country with more than 200 industry participants, providing guidance about the deposit insurance application process. The FDIC has designated subject matter experts in each of our regional offices, providing applicants with dedicated points of contact for deposit insurance applications, and we recently finalized a handbook for organizers of *de novo* institutions, describing the process of applying for federal deposit insurance and providing instruction about the application materials required.[14] In a rising interest rate environment, the FDIC is seeing increased interest in *de novos* and has approved four new applications for deposit insurance in the past nine months.

Reduced Applications Requirements. The FDIC eliminated requirements for institutions to file applications under part 362 of the FDIC Rules and Regulations to conduct activities permissible for national banks through certain bank subsidiaries organized as limited liability companies. The FDIC estimates the vast majority of the part 362 applications processed

[13] FDIC Rescinds De Novo Time Period Extension; Releases Supplemental Guidance on Business Planning (April 6, 2016), https://www.fdic.gov/news/news/press/2016/pr16027.html.
[14] See Applying for Deposit Insurance: A Handbook for Organizers of *De Novo* Institutions, April 2017, https://www.fdic.gov/regulations/applications/handbook.pdf.

during the ten years before the streamlined procedures were adopted involved limited liability companies, so this change will result in a significant reduction in filing requirements.

Reduced Paper-Based Submissions. The FDIC established a process to allow for electronic submission of audit reports required by part 363 of the FDIC Rules and Regulations via FDIC*connect*, eliminating the need for institutions to mail hard copies. FDIC*connect* is a secure, transactions-based website that provides alternatives for paper-based processes and allows for the submission of various applications, notices, and filings required by regulation.

Clarified Capital Rules Treatment for S-Corporations. In 2014, the FDIC issued guidance to FDIC-supervised institutions, clarifying how the agency would treat certain requests from S-corporation institutions to pay dividends to their shareholders to cover taxes on their pass-through share of bank earnings when those dividends are otherwise not permitted under the new capital rules. The FDIC told banks that unless there were significant safety and soundness issues, the FDIC would generally approve those requests for well-rated banks.

Streamlining Living Will Requirements

The U.S. global systemically important banks have made substantial progress in improving their resolvability and have taken concrete steps to implement important organizational, governance, and operational measures developed in the course of their resolution planning exercises. These firms will be filing new plans on July 1 that should incorporate agency feedback and guidance. The Federal Reserve and FDIC will engage in a full review of these plans.

We are exploring with the Federal Reserve Board ways to improve the resolution planning process. We believe it is worthwhile to consider extending the cycle for living will submissions from annual to once every two years and focusing, every other filing, on key topics of interest and the material changes from the prior full plan submission. In addition, there may be opportunities to greatly reduce the submission requirements for a large number of firms due to their relatively small, simple, and domestically-focused banking activities. Such an approach could limit full plan filing requirements to firms that are large, complex, or have a systemically critical operation.

Recommended Legislative Reforms

Some EGRPRA commenters suggested raising the $10 billion in total assets threshold for conducting annual stress tests set forth in Section 165(i)(2) of the Dodd-Frank Act. The FDIC agrees with these commenters, and supports legislative efforts to increase the threshold from $10 billion to $50 billion. However, the FDIC also believes it is important to retain supervisory authority to require stress testing if warranted by a banking organization's risk profile or condition.

In addition to this recommendation, the FDIC would be receptive to legislation further increasing the asset threshold for banks eligible for an 18-month examination cycle from $1 billion in total assets to $2 billion in total assets. This would allow about another 340 institutions to potentially qualify for extended examination cycles, which would bring the number of qualifying institutions to approximately 93 percent of all institutions. These institutions also

would be eligible for extended Bank Secrecy Act and anti-money laundering reviews. Moreover, after notice and comment, the agencies also could consider raising the threshold for the community bank Call Report to match a higher examination frequency threshold.

The FDIC understands the concerns about delays in receiving appraisals, particularly in rural areas, and how such delays can create significant problems in engaging in residential mortgage lending in those areas. In response to these concerns, the FDIC supports legislative changes that would create a new appraisal threshold exemption in that would minimize burden for many community banks. Namely, the exemption would apply to insured depository institutions that originate a *de minimis* number, such as less than 25, of residential mortgage loans in a calendar year with a transaction value of more than $250,000 and secured by properties in rural counties. Additionally, we would propose that the aggregate amount of such transactions (regardless of whether the loans were retained) for each calendar year not exceed a certain level, perhaps 5 percent, of the institution's total equity capital as of the end of the prior year. Institutions meeting such criteria would not be required to obtain appraisals for residential mortgage loans in rural counties regardless of the amount of the transaction, but would be required to conduct evaluations for these transactions in accordance with outstanding guidance.[15] The FDIC believes that such a change would be responsive to community banks in rural areas that have problems in obtaining timely appraisals, while the *de minimis* nature of the proposed exemption limits safety and soundness concerns.

[15] FDIC FIL-82-2010, *Interagency Appraisal and Evaluation Guidelines*, December 2, 2010, https://www.fdic.gov/news/news/financial/2010/fil10082.html
and FDIC FIL-16-2016, *Supervisory Expectations for Evaluations*, March 4, 2016. https://www.fdic.gov/news/news/financial/2016/fil16016.html

The Treasury Report

I now would like to discuss the recently released Treasury Department review of the regulatory framework for the depository sector, focusing for today on two key areas that bear significantly on the FDIC's mission. In general terms, as noted in the report, the financial regulations issued since the crisis were a response to important weaknesses in the pre-crisis financial regulatory framework. A significant body of new rules has been introduced, and there is value in a review of the new framework and its effects. The report contains suggestions regarding tailoring the scope, frequency, and compliance requirements of a number of specific aspects of the new regulations that are worthy of consideration, particularly as they apply to small- and medium-sized institutions. The FDIC is prepared to engage with other interested stakeholders about these issues.

As these proposals are considered, I also would emphasize the important role the post-crisis reforms have had in strengthening the capital and liquidity position and overall financial resilience of the U.S. banking system, particularly for large systemically important financial institutions. As discussed earlier, with their greatly improved capital and liquidity, U.S. banking organizations have provided strong support to U.S. economic activity. Large U.S. banking organizations are better capitalized than their European counterparts, have grown their loans faster, and have been a stronger source of support for the U.S. economy. This is a strength we should preserve and be particularly attentive to when considering changes.

Two specific recommendations in the report bear directly on the FDIC's mission. The first relates to the recommendation to remove the FDIC from the living will process. Resolution

plans, or living wills, are an important tool for protecting the economy and preventing future taxpayer bailouts. Requiring these plans ensures that firms establish, in advance, how they could be resolved in an orderly way under the Bankruptcy Code in the event of material financial distress or failure. Currently, the Federal Reserve and the FDIC share responsibility for reviewing these plans. In reviewing these plans, the Federal Reserve brings its perspective as supervisor of the holding company. The FDIC brings its perspective as the agency charged with the resolution of failed depository institutions. Both perspectives have value, and both agencies should remain involved in the review of living wills.

The report also includes several recommendations pertaining to the agencies' supplementary leverage ratio (SLR) and enhanced supplementary leverage ratio (ESLR) rules. The report recommends removing central bank deposits, Treasury securities, and initial margin on derivatives from the denominator of the SLR and ESLR, and recalibrating the numerical requirements for these ratios to be consistent with international standards. During the crisis, leverage capital had greater credibility with financial markets than risk-based capital, and counterparties recognized this. The changes being proposed to the SLR and ESLR would significantly reduce leverage capital requirements for large systemically important banking organizations and significantly weaken the resiliency of the U.S. banking system to future financial stress. For these reasons, the SLR and ESLR requirements should not be weakened.

Conclusion

In conclusion, the experience of the crisis and its aftermath suggests that a strong and well-capitalized banking system is a source of strength and support to our national economy.

The reforms implemented in the post-crisis period have been aimed at making the system more resilient to the effects of future crises or recessions and better able to sustain credit availability throughout the business cycle.

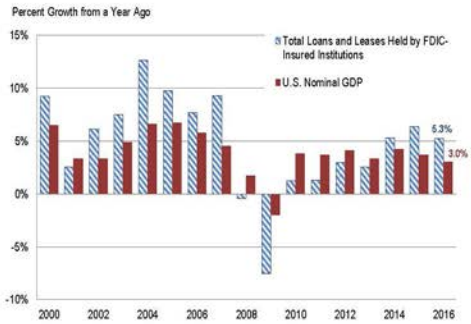
It is desirable that financial regulations be simple and straightforward, and that regulatory burdens and costs be minimized, particularly for smaller institutions. In considering ways to simplify or streamline regulations, however, it is important to preserve the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking system.

Appendix A

Charts Referenced in the Statement

Figure 1

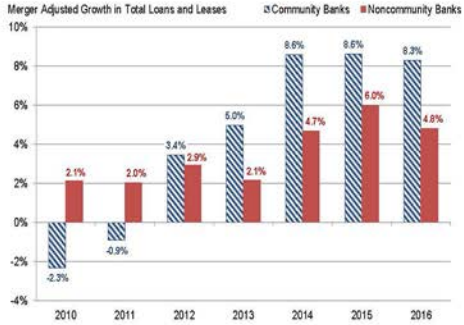
After a sharp decline during the financial crisis, U.S. bank loans have grown faster than nominal GDP in each of the past 3 years.



Sources: FDIC; Bureau of Economic Analysis (Haver Analytics)

Figure 2

Community bank loan growth has exceeded growth at noncommunity banks for five consecutive years.



Source: FDIC.

Appendix A

Charts Referenced in the Statement

Figure 3

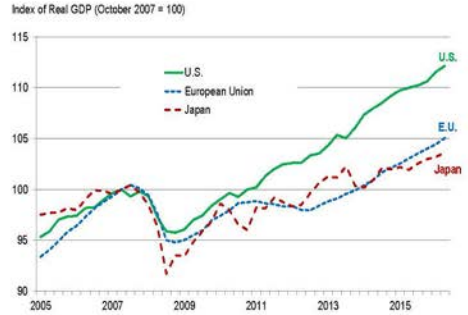
Large U.S. banking organizations have built their capital faster than European banks.

Sources: Y-9C data for U.S. institutions, SNL Financial data for non-U.S. institutions.

Notes: Global systemically important banks (GSIBs) are defined by the Financial Stability Board and include eight U.S. bank holding companies. Certain non-U.S. GSIBs are excluded due to lack of data availability. Estimated IFRS Tier 1 Leverage Ratio is calculated as Tangible Equity / (Tangible Assets + Netted Derivatives Adjustment). Tangible Equity and Tangible Assets exclude Goodwill and other intangible assets. "Netted Derivatives Adjustment" represents the amount of derivatives with a positive fair value that are excluded from the consolidated balance sheet as a result of netting permitted under GAAP, which approximates the positive fair value that would be reported under IFRS.

Figure 4

The U.S. macroeconomic recovery has outpaced that of the European Union and Japan.



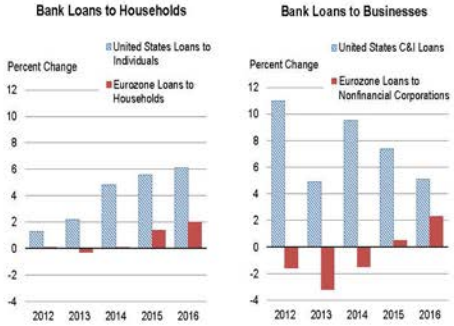
Source: Federal Reserve Bank of St. Louis (FRED).

Appendix A

Charts Referenced in the Statement

Figure 5

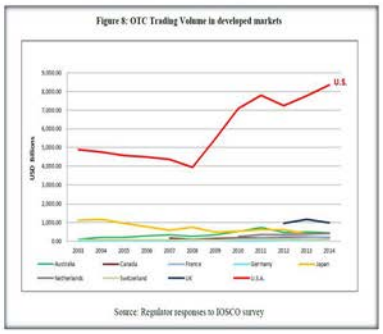
Bank loan growth in the U.S. has outpaced the Eurozone substantially in the post-crisis period.



Source: FDIC, European Central Bank.

Figure 6

The volume of secondary market trading of corporate bonds has surged in the U.S. in the post-crisis period.



Source: "Examination of the Liquidity of the Secondary Corporate Bond Markets: Final Report," International Organization of Securities Commissions (IOSCO), February, 2017, Figure 8, page 26.
https://www.iosco.org/library/pubdocs/pdf/IOSCOPD558.pdf

Appendix B

The FDIC Community Banking Initiative

As the primary federal regulator of most community banks, the FDIC has provided support to community banks under the multi-year Community Banking Initiative. As part of this initiative, we have established the FDIC Advisory Committee on Community Banking to provide the FDIC with advice and guidance on a broad range of important policy issues impacting community banks throughout the country, as well as the local communities they serve, with a focus on rural areas.

The FDIC also has pursued an agenda of research and outreach focused on community banking issues, including the FDIC Community Bank Study, a data-driven analysis of the opportunities and challenges facing community banks over a 25-year period, as well as research regarding the factors that have driven industry consolidation over the past 30 years, minority depository institutions, branching trends, closely held banks, efficiencies and economies of scale, earnings performance, and rural depopulation.[16] We also introduced a Community Bank Performance section of the FDIC *Quarterly Banking Profile* to provide a detailed statistical picture of the community banking sector.

The FDIC has also provided significant technical assistance to community banks. We established a Directors' Resource Center on the FDIC's website that, among other things, contains more than 25 technical assistance videos designed for bank directors and management on important and complex topics. We have revised banker guidance on deposit insurance coverage and conducted related outreach sessions for bankers. We also developed and

[16] See FDIC Community Banking Study, December 2012, https://www.fdic.gov/regulations/resources/cbi/study.html.

distributed to all FDIC-supervised institutions a *Community Bank Resource Kit*, containing a copy of the FDIC's *Pocket Guide for Directors*, and reprints of various *Supervisory Insights* articles relating to corporate governance, interest rate risk, and cybersecurity.

The FDIC also looks for ways to change supervisory processes to improve efficiencies and minimize burdens on community banks. For example, we reduced the frequency of consumer compliance and CRA examinations for small and *de novo* banks in 2013. Previously, small banks (those with assets of $250 million or less) that received a Satisfactory or Outstanding rating for CRA were subject to a CRA examination no more than once every 48 to 60 months, respectively. Small banks with favorable compliance ratings and Satisfactory CRA ratings now are examined every 60 to 72 months for joint compliance and CRA examinations and every 30 to 36 months for compliance only examinations. Additionally, in April 2016, the examination frequency for the compliance and CRA examinations of *de novo* institutions and charter conversions was changed. More specifically, the *de novo* period, which had required annual on-site presence for a period of five years, has been reduced to three years.

We also implemented an electronic pre-examination planning tool for both risk management and compliance examinations. This tool allows the FDIC examination staff to tailor requests for documents and data to ensure that only those items that are necessary for the examination process are requested from each institution. Tailoring pre-examination request lists minimizes burden for institutions, and receiving pertinent information in advance of the examination allows examiners to review certain materials off site, reducing on-site examination hours.

We have improved communication with bank boards of directors and management by reissuing and updating guidance on examination findings[17] to re-emphasize the importance of open communications regarding supervisory findings and to provide an additional informal review process at the Division Director level for banker concerns that are not eligible for another review process. We also improved transparency in the supervisory process, when the FDIC Board of Directors issued two statements that set forth basic principles to guide FDIC staff in developing and reviewing supervisory guidance and communicating supervisory recommendations to financial institutions under its supervision. We also proposed revised guidelines for supervisory appeals to provide more transparency and access to the appeals process. Among other things, these improvements in communication and transparency are intended to avoid the "trickle-down" effect that we sometimes hear about from bankers, and to inform community bankers, in particular, of the avenues available if they feel a regulation or examination process intended for larger banks has been applied to them.

[17] See FIL-51-2016, Reminder on FDIC Examination Findings, July 29, 2016, https://www.fdic.gov/news/news/financial/2016/fil16051.html.

PREPARED STATEMENT OF J. MARK McWATTERS

ACTING BOARD CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION *

JUNE 22, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, as Acting Chairman of the National Credit Union Administration Board, I appreciate the invitation to testify about regulatory relief. I was sworn in as a Member of the NCUA Board in 2014 and named Acting Chairman by President Trump on January 23, 2017.

As requested in your letter of June 6, my testimony today addresses recommendations to achieve real relief while maintaining safety and soundness and compliance with all legal requirements. I cover recommendations in the most recent report under the Economic Growth and Regulatory Paperwork Reduction Act, EGRPRA, and in the U.S. Treasury Department's June 2017 report, "A Financial System That Creates Economic Opportunities Banks and Credit Unions." I also discuss the NCUA Board's most recent efforts to reduce regulatory and examination burdens for credit unions to help create economic growth.

Economic Growth and Regulatory Paperwork Reduction Act

The NCUA voluntarily participates in the ongoing interagency review process created by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).[1] EGRPRA requires the Federal Financial Institutions Examination Council and its member agencies to review their regulations at least once every 10 years to identify rules that might be outdated, unnecessary, or unduly burdensome.

Overview of the NCUA's Participation in EGRPRA

The NCUA is not required by law to participate in the EGRPRA review process, because the NCUA is not defined as an "appropriate Federal banking agency," under EGRPRA.[2] Nonetheless, the NCUA embraces the objectives of EGRPRA and, in keeping with the spirit of the law, the NCUA participates in the review process. (The NCUA also participated in the first EGRPRA review, which ended in 2006).

The categories used by the NCUA to identify and address issues are:

- Agency Programs;
- Applications and Reporting;
- Capital;
- Consumer Protection;
- Corporate Credit Unions;
- Directors, Officers and Employees;
- Money Laundering;
- Powers and Activities;
- Rules of Procedure; and
- Safety and Soundness.

These categories are comparable, but not identical, to the categories developed jointly by the banking agencies covered by EGRPRA, and reflect some of the fundamental differences between credit unions and banks. For example, 'corporate credit unions' is a category unique to the NCUA. For the same reason, the NCUA decided to publish its notices separately from the joint notices used by the banking agencies, although all of the notices were published at approximately the same time. The NCUA included in its EGRPRA review all rules over which the NCUA has drafting authority, except for certain rules that pertain exclusively to internal operational or organizational matters at the agency, such as the NCUA's Freedom of Information Act rule.

The NCUA is also mindful that credit unions are subject to certain rules issued or administered by other regulatory agencies, such as the Consumer Financial Protection Bureau (CFPB) and the Department of the Treasury's Financial Crimes Enforcement Network. Because we have no independent authority to change such

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* NCUA is the independent Federal agency created by the U.S. Congress to regulate, charter, and supervise Federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of 108 million account holders in all Federal credit unions and the overwhelming majority of State-chartered credit unions. At *MyCreditUnion.gov* and Pocket Cents, NCUA also educates the public on consumer protection and financial literacy issues.

[1] 12 U.S.C. 3311.

[2] See 12 USC 1813(q).

rules, our notices (like the joint notices prepared by the other agencies) advise that comments submitted to us but focused on a rule administered by another agency will be forwarded to that agency for appropriate consideration.

Response to EGRPRA Comments:

Field of Membership

Credit unions are limited to providing service to individuals and entities that share a common bond, which defines their field of membership. The NCUA Board diligently implements the Federal Credit Union Act's directives regarding credit union membership. In October 2016, the NCUA Board modified and updated its field of membership rule addressing issues such as:

- The definitions of local community, rural district, and underserved area;
- Multiple common-bond credit unions and members' proximity to them;
- Single common-bond credit unions based on a trade, industry, or profession; and
- The process of applying for a new charter or expanding an existing Federal credit union.[3]

Member Business Lending

Congress has empowered the Board to implement the provisions in the Federal Credit Union Act that address member business loans. A final rule adopted by the NCUA Board in February 2016 was challenged by the Independent Community Bankers of America, but was affirmed by the District Court for the Eastern District of Virginia in January 2017. The final rule, approved unanimously by the Board, is wholly consistent with the Act, as the Court reinforced, and contains regulatory provisions which:

- Give credit union loan officers the ability, under certain circumstances, to no longer require a personal guarantee;
- Replace explicit loan-to-value limits with the principle of appropriate collateral and eliminating the need for a waiver;
- Lift limits on construction and development loans;
- Exempt credit unions with assets under $250 million and small commercial loan portfolios from certain requirements; and
- Affirm that nonmember loan participations, which are authorized under the Federal Credit Union Act, do not count against the statutory member business lending cap.

Federal Credit Union Ownership of Fixed Assets

In December 2016, the NCUA Board issued a final rule that eliminated the requirement that Federal credit unions have a plan by which they will achieve full occupancy of premises within an explicit timeframe. The final rule allows Federal credit unions to plan for and manage their use of office space and related premises in accordance with their strategic plans and risk-management policies. It also clarified that, "partial occupancy" means occupation of 50 percent of the relevant space.

Expansion of Share Insurance Fund Coverage

With the enactment by Congress of the Credit Union Share Insurance Fund Parity Act in December 2014, the NCUA was expressly authorized to extend Federal share insurance coverage on a pass-through basis to funds held on deposit at federally insured credit unions and maintained by attorneys in trust for their clients, without regard to the membership status of the clients.[4] Many industry advocates, including some EGRPRA commenters, urged the NCUA to consider ways to expand this type of pass-through treatment to other types of escrow and trust accounts maintained by professionals on behalf of their clients. The NCUA Board issued a proposed rule in April 2015, inviting comment on ways in which the principles articulated in the Parity Act might be expanded into other areas and types of account relationships.

Reviewing the numerous comments received in response to this invitation, the agency undertook extensive research and analysis and concluded that some expansion of this concept into other areas was warranted and legally permissible. Accordingly, in December 2015, the NCUA Board unanimously approved the issuance of a final rule in which expanded share insurance coverage on a pass-through basis would be provided for a licensed professional or other fiduciary that holds funds for

[3] A challenge of this rule by the American Bankers Association is currently pending.
[4] See Pub. L. No 113–252 (December 18, 2014).

the benefit of a client or a principal as part of a transaction or business relationship. As noted in the preamble to the final rule, examples of such accounts include, but are not limited to, real estate escrow accounts and prepaid funeral accounts.

Improvements for Small Credit Unions

The credit union system is characterized by a significant number of small credit unions. The NCUA is acutely aware that the compliance burden on these institutions can become overwhelming, leading to significant expense in terms of staff time and money, strain on earnings, and, ultimately, consolidation within the industry as smaller institutions are unable to maintain their separate existence. While this is a difficult, multi-faceted problem, the NCUA is committed to finding creative ways to ease the regulatory burden without sacrificing the goal of safety and soundness throughout the credit union system.

The agency has approached this problem from several different angles. Among the adjustments and improvements implemented in recent years are the following:

- Responding to requests to facilitate access to and use of secondary capital by low-income credit unions (of which a significant percentage are also small), the agency has developed a more flexible policy. Investors can now call for early redemption of portions of secondary capital that low-income credit unions may no longer need. These changes also were designed to provide investors greater clarity and confidence.[5]
- Low-income designated credit unions have expanded powers to serve their members. The process by which credit unions may claim the low-income designation has also been streamlined and improved. Now, following an NCUA examination, credit unions that are eligible for the designation are informed by the NCUA of their eligibility and provided with a straightforward opt-in procedure through which they may claim the low-income designation. During the 6-year period ending December 31, 2016, the number of low-income credit unions increased from 1,110 to 2,491, reflecting an increase of 124 percent over that timeframe. Today more than 40 percent of credit unions have the low-income designation. Together, low-income credit unions had 39.3 million members and more than $409 billion in assets at year-end 2016, compared to 5.8 million members and more than $40 billion in assets at the end of 2010.
- Explicit regulatory relief: Small credit unions have been expressly exempted from the NCUA's risk-based capital requirements and the NCUA's rule pertaining to access to sources of emergency liquidity.
- Expedited exam process: The NCUA has created an expedited exam process for well-managed credit unions with CAMEL ratings of 1, 2, or 3 and assets of up to $50 million. These expedited exams require less time by examiners onsite and focus on issues most likely to pose threats to the smallest credit unions.
- CDFI enhancements: The NCUA signed an agreement in January 2016 with the Department of the Treasury's Community Development Financial Institutions Fund to double the number of credit unions certified as Community Development Financial Institutions within 1 year. The NCUA is leveraging data it routinely collects from credit unions to provide a pre-analysis and to assist in the streamlining of the CDFI application process. In addition, the NCUA recently adopted several technical amendments to its rule governing the Community Development Revolving Loan Fund. The amendments update the rule and make it more succinct, improving its transparency, organization and ease of use by credit unions.[6]

Expanded Powers for Credit Unions

Enhanced powers for regulated institutions, consistent with statutory requirements, can have a significant beneficial effect that is similar in some ways to a reduced compliance burden. The NCUA has taken several recent steps to provide Federal credit unions with broader powers. These enhancements, as discussed below, have positioned credit unions to take better advantage of the activities Congress has authorized to strengthen their balance sheets.

- In January 2014, the NCUA Board amended its rule governing permissible investments to allow Federal credit unions to invest in certain types of safe and legal derivatives for hedging purposes. This authority enables Federal credit

[5] See *https://www.ncua.gov/newsroom/Pages/NW20150406NSPMSecondaryCapital.aspx* for more information about the low-income credit union secondary capital announcement.

[6] Located within the U.S. Department of the Treasury, the Community Development Financial Institutions Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States.

unions to use simple "plain vanilla" derivative investments as a hedge against interest rate risk inherent in their balance sheets.

- In February 2013, the NCUA Board amended its investments rule to add Treasury Inflation Protected Securities to the list of permissible investments for Federal credit unions. These securities provide credit unions with an additional investment portfolio risk-management tool that can be useful in an inflationary economic environment.
- In March 2016, the NCUA Board further amended its investments rule to eliminate language that unduly restricted Federal credit unions from investing in bank notes with maturities in excess of 5 years. With this change, Federal credit unions are now able to invest in such instruments regardless of the original maturity, so long as the remaining maturity at the time of purchase is less than 5 years. This amendment broadens the range of permissible investments and provides greater flexibility to credit unions, consistent with the Federal Credit Union Act.
- In December 2013, the NCUA Board approved a rule change to clarify that Federal credit unions are authorized to create and fund charitable donation accounts—styled as a hybrid charitable and investment vehicle—as an incidental power, subject to certain specified regulatory conditions to ensure safety and soundness.

Consumer Complaint Processing

Responding to comments received by interested parties, the NCUA conducted a thorough review of the way in which it deals with complaints members may have against their credit union. In June 2015, the agency announced a new process, as set out more fully in Letter to Credit Unions 15–CU–04.[7] The new process refers consumer complaints that involve Federal financial consumer protection laws for which the NCUA is the primary regulator to the credit union, which will then have 60 days to resolve the issue with its member before the NCUA's Office of Consumer Financial Protection and Access considers whether to initiate a formal investigation of the matter. Results of the new process have been excellent, with the majority of complaints resolved at the level closest to the consumer and with a minimal NCUA footprint.

Interagency Task Force on Appraisals

12 CFR part 722 of the NCUA's rules and regulations establishes thresholds for certain types of lending and requires that loans above the thresholds must be supported by an appraisal performed by a State-certified or licensed appraiser. The rule is consistent with an essentially uniform rule that was adopted by the banking agencies after the enactment of FIRREA. The rule covers both residential and commercial lending.[8]

In response to comments received through the EGRPRA process, the NCUA joined with the banking agencies to establish an interagency task force to consider whether changes in the appraisal thresholds are warranted. Work by the task force is underway, including the development of a proposal to increase the threshold related to commercial real estate loans from $250,000 to $400,000. Any other recommendations developed by the task force will receive due consideration by the NCUA.

Recommendations in the June 2017 Treasury Study

The June Treasury Department report, written pursuant to Executive Order 13772, seeks to align the regulation of financial institutions to help meet the needs of our economy more efficiently and effectively. It calls for the tailoring of rules to target specific problems areas and recommends greater cooperation among financial regulators. These recommendations combine to form a framework that is consistent with my approach as Acting Chairman and many of the efforts the NCUA Board has been pursuing in the past several months, which are addressed in this testimony.

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[7] Letter to Credit Unions 15–CU–04. *https://www.ncua.gov/Resources/Documents/LCU2015-04.pdf.*

[8] In contrast to the agencies, the NCUA's rule contains no distinction, with respect to the appraisal requirement, between commercial loans for which either sales of real estate parcels or rental income derived from the property is the primary basis for repayment of the loan, and loans for which income generated by the business itself is the primary repayment source. Under 12 CFR part 722, the dollar threshold for either type of commercial loan is $250,000; loans above that amount must be supported by an appraisal performed by a State certified appraiser. By contrast, the banking agencies' rule creates a separate category for the latter type of commercial loan and establishes a threshold of $1 million; loans in this category but below that threshold do not require an appraisal.

Several of the report's specific recommendations could be particularly effective in achieving regulatory reform, depending on how they are implemented. For example, the proposal to allow institutions with at least 10 percent capital to achieve regulatory relief could be important for all types of financial institutions.

The report also recognizes that the interests of consumers and financial inclusion must be integral pillars of regulatory reform. At the same time, the Treasury report reflects the realization that consumer protection rules are among the most burdensome that financial institutions face. In that regard, the report makes a number of recommendations for regulatory relief, including key changes to the Ability to Repay/Qualified Mortgage rule.

Credit union-specific proposals include raising the threshold for stress testing requirements for federally insured credit unions to $50 billion in assets (from assets of $10 billion) and relief in the examination process, two key areas the NCUA has reviewed. The report also supports greater coordination among the NCUA, CFPB, and State regulators to streamline the supervisory process.

Additional NCUA Initiatives

The NCUA Board is actively considering several initiatives to reduce the regulatory burden on credit unions and to update and improve our rules. These are likely to be implemented within the relatively near term.

Possible Temporary Corporate Credit Union Stabilization Fund Proposal for Early Termination

Congress authorized the creation of the Temporary Corporate Credit Union Stabilization Fund in 2009.[9] The availability of this fund allowed the agency to respond to the insolvency and failure of five large corporate credit unions without immediate depletion of the Share Insurance Fund, which protects the deposits and savings of credit union members. This fund also enabled the agency to fund massive liquidation expenses and guarantees on notes sold to investors backed by the distressed assets of the five failed corporate credit unions.

Current projections are that the distressed assets underlying the notes will perform better than initially expected. In addition to improved asset performance, significant recoveries on legal claims have created a surplus that may eventually be returned to insured credit unions. The NCUA is exploring ways to speed up this process, principally by closing the Stabilization Fund and transferring its remaining assets to the Share Insurance Fund more quickly than initially anticipated. Doing so would bolster the equity ratio of the Share Insurance Fund, leading to a potential distribution of funds in excess of the Share Insurance Fund's established equity ratio.

Call Report Enhancements

The NCUA intends to conduct a comprehensive review of the process by which it conducts its offsite monitoring of credit unions, namely through the Form 5300 Call Report and Profile. As the data reflected in these reports affect virtually all of the NCUA's major systems, the agency's exploration of changes in the content of the Call Report and Profile will be on the front end of the NCUA's recently announced Enterprise Solutions Modernization initiative, which will be a multi-year process. Started in the summer of 2016, this effort is comprehensive, ranging from the content of the Call Report and Profile to the systems that collect and use these data such as CU Online and the Automated Integrated Regulatory Examination System or AIRES. Throughout the process, we will seek input from external stakeholders to ensure our overarching goals are met.

The imperative driving this modernization effort is—quite simply—that credit unions, like other depository institutions, are growing larger and more complex every day. At the same time, smaller credit unions face significant competitive challenges. In such an environment, it is incumbent on the NCUA to ensure its reporting and data systems produce the information needed to properly monitor and supervise risk at federally insured credit unions while leveraging the latest technology to ease the burden of examinations and reporting on supervised institutions.

For these reasons, three of the other FFIEC agencies—the FDIC, OCC, and Federal Reserve—are currently reviewing their Call Report forms with an eye to reducing reporting burden.

The NCUA's goals in reviewing its data collection are:

- Enhancing the value of data collected in pre-exam planning and offsite monitoring;

[9] Pub. L. No. 111–22 (May 20, 2009), § 204(f).

- Improving the experience of users;
- Protecting the security of the data collected; and
- Minimizing the reporting burden for credit unions.

The NCUA will review all aspects of its data collection for federally insured credit unions. This review will go beyond reviewing the content of the Call Report and Profile to look at the systems credit unions use to submit data to the NCUA—namely CU Online. The agency has already conducted a broad canvassing of internal and external stakeholders to obtain their feedback on potential improvements to the Call Report and Profile. We have engaged stakeholders through a variety of methods, including a request for information published in the Federal Register with a 60-day comment period.[10] The comment period was intended to provide all interested parties an opportunity to provide input very early in the process. We also developed a structured focus group process to aid in assessing ideas (to complement internal and State regulatory agency input), and we have created data collection systems that can be used to activate the focus group.

Supplemental Capital

The NCUA plans to explore ways to permit credit unions that do not have a low-income designation to issue subordinated debt instruments to investors that would count as capital against the credit union's risk-based net worth requirements. At present, only credit unions having a low-income designation are allowed to issue secondary capital instruments that count against their mandatory leverage ratios. For credit unions that do not have the low-income designation, only retained earnings may be used to meet the leverage requirements of the Federal Credit Union Act.[11] Consistent with its regulatory review objectives, the NCUA issued an advance notice of proposed rulemaking regarding certain constraints that, if applied to subordinated debt instruments issued by credit unions, would enable institutions to count those instruments as capital for purposes of the risk-based capital rule.

Risk-Based Capital

I intend to revisit the NCUA's recently finalized risk-based capital rule in its entirety and to consider whether significant revision or repeal of the rule is warranted.[12]

Examination Flexibility

In response to the financial crisis and the Great Recession that ensued, the NCUA determined in 2009 to shorten its examination cycle to 12 months.[13] The agency also hired dozens of new examiners at that time. Since then, the agency policy has been that every Federal credit union, and every federally insured, State-chartered credit union with assets over $250 million, should undergo an examination at least once per calendar year.

In an effort to implement regulatory relief and to address some inefficiencies associated with the current program, the agency has undertaken a comprehensive review of all issues associated with examiner time spent onsite at credit unions, including both frequency and duration of examinations. The relatively strong health of the credit union industry at present supports addressing exam efficiencies. A working group within the agency was established, and it solicited input from the various stakeholders, including from within the agency, State regulatory authorities, and credit union representatives. The working group issued recommendations, which the Board incorporated into the agency's 2017–18 budget. These included the recommendation that the agency provide greater flexibility in scheduling exams of well-managed and well-capitalized credit unions, consistent with the practices of other Federal financial regulators and the agency's responsibility to protect the safety and soundness of the Share Insurance Fund.

Other objectives for consideration include evaluating the feasibility of incorporating a virtual examination approach, as well as improvements to examiner training and a movement away from undue reliance on "best practices" that are unsupported by statute or regulation. In addition, the agency intends to revisit its recently enacted rule on stress testing for the largest credit unions to consider whether it is properly calibrated, and also to explore whether to move this important function in-house and out of the realm of expensive third-party contractors. The

[10] 81 Fed. Reg. 36,600 (June 7, 2016).

[11] 12 USC 1790d(o)(2); see Legislative Recommendations, *infra,* for additional discussion about this requirement and the NCUA's support for amending this provision.

[12] 12 CFR part 702, subpart A; see 80 Fed. Reg. 66,706 (October 29, 2015).

[13] Although the exam cycle immediately prior to 2009 had been in the 18-month range, for most of its history the NCUA has followed an exam cycle of approximately 1 year.

ultimate goal of the NCUA's examination review and other initiatives has been and remains that safety and soundness will be assured with minimal disruptive impact on the well-managed credit unions subject to examination.

Enterprise Solutions Modernization

The NCUA's Enterprise Solutions Modernization program is a multi-year effort to introduce emerging and secure technology that supports the agency's examination, data collection and reporting efforts in a cost effective and efficient way. The changes in our technology and other systems will improve the efficiency of the examination process and lessen, where possible, examination burdens on credit unions, including cost and other concerns identified during our EGRPRA review.

Over the course of the next few years, the program will deploy new systems and technology in the following areas:

- ***Examination and Supervision***—Replace the existing legacy examination system and related supporting systems, like the Automated Integrated Regulatory Examination System or AIRES, with modernized tools allowing examiners and supervisors to be more efficient, consistent, and effective.
- ***Data Collection and Sharing***—Define requirements for a common platform to securely collect and share financial and nonfinancial data, including the Call Report, Credit Union Profile data, field of membership, charter, diversity and inclusion levels, loan and share data, and secure file transfer portal.
- ***Enterprise Data Reporting***—Implement business intelligence tools and establish a data warehouse to enhance our analytics and provide more robust data reporting.

Additionally, the NCUA envisions introducing new processes and technology to improve its workflow management, resource and time management, data integration and analytics, document management, and customer relationship management. Consistent with this vision, the NCUA intends to consider ways to more transparently streamline its budget and align its priorities with its budget expenditures.

Additional Areas of Focus

Several other areas present opportunities for the NCUA to focus on improving and enhancing its body of regulations and its oversight of the credit union industry. These include:

- ***Appeals Procedures.*** At present, the procedures by which a credit union or other entity aggrieved by an agency determination may seek redress at the level of the NCUA Board are inconsistent and poorly understood. As a result, the NCUA has developed proposed uniform rules to govern this area, both with respect to material supervisory determinations and other significant issues warranting review by the Board.
- ***Corporate Rule (Part 704).*** Reform and stringent controls over the corporate credit union sector was necessary during the financial crisis that began in 2008. Nine years later, a reconsideration of the corporate rule and an evaluation of whether restrictions therein may be loosened is appropriate. The NCUA will consider a proposed rule at the Board's monthly meeting this Friday.
- ***Credit Union Advisory Council.*** Development of such a council would enable the agency to listen to and learn from industry representatives more directly, enhancing our efforts to identify and eliminate unnecessarily burdensome, expensive, or outdated regulations.

Legislative Recommendations

The Committee asked the NCUA to identify ways to ease credit union regulatory burdens through legislation.

Looking ahead, the NCUA has several proposals to share with the Committee related to regulatory flexibility, field of membership requirements, member business lending, and supplemental capital.

Regulatory Flexibility

Today, there is considerable diversity in scale and business models among financial institutions. As noted earlier, many credit unions are very small and operate on extremely thin margins. They are challenged by unregulated or less-regulated competitors, as well as limited economies of scale. They often provide services to their members out of a commitment to offer a specific product or service, rather than a focus on any incremental financial gain.

The Federal Credit Union Act contains a number of provisions that limit the NCUA's ability to revise regulations and provide relief to such credit unions.

Examples include limitations on the eligibility for credit unions to obtain supplemental capital, field-of-membership restrictions, investment limits, and the general 15-year loan maturity limit, among others.[14]

To that end, the NCUA encourages Congress to consider providing regulators with enhanced flexibility to write rules to address such situations, rather than imposing rigid requirements. Such flexibility would allow the agency to effectively limit additional regulatory burdens, consistent with safety and soundness considerations.

As previously noted, the NCUA continues to modernize existing regulations with an eye toward balancing requirements appropriately with the relatively lower levels of risk smaller credit unions pose to the credit union system. Permitting the NCUA greater discretion with respect to scale and timing when implementing statutory language would help mitigate the costs and administrative burdens imposed on smaller institutions, consistent with congressional intent and prudential supervision.

The NCUA would like to work with Congress so that future rules can be tailored to fit the risk presented and even the largest credit unions can realize regulatory relief if their operations are well managed, consistent with applicable legal requirements.

Field-of-Membership Requirements

The Federal Credit Union Act currently permits only Federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership. We recommend Congress modify the Federal Credit Union Act to give the NCUA the authority to streamline field of membership changes and permit all Federal credit unions to grow their membership by adding underserved areas. The language of H.R. 5541, the Financial Services for the Underserved Act, introduced in the House during the 114th Congress by Congressman Ryan of Ohio, would accomplish this objective.

Allowing Federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could enable more credit unions to participate in programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of affordable financial services in distressed areas.

Congress may wish to consider other field of membership statutory reforms, as well. For example, Congress could allow Federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, Congress could simplify the "facilities" test for determining if an area is underserved.[15]

Other possible legislative enhancements could include elimination of the provision presently contained in the Federal Credit Union Act that requires a multiple common-bond credit union to be within "reasonable proximity" to the location of a group in order to provide services to members of that group.[16] Another legislative enhancement that recognizes the way in which people share common bonds today, would be to provide for explicit authority for web-based communities as a basis for a credit union charter.

The NCUA stands ready to work with Congress on these proposals, as well as other options to provide consumers more access to affordable financial services through credit unions.

Member Business Lending

The NCUA reiterates the agency's long standing support for legislation to adjust the member business lending cap, such as S. 836, the Credit Union Residential Loan Parity Act, which Senators Wyden and Murkowski have introduced. This bipartisan legislation addresses a statutory disparity in the treatment of certain residential loans made by credit unions and banks.

When a bank makes a loan to purchase a one- to four-unit, non-owner-occupied residential dwelling, the loan is classified as a residential real estate loan. If a credit union were to make the same loan, it is classified as a member business loan and

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[14] 12 U.S.C. 1751 *et. seq.*

[15] The Federal Credit Union Act presently requires an area to be underserved by other depository institutions, based on data collected by the NCUA or Federal banking agencies. 12 U.S.C. 1759 (c)(2)(A)(ii). The NCUA has implemented this provision by requiring a facilities test to determine the relative availability of insured depository institutions within a certain area. Congress could instead allow the NCUA to use alternative methods to evaluate whether an area is underserved to show that although a financial institution may have a presence in a community, it is not qualitatively meeting the needs of an economically distressed population.

[16] See 12 U.S.C. 1759(f)(1).

is, therefore, subject to the member business lending cap. To provide regulatory parity between credit unions and banks for this product, S. 836 would exclude such loans from the statutory limit. The legislation also contains appropriate safeguards to ensure strict underwriting and servicing standards are applied.

Supplemental Capital

The NCUA supports legislation to allow more credit unions to access supplemental capital, such as H.R. 1244, the Capital Access for Small Businesses and Jobs Act. Introduced by Congressmen King and Sherman, this bill would allow healthy and well-managed credit unions to issue supplemental capital that would count as net worth. This bipartisan legislation would result in a new layer of capital, in addition to retained earnings, to absorb losses at credit unions.

The high-quality capital that underpins the credit union system was a bulwark during the financial crisis and is key to its future strength. However, most Federal credit unions only have one way to raise capital—through retained earnings. Thus, fast-growing, financially strong, well-capitalized credit unions may be discouraged from allowing healthy growth out of concern it will dilute their net worth ratios and trigger mandatory prompt corrective action-related supervisory actions.

A credit union's inability to raise capital outside of retained earnings limits its ability to expand its field of membership and to offer more products and services to its membership and eligible consumers. Consequently, the NCUA has previously encouraged Congress to authorize healthy and well-managed credit unions to issue supplemental capital that will count as net worth under conditions determined by the NCUA Board. Enactment of H.R. 1244 would lead to a stronger capital base for credit unions and greater protection for taxpayers.

Conclusion

In conclusion, we must slow, if not stop, the machine that grinds out a relentless flow of new regulatory burdens. We must also do much more to improve how we regulate and to consider the costs, as well as the benefits, of each new regulation. Credit unions cannot afford to let time slip through their fingers because they are too busy complying with unnecessary and burdensome regulations. Instead, they must focus on today's challenges and risks while thoughtfully preparing for the future. Absent safety and soundness concerns, the NCUA must not stand in the way of credit unions' efforts to develop and execute their business plans, meet the expectations of their members, and build a robust and dynamic credit union community for the future.

Thank you again for the invitation to testify. I am happy to answer your questions.

PREPARED STATEMENT OF KEITH A. NOREIKA

ACTING COMPTROLLER OF THE CURRENCY, COMPTROLLER OF THE CURRENCY*

JUNE 22, 2017

I. Introduction

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify today about fostering economic growth by strengthening our Nation's financial institutions. I am grateful for the courtesy you have shown me since I became the Acting Comptroller of the Currency on May 6, and I appreciate your ongoing interest in the Office of the Comptroller of the Currency (OCC) and its role in the effective administration of the Federal banking system.

I am honored to serve in this important position and to support the statutory mission of the OCC: to ensure that national banks and Federal savings associations (banks) operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. The agency is comprised of extraordinary professionals who share a deep commitment to this mission, and I am proud to serve alongside them until the Senate confirms the 31st Comptroller of the Currency.

During my service, I look forward to engaging with my colleagues, stakeholders, and Congress to initiate a robust dialogue and explore opportunities to foster economic growth. For our part, we at the OCC will move ahead to do what we can within our current authorities to foster economic growth and opportunity. Our efforts will be informed by the financial regulatory policy of this Administration, as

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*Statement Required by 12 U.S.C. § 250: The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

articulated in the President's Executive Order entitled "Core Principles for Regulating the United States Financial System"[1] and developed more fully in the recent report prepared by the Department of the Treasury (Treasury Report).[2]

The banks that the OCC supervises should be—as they are today—engines of economic growth for the Nation. When the Federal banking system is running well, it can power growth and prosperity for consumers, businesses, and communities across the country. Our job as bank supervisors is to strike the right balance between supervision that effectively ensures safety, soundness, and compliance, while—at the same time—enabling economic growth. To achieve that balance, we need to avoid imposing unnecessary burden and creating an environment so adverse to risk that banks are inhibited from lending and investing in the businesses and communities they serve. Regulation does not work when it impedes progress, and banks cannot fulfill their public purpose if they cannot support and invest in their customers and communities.

In the less than 2 months that I have served as Acting Comptroller, I have already taken several important steps to promote a regulatory environment that is balanced and that provides the certainty needed to encourage investment. In particular, I have met with various trade groups, scholars, community groups, and my colleagues at the Federal and State levels to begin a constructive, bipartisan dialogue on how our regulatory system might be recalibrated to foster economic growth.

For example, I have sought the views of my colleagues at the other Federal banking agencies about simplifying the regulatory framework implementing the Volcker Rule. In recent years, many of the Nation's financial institutions have struggled to understand and comply with these regulations, devoting significant resources that could have been put to more productive uses. There is near unanimous agreement that this framework needs to be simplified and clarified. I have recommended that we invite stakeholders to share their thoughts and ideas at an early stage to help inform how the agencies should proceed. Our conversation on this issue is ongoing, and it is my hope that the effort we undertake will lead to solutions that the agencies can implement and that also will inform Congress's consideration of legislation in this area.

The Volcker Rule provides a practical example of how conflicting messages and inconsistent interpretation can exacerbate regulatory burden by making industry compliance harder and more resource intensive than necessary. Under my leadership, the OCC is undertaking improvements in our internal operations to attack that problem in ways that are within our control. For example, I have emphasized the importance of the OCC speaking with one voice. The banks that we supervise must hear a clear and consistent message, regardless of whether it comes from Washington, DC, or our field offices. A single voice provides certainty, without which businesses and consumers are reluctant to invest in the future, and it instills in the American people confidence in our Government.

I also have made a point of seeking the views of our agency's "boots on the ground" for ideas to reduce unnecessary regulatory burden and improve efficiency in our supervision and regulation of the Federal banking system in order to promote economic growth. The response has been overwhelming. To date, we have over 400 suggestions. OCC employees are excited to operationalize our collective experience and to contribute to efficient and effective regulation of the Federal banking system. In this way, the OCC will play our part to help to minimize the burden associated with regulation and maximize regulatory certainty that will promote healthy lending by banks. The investments by the banking sector in customers, local communities, and businesses will, in turn, drive economic growth. The next section of my testimony discusses the opportunities that I see to maximize regulatory efficiency and promote the availability of credit to fund the needs of consumers and businesses. The third section summarizes the results of the recently completed Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) regulation review. As noted below, I also include an appendix containing a number of legislative ideas and recommendations for the Committee's consideration.

II. Opportunities to Foster Economic Growth

Overview

The United States has the strongest financial system in the world, and one that others want to emulate, in part because it has proven to be dynamic, resilient, and adaptable to changing conditions. Most would agree that whatever improvements we

[1] Executive Order 13772 (February 3, 2017).

[2] U.S. Department of the Treasury, *"A Financial System That Creates Economic Opportunities;* Banks and Credit Unions" (June 2017).

seek to make to that system and the way it is regulated ought to reinforce those qualities, not undermine them. I also believe that now—nearly 10 years after the events that sparked the Great Recession and 7 years after the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)—is a good time to take stock of how well our financial system is working and to strive for balance and improvements in the system and in how we regulate it.

This sort of reevaluation has occurred, typically on a bipartisan basis, at intervals throughout our history. The alphabet soup of financial legislation enacted in modern memory—CEBA, FIRREA, FDICIA, GLBA, and, earlier, the Banking Act of 1933 and the laws creating Federal deposit insurance and bank holding companies (BHC)—were responses to then-current events that compelled a shift in the scope or tenor of the Government's oversight of the financial system. So it is not unusual—in fact, it has been our national practice—to revisit financial regulation from time to time and to make the adjustments that can attract a consensus for reform.

In that same spirit, today I offer recommendations for improvements that would promote the dynamism and resiliency of the Federal banking system while addressing areas that I believe unnecessarily encumber economic growth. In my view, bringing balance to financial regulation in a way that encourages economic investment and expansion involves eliminating unnecessary or duplicative regulatory activities, streamlining and updating regulatory processes to enhance effectiveness and efficiency, and providing regulatory clarity to promote confidence and certainty for market participants. The appendix to this testimony describes each of the OCC's recommendations, and I will highlight a few of them here. In most cases, there are a number of approaches that could achieve the objectives of promoting economic growth and trimming burden. I would like to start a dialogue about which ones are best.

Our recommendations are informed by two straightforward ideas. First, while the content of some regulations can rightly be described as burdensome because, for example, the regulation is needlessly prescriptive or complex, it also is the case that a multiplicity of regulators performing overlapping functions can contribute substantially to regulatory burden and hinder economic growth. Our system sometimes deploys multiple regulators to solve the same problem. That is an approach that can lead to waste, redundancy, and duplication of resources both in the regulatory agencies and for the institutions we supervise. I have suggestions for where we might streamline supervision to reduce regulatory redundancy.

Second, our system sometimes covers more institutions or broader categories of activity than it needs to in order to contain or mitigate the risks it seeks to address. This has often been referred to as a lack of appropriate "tailoring" or, conversely, as a "trickling-down" to lower-risk institutions or activities of regulatory standards or approaches that really are only appropriate for high-risk institutions or activities. I have suggestions to offer in this category as well.[3]

The OCC's recommendations are consistent with the Treasury Report, which is guided by free-market principles and aimed at maximizing sustainable, economic growth. The Treasury Report includes proposals to break the cycle of sluggish growth, improve access to credit, maintain liquid markets, and engage in a holistic analysis of the cumulative impact of the regulatory environment. The Treasury Report is a thoughtful addition to the ongoing discussion of how to promote economic growth, and I appreciate Treasury's consultation with the OCC in developing it.

Maximizing Economic Growth by Minimizing Regulatory Inefficiency

Our organically developed, uniquely American system of independent banking regulators risks, at times, unnecessary regulatory burden and overlap. Accordingly, we need to be mindful to calibrate regulatory jurisdiction to maximize regulatory efficiency by minimizing unnecessary regulatory duplication.

As the Treasury Report notes, many of the changes that would streamline regulation and free up resources that could fuel economic growth are not possible under the current statutory framework. In some instances, Federal banking law allocates jurisdiction to regulators in a way that actually promotes duplication and redundancy. Congress could foster economic growth by reducing regulatory overlap and increasing coordination within the Federal financial regulatory framework.

For example, under current law (subject to certain exemptions, like the one for banks that conduct only fiduciary activities) companies that own banks are regulated as BHCs by the Board of Governors of the Federal Reserve System (Federal Reserve Board) under the Bank Holding Company Act. Their depository institution subsidiaries, however, are often regulated at the Federal level by a different

[3] The OCC's proposals also contain suggestions for updating laws that may impede economic growth because they no longer reflect modern business practice.

regulator.[4] This means that most companies that own banks have at least two regulators, even if they are small and even when the depository institution subsidiary comprises the vast majority of the company's assets so that there is no meaningful distinction between the business of the company and the business of its bank subsidiary. Congress could reduce regulatory redundancy in this situation by amending the Bank Holding Company Act to provide that when a depository institution constitutes a substantial portion of its holding company's assets (*e.g.,* 90 percent), the regulator of the depository institution would have sole examination and enforcement authority for both the holding company and the depository institution. This change would eliminate supervisory duplication and its inherent inefficiencies, freeing resources to meet the needs of banks' customers and communities. It could be limited to BHCs of a certain asset size. At the same time, banking law would continue to recognize that it is appropriate to have a separate regulator for large companies that conduct complex activities, including securities and derivatives businesses, as well as consumer and commercial banking. The proposed change simply would extend to smaller banking organizations the benefits of having a single Federal regulator at both the bank and holding company levels that State banks that are members of the FRS and their holding companies already enjoy today.

Another approach to the problem of multiple regulators would be to eliminate statutory impediments for firms that want the choice to operate without a holding company. Congress could modernize the corporate governance requirements for national banks by allowing them to adopt fully the governance procedures of, for example, the State in which their main office is located, the Delaware General Corporation Law, or the Model Business Corporation Act. This change would put these banks on the same footing as BHCs and benefit banks that wish to operate and access the capital markets without a holding company.

A second example of regulatory duplication in banking law is the allocation of authority to the Consumer Financial Protection Bureau (CFPB) to examine and supervise the activities of IDIs over $10 billion in asset size with respect to compliance with the laws designated as Federal consumer financial laws. This division of authority means that two separate regulators—the CFPB and the prudential regulator—conduct examination and supervision activities with respect to the same institutions.

There are many options Congress could consider to address this overlap. For example, Congress could return examination and supervision authority with respect to Federal consumer financial laws to the Federal banking agencies for the institutions that they otherwise have jurisdiction to supervise, without regard to an institution's asset size. Under this approach, the CFPB would continue to set the standards with respect to the Federal consumer financial laws, supervise nondepository institutions, and take enforcement action. Depository institutions would have a single supervisor overseeing compliance with Federal consumer financial and other laws, as well as their safety and soundness, reinforcing the interdependency between sound banking practices and fair treatment of a bank's customers. As is the case today, the primary prudential regulator would retain enforcement authority with respect to institutions at or under $10 billion in asset size. The primary regulator also would retain the current "back-up" enforcement authority with respect to institutions over $10 billion in asset size, which enables it to bring an enforcement action when warranted if the CFPB declines to do so.

This approach would reduce regulatory burden and provide regulatory certainty by eliminating the need for an institution to prepare for multiple, potentially overlapping examinations and to meet the differing expectations of multiple regulators. This approach also could result in a more effective deployment of limited regulatory resources and thus facilitate more effective and efficient supervision with existing resources. In this regard, it may be useful—either as the predicate for or an alternative to this revision to current law—for Congress to require a study of how the CFPB's authorities are currently used. It has been the OCC's experience that the CFPB has focused its examination and supervisory resources primarily on the largest banks that serve the greatest number of consumers. If that observation is accurate, then returning supervisory responsibility to the primary regulator should result in a more appropriate level of oversight for midsize institutions.

As the Treasury Report describes, the formation of new financial institutions is crucial to maintain a vibrant and growing economy. Federal law currently requires

[4] The regulator of the insured depository institution (IDI) subsidiary of the BHC will be the OCC in the case of national banks and Federal savings associations, the Federal Deposit Insurance Corporation (FDIC) in the case of State-chartered banks that are not members of the Federal Reserve System (FRS), and the Federal Reserve Board itself in the case of State-chartered banks that are FRS members.

the approval of two regulators to form an IDI—the chartering authority (*i.e.,* the OCC for national banks and Federal savings associations) and the FDIC. This requirement for dual approval has slowed the formation of *de novo* institutions in recent years. To facilitate new entrants into the market, Congress could streamline the process of forming *de novo* banks by allowing banks that receive deposits (other than trust funds) to obtain FDIC deposit insurance upon certification of the OCC when the OCC charters and authorizes new banks to commence business. This was the state of the law prior to 1991, and I believe it is preferable to the current process which requires applicants for a bank charter to submit two applications covering the same proposal to two different Federal agencies, each of which reviews the proposal for essentially the same issues.

The current process wastes resources, results in unnecessary delays, and represents a significant barrier to entry into the banking business. Instead, we should ensure that our processes tilt in favor of chartering and insuring entities that can qualify under the statutory standards. Congress also could explore providing the FDIC with a specified time period—such as 30 days—within which to object to the grant of deposit insurance to a particular new bank and provide written reasons for its objection. Statutory consequences would attach to the FDIC's action. The FDIC's failure to object would result in the grant of insurance; the FDIC's objection, together with its rationale, would be reviewable in court as final agency action.

The options above—the allocation of supervisory authority over consumer compliance matters and the role of the primary regulator in the decision to grant deposit insurance—suggest an approach that might be used more generally to address situations where there has been an unnecessary overlap of regulators. The approach is akin to a system of traffic lights. One regulator has the lead responsibility or primary authority: it has a "green light" to act. Other regulators that have concurrent or back-up authority have a "red light." They wait to act until a contingency provided in the law has occurred.

There are a number of places where the banking laws use this approach today. The backup authority that primary regulators have to the CFPB with respect to the enforcement of consumer laws in the case of institutions over $10 billion in asset size, discussed above, is one example.[5] The primary regulators' back-up examination authority with respect to the conduct of bank-permissible activities by nondepository institution subsidiaries of a BHC is another.[6] In my view, the primary Federal prudential regulator ordinarily should have the lead responsibility for matters pertaining to an entity supervised by that regulator. But providing for the exercise of back-up, secondary, or contingent authority in well-defined circumstances by another Federal regulator with a statutory interest in the conduct of activities of the supervised entity can provide an orderly mechanism for accomplishing the objectives of multiple statutes that apply to the entity.

Right-Sizing Regulation

The statutes do not always provide the Federal banking agencies with sufficient flexibility to tailor their regulations to the risk profiles of different institutions. This is true despite the fact that the risks inherent in large, complex institutions are markedly different in type and scope from those of smaller institutions. As a result, statutes that were intended to address the systemic risks typically associated with larger institutions often must be applied to smaller ones that do not pose such broad, systemic risks. This portion of my testimony provides a few examples of unintended consequences that could be reversed if specific statutes were amended to eliminate the most onerous consequences for smaller banks.

For purposes of this discussion, "right-sizing" certainly means tailoring rules to fit the community bank business model. In some cases, such as the Volcker Rule, that may mean exempting community banks altogether from the obligation to comply with a rule because they simply do not engage in the type of activity or present the levels of risk that the rule was designed to address.

In my view, right-sizing also means tailoring rules to the business models of midsize, or regional, banks. For midsize institutions, the threshold approach taken in a number of provisions in the law—$50 billion commonly defines the line between midsize and large institutions—represents a barrier to growth because, above that line, compliance costs rise so dramatically. The effect is to discourage competition with the largest institutions. For that reason, while asset size can appropriately be used as one measure of when and how to tailor regulations, in many cases, it should be supplemented by measures that better capture the level of risk an institution presents. The nature and scope of the institution's activities are one such measure.

[5] 12 U.S.C. 5515(c)(3).
[6] 12 U.S.C. 1831c(d)(2).

So is a prudential regulator's judgment—based on the qualitative and quantitative results of the regulator's examinations—about the institution's effectiveness in managing the risk that it does take on.

Application of the Volcker Rule again illustrates the point. In reforming the Volcker Rule, it is preferable to create an "off-ramp"—a clear path to exit for those institutions that do not present the risks that the Volcker Rule was designed to address. In my view, while size could be a factor in constructing the off-ramp, it is equally important to identify the nature and level of the activities that would bar an institution from the use of an off-ramp. In some cases, such as with community banks, an organization's size generally reflects its traditional, noncomplex activities. Because the activities of an organization will change over time as banks enter new business lines, perhaps in new ways, I favor using notice-and-comment rulemaking, undertaken by the Federal banking agencies, as the best way to decide how to define them.

Similarly, section 165 of the Dodd-Frank Act requires an annual stress test for all banks with assets of more than $10 billion, limiting regulators' flexibility to determine when and within what parameters a stress test should be conducted. In certain circumstances, the burden of annual stress testing, particularly in accordance with prescriptive statutory requirements, is not commensurate with the systemic risks presented by an institution.

The Treasury Report recommends raising the threshold for these stress tests from $10 billion to $50 billion, recognizing that institutions in this size range, as a practical matter, generally do not present the risks that require annual stress testing. In addition, the Treasury Report would grant the banking regulators authority to further calibrate the threshold for banks above the $50 billion threshold to account for risk and complexity. Another option to address this issue would be for Congress to give the Federal banking agencies broad authority to tailor by rule the statutory stress testing requirement, without regard to an asset threshold. This approach is consistent with the principle of bringing balance to financial regulation I discussed earlier in my testimony. It would avoid the potential for over and under inclusiveness associated with fixed-asset thresholds. It also provides regulators flexibility to calibrate rules and requirements to be commensurate with the systemic risks presented by individual or groups of institutions.

Congress also could simplify the capital requirements currently applicable to community banks by exempting banks that do not use models-based capital requirements from section 171 of the Dodd-Frank Act (the "Collins Amendment"). This provision was adopted to prevent banks using models-based capital requirements from holding less than the generally applicable amount of capital. But smaller banks do not use models-based capital requirements, so the Collins Amendment may limit bank regulators from tailoring capital requirements to these smaller institutions even when the original purpose of the Collins Amendment is not present. Adopting this change would allow the Federal banking agencies to tailor the capital rules to match the size and complexity of the institutions to which this provision applies, consistent with the recommendations of the Treasury Report. One such approach that the agencies could pursue with this legislative change is the idea to exempt community banks from the Basel-based capital standards that currently apply, provided they comply with a robust leverage ratio requirement—10 percent, for example—and also do not engage in a set of risky activities that the regulators should define through notice-and-comment rulemaking.

Congress also could streamline the reporting requirements to which community banks are subject, freeing the banks' employees to return to the business of banking. For example, Congress could repeal section 122 of the Federal Deposit Insurance Corporation Improvement Act, which requires the Federal banking agencies to collect unneeded information on small business lending.[7] Congress could repeal other unnecessary information collection provisions, such as the requirement stemming from section 1071 of the Dodd-Frank Act that banks gather extensive information on business loans, the benefits of which are unclear.

The potential legislative changes I have discussed seek to strike the right balance between maintaining the strength of the Federal banking system through appropriate oversight of the Nation's banks, while simultaneously enabling economic opportunity and encouraging economic growth. The balance can be achieved by eliminating duplication and redundancy and providing appropriate flexibility and discretion to promulgate rules that are effective and appropriately tailored. Balanced and coherent regulation, in turn, results in minimizing the cost of effective supervision

[7] The Treasury Report also recommended that the OCC, FDIC, and Federal Reserve Board continue their ongoing work to simplify the Call Report. I fully support this work and have encouraged these efforts at the OCC.

and regulation and maximizing regulatory certainty and efficient compliance in order to promote growth and lending by banks that drives economic growth.

III. EGRPRA

The agency already has streamlined and reduced duplication and redundancy in several of its regulations following the recently completed EGRPRA process. EGRPRA requires the OCC, FDIC, and Federal Reserve Board, along with the Federal Financial Institutions Examination Council (FFIEC), to conduct a review of their regulations at least once every 10 years to identify outdated or otherwise unnecessary regulatory requirements imposed on IDIs.

The agencies completed the first decennial EGRPRA review in 2007, and in June 2014, they began the second EGRPRA review. Over an 18-month period, the agencies jointly published four Federal Register notices, inviting the public to consider every rule applicable to the institutions they supervise, including the then-recently finalized capital rules and rules issued pursuant to the Dodd-Frank Act, and to identify outdated, unnecessary, or unduly burdensome regulations.

In each notice, the agencies identified specific issues for the public to consider, such as whether a rule or underlying statute imposed unnecessary requirements, created competitive disadvantages, or failed to account for the unique characteristics of a particular type of financial institution. The agencies also asked specific questions about how the regulations or underlying statutes affected community banks and other small IDIs. These questions reflected the agencies' particular concern about the effect of regulatory burden on smaller institutions and their understanding that smaller institutions do not have the resources that larger institutions can bring to bear on regulatory compliance.

To broaden public participation in the EGRPRA review, the agencies hosted six public outreach sessions in geographically diverse areas across the country, including a session focused on rural banks in Kansas City, Missouri. These outreach sessions provided the public with an opportunity to present their views directly to the agencies. Agency principals and staff participated in each session, as did representatives from banks, community and consumer groups, and other interested parties. Live and recorded audio and video broadcasts of each session were accessible on the agencies' joint EGRPRA website to extend the reach of the EGRPRA review.

From the beginning and throughout the review, the agencies received a steady stream of public feedback with ideas about how to reduce regulatory burden. Although the commenters identified a wide range of issues, they singled out certain areas where agency or legislative action could lead to meaningful burden reduction, including regulatory reporting, exam frequency, real estate appraisals, and the capital rules.[8]

The agencies took important steps to address issues raised by commenters while the review was still in process. As noted in the Treasury Report, they finalized Call Report revisions, including a streamlined Call Report for institutions having only domestic offices and less than $1 billion in total assets. This new Call Report reduced the number of data items required by approximately 40 percent and can be used by approximately 90 percent of all institutions required to file Call Reports.

The agencies also finalized rules to raise the asset threshold for well capitalized and well managed institutions to qualify for an 18-month (rather than a 12-month) safety and soundness examination cycle. An additional 600 institutions now can qualify for this extended examination cycle. Institutions that qualify for the 18-month examination cycle also should be subject to less frequent Bank Secrecy Act (BSA) exams because an institution's BSA compliance program is typically reviewed during its safety and soundness examination. In response to commenters' concerns, the agencies also clarified when less burdensome evaluations can be performed in place of appraisals on real estate loans and issued guidance advising institutions of measures to address the shortage of State certified and licensed appraisers, particularly in rural areas.

In addition to these interagency projects, the OCC independently took steps prior to the completion of the EGRPRA review to address comments received during the EGRPRA process, as well as to make other burden-reducing changes identified by OCC staff. For example, the OCC revised its licensing rules to provide expedited and simplified procedures for certain transactions and simplified requirements applicable to Federal savings associations. As always, the agency's actions were framed by its statutory authority and calibrated to preserve the right balance where prudent oversight provides ample room for economic growth and investment. Upon

[8] A discussion of the significant issues raised in the EGRPRA review and the agencies' responses are included in the *Joint Report to Congress,* Economic Growth and Regulatory Paperwork Reduction Act (March 2017) (EGRPRA Report), at 22–78.

completion of the EGRPRA review, in March 2017, the agencies published the EGRPRA Report. This report summarizes the significant issues raised by the more than 230 written comments received in response to the Federal Register notices and the many comments from the panelists and attendees at the outreach sessions, each of which was carefully reviewed and considered. The EGRPRA Report highlights ongoing work, as well as steps the agencies plan to pursue jointly, in response to issues raised by commenters, including:

- Replacing the complex treatment of high-volatility commercial real estate exposures in the current, capital framework with a more straightforward treatment for most acquisition, development, or construction loans;
- Simplifying the regulatory capital treatment for mortgage servicing assets, certain deferred tax assets, and holdings of regulatory capital instruments issued by financial institutions;
- Simplifying the limitations on minority interests in the current regulatory capital framework;
- Increasing from $250,000 to $400,000 the threshold for when an appraisal is required for commercial real estate loans;
- Adjusting certain asset-size thresholds that trigger the prohibition on a management official of one depository organization serving as a management official of an unaffiliated depository organization; and
- Clarifying our flood insurance guidance on the escrow of flood insurance premiums, force-placed insurance, and detached structures.

The EGRPRA Report also details individual agency efforts to address comments received during the EGRPRA process, including OCC projects to:

- Continue to integrate national bank and Federal savings association rules to promote economic growth by reducing regulatory burden, ensuring fairness in supervision, and creating efficiencies;
- Remove redundant and unnecessary supervisory information requests;
- Improve the planning of onsite and offsite examinations; and
- Make the examination process more efficient and less burdensome by leveraging technology.

The agencies are aware that regulatory burden does not emanate only from statutes and regulations, but also from the processes and procedures related to examinations and supervisory oversight. In this regard, through the FFIEC, the agencies are jointly reviewing the examination process, examination report format, and examination report preparation process to identify further opportunities to minimize burden, principally by rethinking traditional processes and the use of technology. This effort is consistent with the Treasury Report's recommendation that the regulators expand on current efforts to coordinate and rationalize examination procedures to promote accountability and clarity.

The OCC also is continuing its work to enhance supervision with respect to consumer protection and compliance; to address our Community Reinvestment Act performance evaluation backlog; and to provide guidance on compliance with respect to the BSA and consumer protection matters. At the same time, the OCC continues its ongoing practice of reviewing and updating its supervisory and examiner guidance to align it with current practices and risks and to eliminate unnecessary or outdated guidance.

The EGRPRA review and the resulting EGRPRA Report represent a significant effort on the part of the agencies and provided us and the public with an opportunity to take stock of how our regulations affect the institutions to which they apply and the improvements that we can make. The information we learned from this effort will inform our work to reduce regulatory burden, and I will ensure that these efforts continue during my time at the OCC.

IV. Conclusion

During my tenure as Acting Comptroller of the Currency, I will support the OCC's efforts and work with my colleagues at the other Federal banking agencies to foster economic growth, including by championing regulatory and legislative changes that eliminate unnecessary regulatory burden and promote the health and vitality of the banking system. I will pursue opportunities to make this system more inclusive to new banks engaged in the business of banking. I will work to ensure accountability within the agency.

Thank you for the opportunity to provide this Committee with my views on fostering economic growth by strengthening our Nation's financial institutions. I look forward to working with you to achieve this goal.

APPENDIX

Legislative Proposals to Foster Economic Growth by Strengthening our Nation's Financial Institutions

I. Proposals to Maximize Economic Growth By Minimizing Regulatory Inefficiency

1. Streamline the Supervision of Holding Companies in Certain Circumstances

Summary: This proposal would provide the appropriate Federal banking agency (*i.e.,* the OCC, FRB, or FDIC) with sole examination and enforcement authority for a BHC and savings and loan holding company with total assets below a certain threshold where a bank or savings association comprises a substantial amount (*e.g.,* 90 percent) of the assets of the holding company. Under this approach, the FRB would retain authority to issue regulations implementing the Bank Holding Company Act and the provisions of the Home Owners' Loan Act (HOLA) relating to savings and loan holding companies.

Explanation: Depository institutions often comprise a substantial amount of the assets of holding companies. This is certainly true for those holding companies with less than $50 billion in assets. However, in most cases the depository institution and the holding company have different supervisors. Smaller institutions where the depository institution makes up the bulk of the assets in the holding company do not engage in the expansive activities that give rise to the types of complexity and interconnectedness that raise macroprudential concerns (such as resolvability). Requiring these institutions to respond to two supervisors is inefficient, redundant, and burdensome on the institution. Legislative changes that require a single regulator to oversee both the holding company and its depository institution and other subsidiaries would streamline the regulatory process, reduce the potential for supervisory duplication and inefficiencies, strengthen the regulators' accountability, and enhance opportunities for economic growth by reducing regulatory burden. The proposal simply would extend to smaller institutions the benefits of having a single Federal regulator at both the bank and holding company levels that State banks that are members of the FRS and their holding companies already enjoy today.

2. Modernize the Corporate Governance Procedures Applicable to National Banks

Summary: This proposal would repeal the residency and stock ownership requirements for directors in 12 U.S.C. 72 and harmonize and modernize the shareholder notification and meeting requirements for mergers in 12 U.S.C. 214a, 215 and 215a. It would also allow national banks to fully adopt the corporate governance procedures of, for example, the law of the State in which the main office of the bank is located, the Delaware General Corporation Law, or the Model Business Corporation Act.

Explanation: National banks currently have the option to adopt the corporate governance procedures identified above, but only to the extent not inconsistent with corporate governance procedures set forth in applicable Federal banking statutes or regulations, or bank safety and soundness (12 C.F.R. § 7.2000). Amending relevant law to allow national banks to fully adopt a corporate governance regime would modernize corporate governance for national banks and enhance efficiencies for banks with public stock. The National Bank Act (NBA) and other relevant law contains a number of corporate governance procedures that are inflexible and outdated compared to State corporate law, such as requiring shareholder supermajorities, requiring notice to shareholders by publication and certified mail, requiring formal meetings, and requiring explicit shareholder votes. These proposals would modernize these corporate governance provisions and place national banks on the same footing as BHCs and State banks. Modernization of these provisions would benefit national banks by providing them flexibility to operate more efficiently and access the capital markets without having to employ a holding company structure and being subject to the associated regulatory burden.

3. Modernize and Add Flexibility to the Federal Savings Association Charter

Summary: This proposal would amend the HOLA to give Federal savings associations the ability to elect to exercise national bank powers subject to restrictions applicable to national banks without changing their charters. HOLA could also be amended to streamline the ability of savings associations to issue securities.

Explanation: HOLA requires that a specified percentage of the assets of a savings association be in qualified thrift investments. Under existing law, a Federal savings association must convert to a bank charter to implement a strategic decision to

engage in commercial or consumer lending to a greater extent than is permitted by HOLA. The charter conversion process can be time consuming and burdensome, particularly for smaller institutions. Federal mutual savings associations face especially hard choices, since they must convert to the stock form of organization before they can convert to a bank charter.

In addition, section 4(h) of HOLA (12 U.S.C. 1463(h)) provides that no savings association shall: (1) issue securities which guarantee a specific maturity except with the specific approval of the appropriate Federal banking agency; or (2) issue any securities the form of which has not been approved by the appropriate Federal banking agency. The limitation of section 4(h) of HOLA is an inhibitor to savings associations' access to the capital markets.

Amending HOLA to provide Federal savings associations with additional flexibility to adapt to changing economic conditions and business environments without having to change their corporate form would enable them to better meet the needs of their communities. In addition, streamlining the ability of savings associations to issue securities would enhance their capacity to raise capital which they could deploy to make loans and invest in consumers, local businesses, and communities and support economic growth. National banks are not subject to restrictions of the type set forth in section 4(h). The OCC's experience with national banks does not demonstrate a need for these restrictions. OCC regulations already require approval for national banks and Federal savings association to increase capital in appropriate circumstances, such as when a national bank or Federal savings association issues securities for consideration other than cash, or is required to obtain agency approval pursuant to the terms of an enforcement action.

4. Streamline Supervision and Enforcement of Federal Consumer Financial Laws

Summary: This proposal would amend the Dodd-Frank Act to return examination and supervision authority with respect to Federal consumer financial laws (as defined in the Dodd-Frank Act) to the Federal banking agency for the financial institutions over which it has jurisdiction, without regard to an institution's asset size. Under this approach, the CFPB would continue to set the standards with respect to Federal consumer financial laws, supervise nondepository institutions, and take enforcement action. In connection with, or as an alternative to, this proposal, Congress could require a study of how the CFPB's authorities are currently used.

Explanation: Providing for a single regulator to oversee a depository institution's compliance with Federal consumer financial laws, in addition to its safety and soundness and compliance with other laws and regulations, would reduce regulatory burden and enhance opportunities for economic growth. It would minimize redundancy and enhance regulatory certainty by eliminating the need for a depository institution to prepare for multiple, potentially overlapping examinations and to meet the differing expectations of two separate regulators. Currently, the CFPB and prudential regulator examinations for depository institutions over $10 billion in assets may overlap because the prudential regulators have supervisory responsibility for a number of consumer-related laws (including the Fair Housing Act, the Community Reinvestment Act, the Servicemembers Civil Relief Act, and the unfair or deceptive acts or practices prohibitions of section 5 of the Federal Trade Commission Act) that intersect with the Federal consumer financial laws under the CFPB's supervisory jurisdiction. Also, each agency that examines a bank for compliance with consumer-related laws reviews aspects of the bank's compliance management system and assigns a Consumer Compliance Rating, raising the potential for unnecessary burden created by differing expectations or inconsistent findings.

A study of how the CFPB's authority is currently used would assist Congress in identifying any gaps in the enforcement of Federal consumer financial laws and determining how best to allocate regulatory resources to ensure an appropriate level of oversight.

5. Simplify the Process for National Banks to Obtain Deposit Insurance

Summary: This proposal would simplify the process for national banks to obtain deposit insurance. One approach would be to restore the process that existed under the Federal Deposit Insurance Act (FDI Act) prior to 1991. Under that process, a national bank engaged in the business of receiving deposits other than trust funds would become an insured bank upon chartering by the OCC and being authorized by the OCC to commence business. A separate application to the FDIC was not required. In addition to its other chartering requirements, the OCC, among other things, was required by statute to give consideration to the same factors that the FDIC currently must consider under the FDI Act in granting deposit insurance. The

OCC would issue a certificate to the FDIC that consideration had been given to those factors.

Congress could also explore providing the FDIC with a specified time period—such as 30 days—within which to object to the grant of deposit insurance to a particular entity. Inaction by the FDIC would result in the grant of insurance. An FDIC objection would have to specify the reasons for the objection and would constitute a final agency action subject to judicial review.

Explanation: Congress amended the FDI Act in 1991 to require national banks to apply to the FDIC separately for deposit insurance. The statute also adopted a similar process for State banks. As a result, applicants to become nationally or State chartered depository institutions must submit two parallel applications covering the same proposal to two different Federal agencies that review the proposals essentially for the same matters. This creates duplication, the need to spend extra resources and time, and the potential for delay. In the case of national banks this duplication is particularly unwarranted since the Comptroller of the Currency is a coequal Federal bank regulator and is a member of the FDIC's board. A separate application for insurance at the FDIC in effect permits the FDIC to overrule OCC decisions about chartering. Moreover, the proposal would ensure that obtaining deposit insurance can be as efficient as other fundamental aspects of the chartering process. Specifically, while national banks are required to become members of the FRS as part of the chartering process, Federal law does not require a separate application and approval by the FRB. The decision of the OCC to grant a charter is sufficient to confer FRS membership.

6. Require an EGRPRA-Like Review Process for Bank Secrecy Act (BSA) Regulations

Summary: This proposal would require Treasury to conduct a periodic review of all BSA regulations in order to identify outdated, unnecessary, or unduly burdensome requirements for financial institutions. Most of these regulations are issued by the Financial Crimes Enforcement Network (FinCEN). The proposal could require Treasury to consult with the Federal banking agencies, law enforcement agencies, and other stakeholders, as appropriate. It could require Treasury to solicit public comment and to submit a report to Congress on the results of its review. It could also require Treasury to specifically solicit public comment on technology that could reduce cost and burden on financial institutions, including community banks.

Explanation: During the most recent EGRPRA review, the OCC, FDIC, and FRB received many comments about the burdens imposed on financial institutions—particularly community banks—by FinCEN's BSA rules. This new requirement would give financial institutions an opportunity to express their concerns directly to the agency with the authority to issue, repeal, and modify BSA rules and require review and response by that agency.

7. Require Information Sharing in Connection with the Stress Test Requirements of Section 165

Summary: This proposal would amend section 165(i) of the Dodd-Frank Act to require the FRB to provide the appropriate primary financial regulatory agencies access to the models used to conduct its supervisory stress tests. Additionally, this proposal would require that the FRB provide the agencies with the model assumptions and the derivation of those assumptions. This proposal would also amend section 165(i) of the Dodd-Frank Act to require that the FRB share the results of supervisory stress tests with the appropriate financial regulatory agencies in a timely manner before those results are released to the public.

Explanation: Section 165(i)(1)(A) of the Dodd-Frank Act requires the FRB to conduct supervisory stress tests of nonbank financial companies supervised by the FRB and BHCs with total consolidated assets of $50 billion or more "in coordination with the appropriate primary financial regulatory agencies and the Federal Insurance Office." Section 165 also requires "all other financial companies" (*i.e.,* banks and savings associations) with $10 billion or more in assets to conduct company-run stress tests in accordance with regulations that the Federal primary financial regulatory agencies have issued.

The FRB develops and operates its own models to conduct the supervisory stress tests known as the Comprehensive Capital Analysis and Review (CCAR). In many instances, an IDI is the primary driver of a BHC's CCAR results. In addition to CCAR, those IDIs are required to complete depository institution-level stress tests under section 165(i)(2), known as Dodd-Frank Act stress testing (DFAST). The FRB frequently uses the CCAR stress test models and assumptions as a basis for developing the DFAST stress tests. The other Federal banking agencies should have access to the FRB's CCAR stress test models and assumptions to enhance their

assessment of the DFAST stress tests performed by IDIs. The OCC and FDIC also need time to review the results of CCAR supervisory stress tests before they are released to the public to ensure that the OCC and FDIC understand the underlying reasons for the results, which allows the OCC and FDIC to improve supervision and respond to questions from the public. The proposal would ultimately enhance the consistency and robustness of stress testing processes.

8. Make the OCC's and FDIC's Authority to Clear PRA Notices Consistent with that of the FRB

Summary: This proposal would amend the Paperwork Reduction Act (PRA), specifically, 44 U.S.C. 3507(i), to direct the Office of Management and Budget (OMB) to designate an officer of the OCC and the FDIC to approve proposed collections of information for all agency purposes. This change would give the OCC and FDIC the same authority as the FRB to clear their own collections of information.

Explanation: The PRA requires each Federal agency to establish a process for reviewing collections of information, to solicit public comment on proposed collections of information, and to submit proposed collections of information to the OMB for review and approval. The process of reviewing a collection of information, soliciting public comment on it, and obtaining OMB approval generally takes about 4 months. A 4-month delay in information collection activities to seek approval from OMB, an agency that does not have expertise in banking or financial services regulation or practices, can significantly hinder the OCC's and FDIC's ability to address emerging issues in individual institutions and in the larger financial system; this has the potential to undermine the effectiveness and efficiency of supervision by the OCC and FDIC. The OMB has provided the FRB with the authority to review and approve its own collection of information requests, collection of information requirements, and collections of information in current rules. The OCC and FDIC should have the same authority as the FRB.

II. Proposals to Right-Size Regulation

9. Volcker Rule: Exempt Community Banks, Provide an Off-Ramp for Midsize Banks, and Simplify Requirements

Summary: This proposal would revise the Volcker Rule to limit its scope and focus on banking entities that are materially engaged in risky trading activities that have the potential to trigger systemic consequences. Community banks, given the nature and scope of their activities, would be exempted altogether. Other institutions would be exempted if they qualify for an "offramp." While asset size could be a factor in designing the off-ramp, qualification for the offramp would also depend on whether an institution engages in the type of activities, or in activities that present the type of risk, that the Volcker Rule was designed to restrict. The activities measure could be based on the nature or the scope of the bank's trading activities. A bank could qualify for the off-ramp if its trading activities are low-risk, if the volume of its trading is relatively low, or if its trading revenues do not comprise a significant percentage of its total revenues. A combination of these measures could be used as well. The features of this off-ramp should be determined through a notice-and-comment rulemaking.

Institutions that did not qualify for the off-ramp would continue to be subject to the Volcker Rule, but the Rule's prohibitions and requirements would be simplified. The proprietary trading definition would be revised so that the determination whether trading is proprietary does not depend on the purpose of a trade. Instead, regulators would use bright-line, objective factors, such as applying the rule only to trading positions covered by the Market Risk Capital Rule. In addition, the requirements for permitted activities, such as market-making and risk-mitigating hedging, would be streamlined. Similarly, the covered fund prohibition could be simplified by narrowing the prong of the covered fund definition that refers to sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 so that the definition of a covered fund would only cover funds with certain characteristics.

Explanation: The statutory prohibition applies to any "banking entity."[9] As a result, the Volcker Rule applies to many entities that do not engage in the activities or present the risks that the Rule was designed to address. Applying the Rule to community banks engaged primarily in traditional banking activities or to institutions that are not materially engaged in risky trading activities does not further the statutory purpose. Exempting community banks and providing an off-ramp for larger institutions depending on the nature and scope of their trading activities would

[9] "Banking entity" is statutorily defined to include any IDI, any company that controls an IDI, or that is treated as a BHC for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of such entity. 12 U.S.C. § 1851(a)(1); 12 U.S.C. § 1851(h)(1).

reduce complexity, cost, and burden associated with the Volcker Rule by providing a tailored approach to addressing the risks the Rule was designed to contain.

The Volcker Rule's proprietary trading and covered fund provisions are complex and needlessly burdensome. Streamlining these provisions would facilitate institutions' ability to engage in permissible activities, such as market-making and risk-mitigating hedging, and would reduce compliance costs so that resources could be put to more productive uses. For example, if proprietary trading was redefined to include only Market Risk Capital Rule-covered positions for banks, the proprietary trading restrictions would apply to a smaller number of banks, and banks and the regulators could determine whether an activity constitutes proprietary trading without examining intent. This would promote efficiency and conserve resources for both banking entities and the agencies charged with implementing the rule.

10. Eliminate Size Thresholds and Frequency Requirements for DFAST

Summary: This proposal would eliminate the $10 billion threshold and the requirement that stress tests of "all other financial companies" (including banks and savings associations) be conducted annually under section 165(i)(2) of the Dodd-Frank Act. Instead of proposing alternative statutory requirements for size thresholds and frequency, this proposal would direct the primary Federal financial regulatory agencies to each issue rules establishing the frequency for stress testing of institutions of various sizes and characteristics. Legislation could set out factors for the agencies to consider in issuing those rules, such as asset size and complexity.

Explanation: Supervisors should have more flexibility, within certain parameters, about when and under what scenarios DFAST stress tests are conducted, and to which institutions they must apply. These changes would tailor stress testing requirements to fit the needs and risk profiles of various types of institutions.

11. Exempt Community Banks from the Collins Amendment

Summary: This proposal would modify section 171 of the Dodd-Frank Act (commonly referred to as the "Collins Amendment") to exempt banks that do not use models-based capital requirements from having to comply with the "generally applicable" capital rules.

Explanation: The Collins Amendment currently requires the Federal banking agencies to apply a common set of "generally applicable" capital requirements to all depository institutions, nearly all depository institution holding companies, and nonbank financial institutions supervised by the FRB (except for certain insurance companies), without regard to asset size or amount of foreign exposure. This requirement was included in the Dodd-Frank Act to prevent the Federal banking agencies from permitting relatively large banking organizations to use advanced models-based approaches to determine regulatory capital requirements that could be lower than the standardized requirements applied to smaller, less complex institutions.

An exemption from the Collins Amendment for banks that do not use models-based capital requirements would free the Federal banking agencies from impediments that currently prevent the agencies from tailoring their capital rules for highly capitalized smaller institutions that wish to escape the regulatory burden of calculating and complying with the standardized capital requirements. The exemption would allow the agencies to tailor the capital rules to match the size and complexity of the institutions to which the Collins Amendment applies to reduce regulatory burden for smaller and less complex institutions, which would contribute to economic growth.

12. Exempt Certain Community Banks from Capital Standards

Summary: This proposal would exempt smaller, less complex depository institutions from the Basel-based capital standards that currently apply if those institutions comply with a robust leverage ratio requirement (*e.g.,* 10 percent) and do not engage in a set of risky activities identified by the Federal banking agencies by rule.

Explanation: Simplifying capital requirements for these smaller, less complex depository institutions would reduce regulatory burden and contribute to economic growth.

13. Focusing the Scope of Section 165 of the Dodd-Frank Act

Summary: This proposal would raise the threshold for application of enhanced prudential standards under section 165 of the Dodd-Frank Act to some higher level, or use a qualitative assessment process, to more specifically capture the companies that present the types of risks requiring application of enhanced prudential standards.

Explanation: The enhanced prudential standards under section 165 of the Dodd-Frank Act apply to BHCs with $50 billion or more in total consolidated assets.

While enhanced prudential standards should apply to the largest, most complex companies, they should not apply to regional institutions that have business models more like a community bank. Raising the threshold for the application of, or using an assessment process that more closely aligns with the risk being addressed by, the enhanced prudential standards under section 165 would reduce regulatory burden for BHCs with a more traditional business model. Such companies would not have to comply with enhanced prudential standards that are more appropriately imposed on larger and more complex companies.

Moreover, given the multitude of requirements and burdens that are imposed by the enhanced standards of section 165 of the Dodd-Frank Act, when the thresholds associated with these standards are set at a low level, they become an effective barrier to competition that protects the market position and competitive advantage of the largest, most complex firms. All firms subject to section 165 of the Dodd-Frank Act, whether they have trillions of dollars in assets or just $50 billion in assets, must comply with the enhanced prudential standards and the associated costs and burden. Because these burdens and costs tend to be proportionally larger and higher for smaller institutions, larger firms have a return-on-cost advantage that increases as their asset size increases, and they can more effectively absorb the impact of dealing with enhanced prudential standards. In addition, smaller firms crossing the threshold simply lack the resources and regulatory know-how to navigate the labyrinth of these enhanced prudential standards. Because competition fosters innovation that makes the banking system more vibrant and banking products more cheaply available over time, the barrier to entry created by a dollar threshold that is set too low harms the health of the system, consumers, and ultimately economic growth.

14. Reduce Regulatory Burden by Repealing Unnecessary Call Report Requirement to Collect Data on Small Business Lending

Summary: This proposal would repeal section 122 of the Federal Deposit Insurance Corporation Improvement Act.

Explanation: Section 122 of the Federal Deposit Insurance Corporation Improvement Act of 1991 requires the Federal banking agencies to collect data on small business lending in the Call Report; however, the agencies do not use this information. Eliminating this section would reduce burden on the banking industry and contribute to economic growth. The Federal banking agencies received comments from numerous bankers that providing this information is particularly burdensome and should be eliminated. Agency staff does not use this information for any supervisory or examination purpose, yet it must still be collected due to the statutory requirement.

15. Reduce Regulatory Burden by Repealing the Small Business Data Collection Requirement in Section 1071 of the Dodd-Frank Act

Summary: This proposal would repeal section 1071 of the Dodd-Frank Act.

Explanation: Section 1071 of the Dodd-Frank Act amends the Equal Credit Opportunity Act to require a financial institution making a business loan to obtain and maintain information on whether the loan is being extended to "a women-owned, minority-owned, or small business." Moreover, the financial institution must collect additional granular data from each loan applicant in the form and manner provided in section 1071, and any data that the CFPB "determines would facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses." The Dodd-Frank Act directs the CFPB to write regulations or issue guidance, as necessary, to implement this section.

The CFPB has just begun the rulemaking process and has not yet issued a proposed regulation for implementation of this section. It likely will be very difficult to come up with workable definitions for this type of data collection in the small business lending context, and the rulemaking process itself could be protracted and burdensome. Moreover, once issued, the regulation implementing this section is likely to impose new and burdensome reporting requirements on financial institutions, including smaller banks that will be challenged to find the resources to comply with the new requirements, and the benefits from such reporting in the promotion of fair lending and community development are uncertain.

III. Proposals to Provide Regulatory Certainty and Promote Economic Growth

16. Support Clarification of the Applicability of the "Valid when Made" Doctrine

Summary: This proposal would overturn the Second Circuit's decision in *Madden v. Midland Funding, LLC* by providing that the rate of interest on a loan made by a bank, savings association, or credit union that is valid when the loan is made remains valid after transfer of the loan.

Explanation: This proposal reduces uncertainty by reestablishing well-settled black-letter law that a loan is valid when made and the interest rate charged by a national bank legally at origination remains legal upon assignment of the loan to a third-party. It would also create a uniform standard so that there is no longer a difference in the treatment of loans made in different judicial circuits. The proposal supports economic growth by facilitating the ability of banks, savings associations, and credit unions to sell their loans, thereby promoting liquid markets.

17. Modernize Receivership Authorities for Uninsured National Banks and Federal Branches

Summary: This proposal would modernize the powers available to receivers of uninsured national banks, as well as uninsured Federal branches and agencies of foreign banks ("uninsured Federal branches") by amending the NBA to provide the OCC with the same receivership authorities provided to the FDIC under the FDI Act. An alternative proposal would be to amend the FDI Act to specify the FDIC as the entity to serve as the receiver for OCC-chartered banks and OCC-licensed branches, without distinction between insured and uninsured status. For uninsured national banks, this would restore the status quo to the framework established by Congress when the FDIC was created in 1933, which existed until the enactment of the Federal Financial Institutions Reform, Recovery, and Enforcement Act in 1989.

Explanation: Currently, the OCC appoints and supervises receivers for uninsured national banks and Federal branches. The OCC's receiver liquidates the institution or the branch pursuant to receivership powers and directives set forth in the NBA. These statutory provisions date back to the creation of the national banking system in 1863. The receiver for an uninsured Federal branch exercises the same rights, privileges, powers, and authority as a receiver for an uninsured national bank, pursuant to the International Banking Act. This proposal would provide uninsured national banks and Federal branches with additional certainty and clarity about the receivership process. It would also provide the OCC with updated authority to help address issues faced by modern institutions.

TESTIMONY OF

CHARLES G. COOPER

BANKING COMMISSIONER

TEXAS DEPARTMENT OF BANKING

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

FOSTERING ECONOMIC GROWTH: REGULATOR PERSPECTIVE

Before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

Thursday, June 22, 2017, 10:00 AM

538 Dirksen Senate Office Building

Introduction

Good morning, Chairman Crapo, Ranking Member Brown, and distinguished members of the Committee. My name is Charles Cooper, and I am currently serving in my ninth year as the Commissioner of the Texas Department of Banking (DOB), which is responsible for the supervision, regulation, and examination of 273 state-chartered banks with aggregate assets of approximately $275.3 billion.[1] Additionally, DOB supervises trust companies, money service businesses, and foreign bank agencies and branches. I have more than 47 years of experience in the financial services industry – 12 as an FDIC bank examiner, 26 as a banker in both community and large banks, and the last nine years as the Texas Banking Commissioner. Most recently, I am the immediate past Chairman of the Conference of State Bank Supervisors, and continue to serve on the Executive Committee. It is my pleasure to testify before you today on behalf of CSBS and state regulators.

CSBS is the nationwide organization of banking regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, and facilitates state implementation of policy through training, educational programs, and production of examiner tools and job aids. Additionally, CSBS represents its members before the federal financial regulatory agencies and Congress.

State regulators' unique perspective is informed by supervision of a diverse field of financial firms and their activities within local communities. States are the chartering authority and primary regulator for 78% of the nation's banks, a figure that represents 4,572 institutions with over $5.3 trillion in assets. These banks vary in asset size, from large and complex institutions that have been categorized as global systemically important banks (G-SIBs) with assets of more than $200 billion,[2] to large regional banks, to smaller institutions that offer products tailored to community needs. In addition to supervising most of our country's banks, the states are the primary regulators of over 20,000 non-depository financial service providers. This category includes residential mortgage lenders and servicers, money service businesses and money transmitters, debt collectors, consumer and small dollar loan lenders, and emerging and established financial technology companies.

State regulators' knowledge of local markets and institutions lends itself to identifying and addressing emerging risks to consumers, and in many instances, bringing those risks to national attention. This on-the-ground perspective, informed by implementation of federal and state law and regulations, contributes to an understanding of how standards can be tailored to not only ensure safety and soundness, but promote responsible innovation and economic growth.

State regulators thank Chairman Crapo, Ranking Member Brown, and the Committee members for your continued efforts to understand how complex, national regulation affects

[1] FDIC Bank Data as of Q1 2017.

[2] Bank of New York Mellon and State Street are both state chartered institutions that have been identified as global systemically important banks (G-SIBs) by the Financial Stability Board (FSB), in consultation with the Basel Committee on Banking Supervision (BCBS). *See* http://www.fsb.org/2016/11/2016-list-of-global-systemically-important-banks-g-sibs/

regional credit communities. By observing local and national trends, state regulators have found evidence that community banks are disproportionately burdened by regulation that is inappropriate for their size, business model, or activities. I appreciate the opportunity to bring this perspective to the Committee's hearing today.

My testimony today focuses on community banks. At the state level, regulators are focused on ensuring that borrowers – wherever they live – have broad, safe access to an array of credit and banking services. Community banks are central to this mission. Collectively, community banks are responsible for 45% of small loans to businesses in the United States, and upwards of three-fourths of agriculture lending. Moreover, in roughly 600 counties across the nation, a community bank is the only physical banking presence.

As someone who works outside of the beltway, I am optimistic that we have a realistic opportunity to appropriately calibrate our regulatory approach, especially for community based institutions. I believe it is possible for us to maintain a strong and effective regulatory program that ensures safety and soundness, protects consumers, and meets the economic needs of local communities without undue burden on the institutions that we supervise.

As policy makers pursue this important task, we are fortunate to have two bodies of work from which to extract ideas. Earlier this year, the Federal Financial Institutions Examination Council (FFIEC) issued its report under the Economic Growth and Paperwork Reduction Act (EGRPRA). The report is the result of a multi-year effort by the FFIEC member agencies to identify areas where regulation can be more efficient and the industry can be relieved of unnecessary burden. The states were active participants in this work. The report offers numerous opportunities for improvement, some of which have already been implemented.

Last week, the Treasury Department also issued its first report in response to the President's Executive Order 13772 on Core Principles for Regulating the United States Financial System. The report, focused on banks and credit unions, makes a powerful case for significant changes to our regulatory approach if we hope to serve the economic needs of local communities.

With nearly 100 recommendations in the Treasury report and 440 pages of comments and recommendations in the EGRPRA report to Congress point to one undeniable fact – we have a problem with the volume, complexity, and overall approach of our regulatory framework. How or why we got to this point is not as important as how we to come together to address it. There are meaningful recommendations in both reports that identify opportunities for both Congress and regulators to act. Today, we are presented with a tangible opportunity to positively impact the banking industry and the economies they serve.

To support the economic growth fueled by small business and agriculture, it must be a priority to reverse the hollowing out of community banking. In this endeavor, regulation plays a key role. My testimony today highlights regulations that disproportionately burden smaller institutions, stalling economic growth and product innovation. Several of these topics have been

raised through the EGRPRA[3] process and in the recent Treasury Department report regarding Executive Order 13772, but warrant continued attention. In particular, my testimony discusses the following opportunities for regulatory relief aimed at bringing economic growth to local communities:

- The adoption of a uniform, activities-based definition for community banks;
- The simplification of the revised capital regime and its treatment of certain activities;
- Granting community banks relief from QM mortgage rules and HMDA reporting requirements; and
- Ensuring that state regulators and local communities are represented in the national policy development process.

I plan to discuss several other issues of concern to state regulators, including: the current use of the Herfindahl-Hirschman Index (HHI) in competitive analyses, a lack of clarity surrounding methodologies and models used in consumer compliance examinations, and the ongoing appraiser shortage in many areas of the country.

Aggregate Performance Data Does Not Reflect Regional Trends in Profitability

If profitability is the only metric used to analyze the entirety of the banking market, then it could be argued that the community banking industry is not in decline. However, because of their local perspective, state regulators know that an appropriate analysis of community bank performance is more nuanced. When one goes beyond national numbers to look at community bank performance data on a regional or state-by-state basis, community bank performance varies significantly. Median return-on-asset (ROA) is relatively high in states with dominant agricultural sectors, with community banks in Oklahoma, South Dakota, North Dakota and Iowa all maintaining an ROA above 1.2. However, there is a significant gap between the profitability indicators of those markets and regions where community bank performance is struggling – North Carolina, Florida, Maryland, Massachusetts, New Hampshire, Connecticut and New Jersey all have a median ROA below .6. Finally, consolidation of smaller institutions reflects that small community banks are struggling to survive in many states.

Despite Resilience of Community Bank Business Model, Consolidation Continues

Small, local banks continue to consolidate across the country, leaving many communities without access to financial services. An astonishing 1,715 community banks have disappeared since 2010, and this trend continues with 54 banks exiting the market in 2017.[4] By contrast, only three community banks have closed due to failure in 2017. Consolidation leaves consumers with less choice, and diminishes healthy competition within the market.

Recent research from the Federal Reserve Bank of Minneapolis has found that there is little correlation between economic recession and trends in bank numbers, highlighting the

[3] USC 12 3311

[4] *See* FDIC Quarterly Financial as of 3/31/2017.

resiliency of community bank business models.[5] However, the study notes that there has been a marked increase in community bank consolidation after major regulatory legislation like the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) or the Dodd-Frank Act (DFA) were implemented.[6] However, in previous instances, this consolidation is also met with new bank formation. We have yet to see that occur in the post Dodd-Frank era. As *Figure 1* illustrates, the banking industry continues to consolidate as the largest banks increase their overall share of assets.

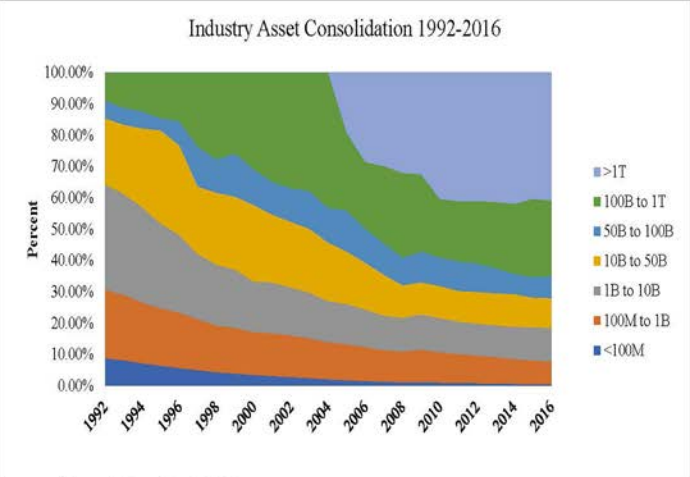

Figure 1 Source: FDIC SDI Data

In Texas, the banking market has lost 159 state-chartered institutions since 2010. Additionally, community banks that exit the market are not being replaced – de novo applications for new bank charters are at all-time lows. There have been only five de novo charters granted since the passage of Dodd-Frank. Further consolidation and lack of de-novo applications could have drastic effects on credit availability. As discussed above, one out of every five U.S. counties have no physical banking offices except those operated by community banks.[7]

In addition to providing fundamental financial services, smaller and less complex banks regularly tailor products to meet local needs. Whether servicing the agricultural markets of the Midwest or the startup communities of Silicon Valley, local banks adapt to their markets. The ability to tailor products to consumer needs is illustrated through the rate at which community

[5] *See* https://www.minneapolisfed.org/research/economic-policy-papers/assessing-community-bank-consolidation . *Assessing Community Bank Consolidation,* (Schreck and Feldman, 2014).
[6] *See id.*
[7] *See* https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf *FDIC Community Banking Study* (2012).

institutions lend to small, local businesses. Despite smaller asset size, community banks' proximity to and familiarity with local economies has driven small business growth – a 2016 survey of small businesses by the Federal Reserve Bank of New York found that small business loan applicants were more likely to be approved at a small bank than an online lender, large bank, or credit union. Additionally, applicants were 20% more likely to be satisfied with a small depository lender than a large bank, further emphasizing the necessity to update regulation to match the evolving role of small institutions in the financial marketplace.[8]

The current pace of consolidation cannot be sustained for much longer. This rapid rate of consolidation, in combination with a lack of de novo institutions, threatens community banking, a franchise that contributes greatly to the economy. Regulatory relief for community banks has been a topic of discussion for quite some time, and it is time to take practical steps to reform existing laws and regulations. CSBS and I urge Congress and my federal regulatory colleagues to act swiftly to further reduce the regulatory burden on community banks before they are gone.

A Uniform, Activities-Based Definition of Community Banks Allows for Effective Supervision

Policymakers have often approached bank regulatory requirements based on an institution's asset size. However, this has led to a fragmented and arbitrary regulatory framework that negatively impacts community banks. *Figure 2* shows a sample of current regulations and their applicability based on asset size, illustrating just how inconsistent this regime can be.

State regulators are concerned that the current approach to applicable regulation falls short in providing a tailored and reasonable approach to community bank regulation, which in turn harms these institutions and the communities they serve. For example, Commissioners have seen community banks approaching the $10 billion asset mark choose to acquire another institution to quickly achieve a size well beyond $10 billion (rather than organically grow) to absorb the increased costs of direct supervision by the Consumer Financial Protection Bureau (CFPB or Bureau). Furthermore, according to results from *CSBS 2016 National Survey of Community Banks*, regulatory burden is the primary reason that community banks exit a specific product or service.[9]

Simply put, our current framework may not be creating the appropriate incentives for the long-term financial stability of the industry and economic opportunities for communities. The recently released Department of the Treasury report regarding Executive Order 13772 similarly recommends that specific asset thresholds for increased regulatory requirements create "innapropriate incentives," and that one-size-fits-all regulatory approach undermines the diversity of our banking markets.[10]

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[8] *See* https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-employer-firms-2016 *New York Federal Reserve Bank Small Business Credit Survey* (2016).

[9] 36.87% of respondents cited regulatory burden as their reason for exiting an activity, and only 26.98% of respondents cited profitability as reason for exiting an activity.

[10] *See* https://www.treasury.gov/press-center/press-releases/Documents/Apercent20Financialpercent20System.pdf pp. 40

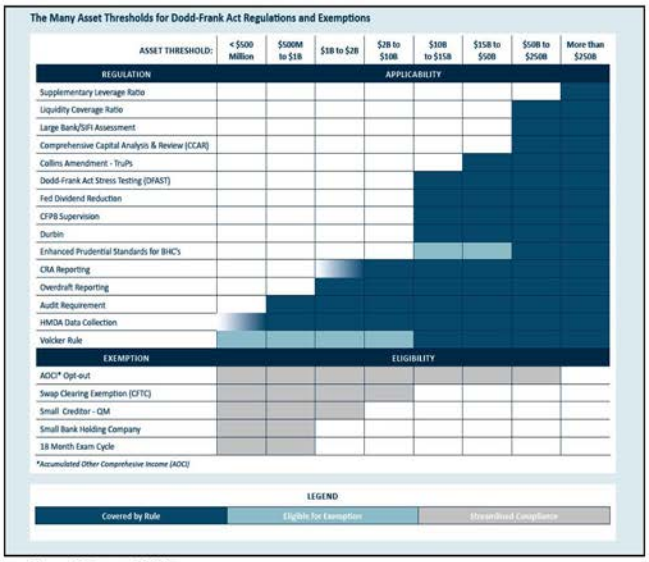

Figure 2 Source: CSBS

CSBS believes policymakers could use a set of factors and measures other than asset thresholds that better reflect the true character of a community bank, such as the Federal Deposit Insurance Corporation's (FDIC) research definition, introduced in 2012. CSBS believes the FDIC research definition of a community bank – which considers an institution's business activities, funding characteristics, and geographic footprint – provides a good foundation on which to build a more rational regulatory and supervisory framework for community banks. State regulators believe there could be other criteria that policymakers use to help identify community banks, such as:

- Operating primarily in local markets;
- Deriving funding primarily from these local markets, specifically through deposits of members of the communities in which a bank operates;
- Focusing on lending out the deposits a bank collects to the communities in which it predominately operates;
- Having a lending model based on relationships and detailed knowledge of the communities and its members, not one that is volume-driven or automated;
- Focusing on providing high-quality and traditional banking services; and
- Having locally based corporate governance.

Approximately 92% of all banks in the United States are considered community banks under the FDIC's research definition, meaning roughly 5,500 community banks are embedded in local communities throughout the country. More than 93% of all state-chartered banks also meet the FDIC's definition of a community bank. In 17 of the 24 states represented on the Senate Banking Committee, more than 90% of the banks in the state are considered community banks under this definition. Recognizing that the community banking business model has both a quantitative and qualitative aspect, CSBS proposes that this definition be coupled with a petition process. This would allow institutions to petition their chartering authority for community bank designation. State supervisors recommend that, to facilitate the petition process, chartering authorities conduct analyses that examine the criteria outlined above, but also provide for additional regulatory judgment and discretion.

Whether Congress uses the FDIC community bank research definition or other measures, state regulators urge you to create a process for community bank identification that is not solely based on asset thresholds, but takes activity-based criteria into account. A more holistic definition of community banks could be used as a basis for a broad range of regulatory right-sizing initiatives. With a new approach in place to identify community banks, Congress and state regulators, in collaboration with their federal regulatory counterparts, could move toward right-sizing a more appropriate regulatory and supervisory approach for these institutions. Creating a right-sized regulatory environment will empower community banks to better serve their local markets, thus, promoting economic growth.

Capital Simplification is Necessary to Ensure that Local Communities Have Access to Financial Services

State regulators continue to support high quantities of quality capital. However, the effect of unwieldy application of federal rules is illustrated by the impact that Basel III standards have had on community banks. The current capital standards, promulgated by the Basel Committee on Banking Supervision (BCBS) regarding risk-based capital, leverage, and liquidity (otherwise known as Basel III) were designed for internationally active, complex organizations. Federal prudential regulators (the Federal Reserve Board, Office of the Comptroller of the Currency, and FDIC) have implemented Basel standards through formal rulemaking, and community banking organizations became subject to the final Basel III rule in 2015. Although the final rule included key changes that federal regulators designed to provide relief to community institutions, the current capital regime introduces unnecessary reporting complexity and costs, which impact community banks' ability to participate in certain activities. The recent Treasury Report regarding Executive Order 13772 similarly recommends that that a simplification of the overall capital regime for community banks is necessary, as the complex U.S. capital rules implementing Basel III standards are not appropriately tailored.

The Complexity of the Capital Rules is Reflected in Call Report Preparation

Throughout the EGRPRA process, community bankers commented that the revised capital rules have placed undue burdens on small institutions, with little discernable benefit to safety and soundness. The capital rules are designed for much more complex and interconnected

institutions, and small banks often need to dedicate staff to regulatory reporting, pulling employees away from serving customer needs. The complexity of the capital rules is reflected in Call Report preparation – Schedule RC-R (Regulatory Capital) requires significant resources to interpret lengthy, complicated instructions, and to collect the data required for the schedule. Indeed, of the 61 pages on the new FFIEC 051 (small bank Call Report), no less than 14 pages are for the capital section. One observes a similar challenge with the instructions, with 113 pages of the total 538 pages (21%) dedicated to capital rules alone. Many data items require manual entry, and as a result, community institutions divert staff resources that could otherwise be used to serve their customers. With the simplification of capital rules, the complexity and difficulty of Call Report preparation can be eased, allowing community institutions to focus on their customer base.

HVCRE Definition Is Overly-Complex & MSA Risk-Weighting is Prohibitive

The capital rules' treatment of certain assets – such as High Volatility Commercial Real Estate (HVCRE) and mortgage servicing assets (MSAs) – have disproportionately affected small bank activity. Under the current capital rules, HVCRE is defined as all acquisition, development, and construction (ADC) commercial real estate loans with a loan to value ratio (LTV) less than or equal to the regulatory agencies' real estate lending standards, with exemptions.[11]

In addition to raising the risk weight applied to HVCRE to 150%, the complex nature of the HVCRE definition has left community lenders unsure as to how to classify CRE loans. Since the classification's introduction in 2011 and implementation in 2013, the agencies have released several pieces of guidance. However, the EGRPRA report listed several comments emphasizing that both the definition of HVCRE and associated exemptions are unclear. State regulators recommend that that HVCRE definition and exemptions be simplified.

Additionally, the revised capital rules' treatment of mortgage servicing assets has affected local credit markets. Under the revised capital rules, MSAs are limited to 10% of a bank's common equity Tier 1 capital, and MSAs in excess must be deducted. Any portion of a bank's MSAs that are not deducted from the calculation of common equity Tier 1 will be subject to a 250% risk weight. Because of the risk weight applied to MSAs and associated compliance costs, community banks will most likely not enter the mortgage servicing space. The prohibitive risk weighting applied to MSAs could potentially limit community bank mortgage servicing, a potential income stream used to manage interest rate risk and maintain valuable customer

[11] All loans and credit facilities used for ADC loans of real property are to be reported as HVCRE unless **one** of the following is met: 1) the loan is secured by one-to-four family residential projects, 2) the loans is secured by a property that would qualify as an investment in a community development project, or 3) is secured by agricultural land and is used for the purchase or development of land that will or can be used for agricultural purposes. Additionally, all loans and credit facilities are to be reported as HVCRE unless **all the following** criteria are met: the project's LTV is less than or equal to the maximum supervisory loan to value limits set forth in applicable regulations, the borrower has contributed capital to the project prior to the advance of funds in the form of cash, unencumbered readily marketable assets, land to be contributed to the project purchased with cash, or certain out-of-pocket development expenses, where the aggregate of such capital contributions is at least 15 percent of the real estate project's "as completed" appraised value; and Borrower-contributed capital is contractually required to remain throughout the life of the project, i.e., until the loan is converted to permanent financing or the debt is paid in full.

relationships. This restriction of MSA activity, in combination with restrictions on hedging implemented by the Volcker Rule, limits available options for community banks to manage interest rate risk.[12]

The 2017 EGRPRA Report included a statement from the FFIEC federal member banking agencies that a proposal is under development to simplify the regulatory capital rules for community institutions.[13] This statement highlights the impact that the treatment of HVCRE and MSAs has on local project development and banking relationships, but more important, CSBS sees a need for broader capital simplification for community banks.

Federal Mortgage Rules & Reporting Requirements Are Impeding Community Bank Residential Lending Activity

State regulators continue to observe the effect that recent mortgage regulation has had on community bank residential lending activity. Each year, as part of the CSBS-Federal Reserve *21st Century Research and Policy Conference*, CSBS surveys community banks across the country to gain insight into relevant issues affecting community institutions. Among the 974 bankers from 39 states that participated in the *CSBS 2015 National Survey of Community Banks*, only 69% listed mortgage as a primary product line, which represented a significant drop of 8% from the prior year's survey. The 2016 survey results indicated that mortgage lending activity at community banks continues to decline. Community bankers have also identified QM mortgage rules and HMDA requirements as presenting significant regulatory burden in both their complexity and implementation.

Smaller and less complex institutions have reported that stringent documentation requirements to obtain safe-harbor status from qualified-mortgage (QM) rules have made mortgage lending increasingly unprofitable, and recent research indicates that discontinuation of residential mortgage origination by community banks is on the rise.[14] The CFPB's QM rule and the ability to repay (ATR) requirements,[15] both made effective in 2014, have had a demonstrable effect on community bank residential lending activity.[16] State supervisors find this to be a disconcerting trend, as community banks are the primary source of mortgage credit in many of our communities.

State regulators recommend that lenders that retain mortgages in portfolio should be subject to more flexible underwriting practices, as they are fully incentivized to ensure the borrower can meet the monthly obligations of a mortgage. Specifically, state regulators

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[12] The Volcker Rule, or, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, OCC, Fed, FDIC, December 10, 2013*, limits bank investment in structured products and restricts hedging activity.

[13] 12 USC 3311

[14] *See*:https://www.communitybanking.org/~/media/files/communitybanking/2014/session3_peirce_robinson_stratmann.pdf . How Are Small Banks Faring Under Dodd-Frank? (Peirce, Robinson, Stratman)

[15] 1026.43(c), 1026.43(e)(2)

[16] *See* https://www.federalreserve.gov/boarddocs/SnLoanSurvey/201305/default.htm . April 2013 Federal Reserve Senior Loan Officer Opinion Survey.

recommend granting QM status to all loans held in portfolio by community banks. This approach reflects the alignment of interest between the bank and the borrower, tailoring regulatory requirements to the relationship-based nature of community bank mortgage lending.[17]

The recent expansion of Home Mortgage Disclosure Act (HMDA) reporting requirements has placed a disproportionate burden on smaller and less complex institutions, potentially restricting mortgage lending. In 2018, the number of data points required to comply with HMDA reporting standards is set to double, further increasing compliance costs for smaller institutions. Despite changes to the institutional coverage of HMDA that will provide limited relief to depository institutions that report fewer than 25 loans (over the previous two calendar years), state regulators are concerned that the new reporting requirements will impose a disproportionate cost burden on small reporters that exceed the 25-loan threshold.

State regulators recommend the Bureau institute a threshold of at least 100 covered loans for depository institutions, and implement a tiered approach to HMDA reporting. By establishing a tiered approach to institutions covered under HMDA, it would reduce the burden on smaller institutions and provide value to large bank evaluations. For example, the tiered approach could consist of a tier for those institutions originating less than 100 loans; those institutions would be considered exempt from HMDA reporting. Each tier would represent larger origination volume, and would have corresponding data-reporting requirements commensurate with the volume of the institution. Institutions originating less than 100 loans annually are likely not operating in a regional or national capacity. These entities are likely to be small lenders or brokers, with limited sophistication in both systems and personnel. Because institutions with larger loan origination volume comply with additional HMDA data points, a tiered approach would not only reduce burden on small banks, but make data for all tiers more targeted and meaningful.

In addition to the increased compliance burden imposed by expanded reporting requirements, state supervisors have observed a lack of transparency in the way that HMDA data is evaluated by the various federal agencies that analyze HMDA reporting. Given that this information is a primary lens through which federal regulators determine violations of the Equal Credit Opportunity Act (ECOA) and other fair lending laws, it is critically important that the process of HMDA data collection and validation be transparent, and the data is used appropriately in the fair lending examination process.

Empower Community Banks to Continue Serving Small Businesses' Credit Needs

According to the Federal Reserve's *2016 Small Business Credit Survey*, small banks are a primary source of credit for small businesses, and successful small business loan applicants are most satisfied with small banks. Community banks have an outsized role in small business

[17] *See* https://www.communitybanking.org/~/media/files/communitybanking/2013/dgns_2012_sba_lending.pdf . Small Business Lending and Social Capital: Are Rural Relationships Different? (DeYoung, Glennon, Nigro, Spong, 2013).

lending – despite smaller asset size, community banks make 45% of all small loans to businesses in the US.[18] In fact, small business startups with assets under $1 million are most likely to be approved for financing at community banks. Small banks' small business lending activity levels the playing field, allowing for small firms to gain a foothold in the local market.

Access to affordable and flexible mortgage credit is not simply about advancing homeownership, but also small business growth. Small business owners often rely on home equity as a significant credit source, and the overly rigid ATR standard can inhibit community banks from extending this type of credit to worthy borrowers. Empowering community banks to fulfill their role as a primary credit provider to small firms and startups will level the playing field for new entrants into our economy, continuing economic growth.

As discussed above, HMDA reporting requirements have presented significant challenges to community institutions. Recently, the CFPB has released a request for information (RFI)[19] regarding the small business lending marketplace, with a focus on lending activity to women-owned and minority-owned businesses. The Bureau's request is statutorily mandated pursuant to Dodd-Frank Section 1071, and amends ECOA to require that certain data be collected and maintained regarding small business loan applications, including:

- The number of the application and application date;
- The type and purpose of the loan or credit applied for, including the amount approved;
- Census data regarding business location;
- The gross annual revenue of the business; and
- The race, sex and ethnicity of the principle owners of the business.

State regulators firmly believe that lending should be fair, and that small business owners of minority status should be provided with access to available credit. However, state regulators are concerned that, like HMDA, data collection requirements pursuant to Section 1071 will continue to expand, with no corresponding public policy benefit.

Unlike mortgage lending, which has primarily become a commodity business, small business loans are often tailored to the borrower's unique needs. The CFPB's recent RFI included a request that bankers describe the data points used to make lending decisions to small business borrowers. What the Bureau will surely find, and what state regulators have been aware of for quite some time, is that community banks tailor small business lending products for the borrower's specific needs. Any set of data points and associated reporting requirements cannot be rigid – the nature of small business lending activity simply doesn't lend itself to an inflexible set of data points. Further, utilizing data on small business lending activity to determine ECOA compliance is a point of concern for state supervisors. The definition of small business loan differs on a nearly borrower-by-borrower basis, and attempting to use a generalized data-set to

[18] FDIC Quarterly Banking Profile, Q22016. *See*: https://www.fdic.gov/bank/analytical/qbp/2016jun/qbpcb.html
[19] *See:* https://www.consumerfinance.gov/about-us/blog/request-information-small-business-lending/

determine fair-lending violations will most likely be ineffective. State regulators urge the Bureau to employ an approach that considers the varying needs of small business borrowers, and products that are tailored to those needs.

The relationship lending model employed by community banks is essential in this space – often, small startups and firms do not have long operational histories, but still require funding to expand business in the local market. Because of their proximity to the community and familiarity with the borrower, community banks lend to small firms that may have otherwise been refused funding. Community banks are more likely to approve loans to small firms seeking expansion than large banks, credit unions or online lenders.[20] Community bank small business lending is a major driver of the economy, as new firms are a principal source of net job creation.[21] The uncertainty associated with potential use of HMDA-like reporting for small business lending could discourage community banks from supporting local economies.

Small businesses are the cornerstone of our economy, and community banks continue to serve startups and established small businesses, allowing for a more diverse and competitive marketplace. As regulators, we understand the role and value of data to ensure that institutions are complying with the law and that credit needs are being met. However, Congress and regulators must evaluate the burdens created by new and/or expanded data collection requirements against the goal of ensuring that mandatory data collections are not stifling the very lending that we want our regulated institutions to do.

Providing Relief from Appraisal Requirements Will Address Delays in Local Home Purchase Process

State supervisors continue to observe the delays that a lack of credentialed appraisers impose on the home purchase process, particularly in rural and underserved markets. Several factors influence the ongoing shortage, including: appraisal regulation thresholds, educational requirements for licensed and certified appraisers, and a lack of clarity regarding options for relief.

The appraisal regulation thresholds established by the federal agencies to implement FIRREA[22] are outdated. State regulators continue to be concerned that outdated thresholds may unnecessarily impede credit availability, particularly in rural and underserved urban markets. The current threshold of $250,000 for both residential and nonresidential (commercial) real estate transactions has not been adjusted since 1994.[23] Real estate loans over the dollar threshold must be supported by an appraisal performed by a licensed or certified appraiser, while loans

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[20] *See* https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmploverFirms-2016.pdf. 42% of small businesses rely exclusively on their owners' personal credit scores to secure debt, another 45% use both the owner's personal scores and business credit scores. Firms under $1 million are most likely to use a personal guarantee as collateral to secure outstanding debt. Despite applying to large and small banks at similar rates, small firms were most likely to gain approval at small banks.

[21] See http://www.hbs.edu/faculty/Publicationpercent20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf. Harvard Business School, *The State of Small Business Lending* (Mills & McCathy, 2016).

[22] *See* 12 CFR 34.43

[23] *See* 12 C.F.R. 323.3(a)(1)

below the threshold may have the market value of the property determined by an evaluation[24] that conforms to published regulatory guidelines.[25] Evaluations do not require a credentialed appraiser, but the evaluation preparer should be knowledgeable of the market and property values.

The Appraisal Regulatory Thresholds Should be Adjusted to Reflect Inflation

In many instances, the costs associated with an appraisal on a relatively small real estate loan are high in comparison to the property's purchase price. Further, the lack or limited number of qualified appraisers in numerous markets throughout the country can lead to even higher appraisal costs and delays in the real estate transaction process.

Although the most recent EGRPRA Report stated that the agencies are developing a proposal to raise the thresholds for commercial real estate loans from $250,000 to $400,000, state supervisors recommend that the agencies also consider raising the threshold for residential real estate loans to reflect inflation. As part of state regulators' participation in the EGRPRA review, the State Liaison Committee (SLC) sent a letter to their fellow FFIEC member agencies urging an indexing of both commercial and residential thresholds to account for changes in real estate value over time. A reasonable increase in the threshold level does not present an undue threat to the safety and soundness of institutions. In addition, state regulators believe that real estate evaluations[26] conforming with regulatory guidance provide reasonable support for market values as well as protection for consumers.

Higher Education Requirements Limit Entry to Appraiser Profession

The Dodd-Frank Act requires that all appraisers, regardless of State Appraiser Regulatory Agency, conform to standards and qualifications issued by the Appraiser Qualifications Board, or AQB.[27] The AQB is overseen by the Appraisal Subcommittee (ASC) of the FFIEC, which was established pursuant to Title X of FIRREA. The AQB most recently published proposed changes to the *Real Property Appraiser Qualification Criteria*, which included the requirement

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[24] *See* 12 C.F.R. 323.3 (b). An evaluation provides an estimate of the property's market value but does not have to be performed by a state licensed or certified appraiser.

[25] *See* https://www.fdic.gov/news/news/financial/2010/fil10082a.pdf and https://www.fdic.gov/news/news/press/2016/pr16017a.pdf .Regulatory expectations for evaluations are detailed within the December 10, 2010 Interagency Appraisal and Evaluation Guidelines, and the March 4, 2016 Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions.

[26] An evaluation is defined in the Interagency Appraisal and Evaluation Guidelines as "A valuation permitted by the Agencies' appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption." Evaluations must be consistent with safe and sound banking practices, support the institution's decision to engage in the transaction, provide a reliable estimate of the collateral's market value as of a stated effective date prior to the decision to enter into the transaction, be based on a valuation method that is appropriate for a transaction rather than the method that renders the highest value, lowest cost, or fastest turnaround time; address the property's physical condition and characteristics, address the economic and market conditions that effect the estimate of the collateral's market value, and not be based on unsupported assumptions, such as an assumption that the property is in average condition, the zoning will change, or the property is not affected by adverse market conditions.

[27] Public Law 111–203, 124 Stat. 1376.

for a Bachelor's degree for appraisers holding a Certified Residential and Certified General Appraiser credential.[28] Further, the changes adopted in 2015 also require that Licensed Residential Appraisers hold thirty semester credit hours of college-level education.

State supervisors see the requirement of a Bachelor's degree and college credit hours as being an unwarranted barrier to entry into the appraiser profession, and recommend that the shortage will only continue if educational standards are not adjusted.[29] It is not demonstrably clear whether a Bachelor's degree is necessary to complete the requisite duties of an appraiser, and the AQB has previously proposed removing the requirement.[30] State regulators recommend that the educational requirements be amended, allowing for more appraisers to be credentialed, and ultimately shortening the delay caused by appraiser shortages.

The Process for Title XI Waiver from Appraisal Requirements is Unclear

Although a waiver-based option for relief is available, state regulators note that the process for attaining a waiver from appraisal requirements is not clear. Title XI of FIRREA authorizes the ASC to grant temporary waivers of any requirement relating to certification or licensing of individuals to perform appraisals in states where there is a shortage of appraisers leading to significant delays. Through the EGRPRA process and a recent public financial institution letter (FIL),[31] the federal financial agencies have listed which entities can make requests, including:

- A state appraiser certifying or licensing agency;
- A federal bank regulatory agency;
- A regulated financial institution; or
- Other persons or institutions with demonstrable interest in appraiser regulation.

The last category is vague, and does not offer clarity as to who or what "other persons or institutions" would be eligible. Further, although the public FIL listed requirements for waiver application submission such as evidence of a demonstrable scarcity of appraisers, the publication does not detail the methodology that should drive a determination. Other process oriented details like where to send the submission, how to format it, and submission examples are not included. State supervisors appreciate the steps the FFIEC member banking agencies have taken to make interested parties aware of the waiver option; however, more clarity and guidance regarding the process is needed. Without further details or guidance, the waiver option risks being largely unused.[32] State supervisors request that the FFIEC member banking agencies issue more

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[28] *See*:https://www.asc.gov/ResourcesFor/RealEstate-Appraisers/AQBRealPropertyAppraiserQualificationCriteria.aspx
[29] *See* Appraisal Institute Comment Letter, Re: Potential Changes to the Real Property Appraiser Qualification Criteria: http://www.appraisalinstitute.org/file.aspx?Document=AI_on_2016_Exposure_Draft-3-31.pdf
[30] *See* Third Exposure Draft of proposed changes to the Real Property Appraiser Qualifications Criteria, March 15th, 2017.
[31] *See* https://www.fdic.gov/news/news/financial/2017/fil17019.html
[32] 58 FR 551 Vol. 58, No. 3 Wednesday, January 6th, 1993. *The Appraisal Subcommittee; Interim Order Granting Commonwealth of the Northern Mariana Islands Emergency Temporary Waiver Relief and Request for Comments.*

substantive and detailed guidance related to the waiver option under Title XI, in addition to exploring further options for relief from appraisal requirements.

Implementation of a Loan Basket Program Would Provide Relief to Community Banks

State regulators recommend that the agencies employ an approach like what was implemented through the *Interagency Policy Statement on Documentation for Loans to Small and Medium-sized Businesses and Farms*, or what is commonly referred to as having a "loan basket."[33] Through the program, well or adequately capitalized institutions with a satisfactory supervisory rating are permitted to identify a portion of their portfolio of small and medium sized business and farm loans, and those loans are exempt from examiner criticism of documentation. Applying the "loan basket" policy to a portion of residential mortgage loans held in portfolio would present significant regulatory burden for smaller and less complex institutions that make and retain a small number of residential mortgage loans. This would significantly streamline the home purchase process, especially for markets with an appraiser shortage, with little cost to safety and soundness.

Re-Evaluating the Use of the Herfindahl-Hirschman Index Serves Consumer Preference in Local Markets

State supervisors continue to observe how the Herfindahl-Hirschman Index (HHI), employed in evaluations of market concentration, may not accurately represent market competitiveness, leading to out of market acquisition and entry of competitors unfamiliar with local consumers. This topic was heavily discussed at the Federal Reserve Bank of Kansas City EGRPRA Outreach meeting, but not substantively addressed in the final EGRPRA Report to Congress.

The HHI serves as the principle measure of market concentration used by federal banking regulators, and its efficacy is highly dependent upon both the definition of the market and the products or services considered in determining market share. Unless specified on a case-by-case basis, non-depositories' market influence is not factored into HHI calculations, and credit union deposits must fulfill specific conditions to be included, albeit often at a lower weight.[34] The *CSBS 2016 National Survey of Community Banks* data indicated that credit unions present significant competitive pressure in local markets, [35] and credit union market presence continues

[33] *See* https://www.fdic.gov/regulations/laws/rules/5000-3400.html. Federal Deposit Insurance Corporation. Interagency Policy Statement on Documentation for Loans

[34] *See*: https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm#faq16 . Credit unions are typically included in these calculations if two conditions are met: (1) the field of membership includes all, or almost all, of the market population, and (2) the credit union's branches are easily accessible to the public. In such instances, a credit union's deposits will generally be given 50 percent weight. Commercial bank deposits are weighted at 100 percent, and deposits of thrifts are weighted at 50 percent. Thrifts may receive 100 percent weight under certain conditions.

[35] *See* https://www.communitybanking.org/~/media/d217da4200ab482a868c9d9cdc8dbccc.ashx. Conference of State Bank Supervisors, *Community Banking in the 21st Century* (2016). 52.2 percent of community bankers perceive credit unions as the biggest current competitors in the consumer lending space, and 49.6 percent of

to grow.[36] Additionally, in many markets where agricultural lending is the dominant industry, the Farm Credit System (FCS) presents significant competition – in fact, survey data indicates that the FCS exerts the most competitive pressure on community banks in those specific markets.[37] However, because the FCS is comprised of non-depository lenders,[38] it is left out of competitive analyses, despite holding 40% of total farm credit market share.

In other words, the current use of the HHI may inaccurately portray local markets as more concentrated and less competitive, because only those deposits reported by depository institutions are considered. We have seen cases where a high HHI figure -- indicative of a noncompetitive market -- tends to be followed by a decrease in banking concentration, often through out-of-market acquisition or entry of a competitor unfamiliar with the local market.[39] This highlights the importance of meaningful HHI calculations – if a banking market's competitiveness is portrayed inaccurately, consumer needs may be ill-served by eventual market entry of a large, deposit holding institution.

The HHI's reliance on deposit market-share to determine market concentration is problematic, as credit unions and members of the FCS, despite exerting obvious competitive pressure, are not considered. The Federal Reserve's explanation of the reliance on deposit-level data is that

> "*Deposits are a reasonable indicator of a level of activity or output of a depository institution, because deposit accounts are widely held by consumers and small businesses and are held in combination with other commercial banking products.*"[40]

There are numerous examples of nonbanks that regularly provide services like that of commercial banks, despite a lack of deposit market-share. Because of its reliance on deposits as a proxy for activity, the HHI does not consider the market share of a wide breadth of financial firms, including: specialty lenders in mortgages and credit cards, commercial lending finance companies, accounts receivable finance companies, and money market mutual funds for deposits. As currently employed, the HHI could disadvantage in-market mergers of peer institutions and result in the entry of a large, deposit-gathering branch of a nationwide institution. In-market

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community bankers indicated that credit unions present future competitive pressure regarding consumer loan activity.

[36] *See* https://www.cuna.org/Research-And-Strategy/Credit-Union-Data-And-Statistics/. Credit Union National Association, *Credit Union Data and Statistics* (April 2017). Credit union total memberships grew .4 percent during April of 2017.

[37] *See* https://www.communitybanking.org/~/media/d217da4200ab482a868c9d9cdc8dbccc.ashx. Conference of State Bank Supervisors, *Community Banking in the 21st Century* (2016). 56.3 percent of community bankers experience the greatest current and future competitive pressure from FCS in the agricultural lending space.

[38] The Farm Credit System (FCS) is comprised of retail nonbank lenders referred to as Farm Credit Associations, or FCAs.

[39] *See* http://www.frbsf.org/economic-research/publications/economic-letter/2003/october/good-news-on-twelfth-district-banking-market-concentration/#subhead4. Research from the San Francisco Federal Reserve Bank indicates that when concentration is high enough to begin with, it does tend to be followed by decreases in concentration in the long run; moreover, the higher the initial concentration, the larger the decreases.

[40] *See* https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm

acquisitions better serve consumer preference, as the majority would rather seek financial services from a community bank.[41]

Reform the Consumer Compliance Exam Process, and Bring Transparency to Models & Methodologies

Effective fair lending enforcement is key to ensuring that financial institutions serve the communities in which they operate. State regulators are committed to consumer protection, and the enforcement of federal and state fair lending laws. However, state regulators see a supervisory approach to these issues that lacks transparency, and is more punitive than corrective.

Community banks sometimes experience a "zero tolerance" approach to compliance issues that leaves no opportunity for institutions to correct internal practices, or for examiners to provide guidance and follow-up steps on how to improve compliance. Even if an institution self-reports an issue and takes independent steps to remediate concerns, state regulators have witnessed situations in which banks are subject to unexpected enforcement actions that can persist for years at a time. For compliance examinations to fulfill their purpose and guarantee that institutions are lending to local consumers, state supervisors recommend the following:

- Federal regulators should adopt stringent expectations regarding the duration of exams. Compliance examinations in which fair lending issues are identified can span multiple years from the start of an examination through completion, often resulting in confusion for the institution and an inability to continue normal operations while a compliance issue is further analyzed at the regional office or Washington, D.C.
- Federal regulators should be more transparent regarding fair lending methodologies, namely models and underlying assumptions. We note that the Treasury Report calls on greater regulatory transparency around models and methodologies. Greater transparency of the compliance process will allow institutions to clearly understand the standards and assumptions being used, learn from each examination experience, and develop more effective compliance programs.
- To further this transparency, federal regulators should define what constitutes a pattern or practice when determining if compliance-related violations exist in a dataset. State regulators are concerned that federal regulators' interpretation of ECOA's referral provisions has the effect of automatically transforming a single occurrence or a very small set of occurrences into a "pattern or practice."
- Additionally, a regulatory review process (like that of the EGRPRA process) should be implemented to ensure that community banks are not held to a higher standard than larger institutions.

For institutions to meet market demand for credit, industry must have insight into what regulatory expectations are, and how they work. A lack of information can discourage lending –

[41] *See*: https://www.bancvue.com/custom/bancvue/pdf/CBI_Executive_Summary-KBV-2015.pdf. BancVue, *2015 Consumer Insights Study* (2015). Per the 2015 Consumer Banking Insights Study, if everything were equal, 66 percent of U.S. adults would rather bank at a community bank or credit union than a larger competitor.

without an understanding of what constitutes a compliance violation, banks may be reluctant to expand lending volume, limiting economic growth.

Modernize the Bank Service Company Act (BSCA) to Continue Legacy of Community Bank Innovation

Community banks have innovated to meet customer needs with great success, delivering financial services that have stimulated economic growth, oftentimes through partnership with technology service providers (TSPs). To support this innovation and to ensure that we, as bank regulators effectively carry out our supervisory responsibilities, effective oversight of these third parties is crucial.

State regulators have authority under state law to examine bank TSPs, and have gained valuable experience in observing how third party relationships affect local banks and consumers. Federal banking regulators' authorities are set out, primarily, in the Bank Service Company Act (BSCA).[42] However, the BSCA contains no reference to state regulators, complicating the supervisory process for third-party service providers who work with state-chartered banks. While the BSCA does not bar state regulators from participating in exams with federal regulators, the law's failure to include state regulators has been interpreted as a barrier to information sharing and regulatory coordination. As a result:

- Federal and state banking regulators are not fully able to share information encompassing vital areas of how banks should conduct their business; and
- Because of this information gap, state and federal regulators encounter challenges in coordinating TSP exams, resulting in duplicative and inefficient supervision.

State supervisors urge Congress to amend the BSCA to include state supervisors, who are well-positioned to understand how TSP relationships affect local banking relationships. Allowing states to supervise the local effects of innovation will not only strengthen industry accountability, but also tailor product innovation to local markets. Amending the BSCA to clearly and explicitly synchronize the authorities of state and federal regulators on TSP exams will enhance coordination, improve information security, and reduce burden on both the regulators and the industry, promoting economic growth.

Without the Perspective of State Supervisors, the National Policy Process Is Incomplete

State supervisors contribute a practical and locally accountable perspective to the development of federal rulemaking and supervisory processes. Given that state regulators are involved in supervising each segment of the financial services industry, a key priority for state regulators has been to ensure state supervisory representation at every level within federal banking agencies. Since 2006, state banking regulators have been voting members of the FFIEC. Additionally, state banking regulators have been non-voting members of the Financial Stability Oversight Council (FSOC) since its creation.

[42] 12 U.S.C. 1867

The Federal Deposit Insurance Act has long required that one member of the FDIC Board have state bank supervisory experience – in other words, at least one member of the FDIC Board must have worked as a state official supervising banks.[43] The legislative history surrounding this provision clearly shows that this requirement calls for an individual who worked in state government supervising banks. State regulators are concerned that the composition of the FDIC Board has not met this requirement for several years and have sought legislation clarifying the language of the Federal Deposit Insurance Act to ensure that this requirement is met. State regulators urge the Administration to follow the letter and spirit of the law in filling vacancies on the FDIC Board.

Additionally, CSBS worked with Congress recently to make a change to the Federal Reserve Act requiring that at least one member of the Federal Reserve Board of Governors have experience working in or supervising community banks.[44]

A recurring theme in the Treasury Report is the importance of improving regulatory coordination. The dual banking system is premised on state-federal coordination and on the benefits for regulators and industry of efficient regulatory coordination. Federal policy tends to address issues found throughout the entire banking industry, while state supervisors bring a more local perspective and local accountability for economic growth. To achieve this regulatory balance, CSBS recommends that the Administration consider individuals who understand the impact that Washington decisions have at the local level, and are committed to regulatory coordination in identifying federal banking agency leadership.

State Regulation Continues to Keep Pace with Innovative Financial Services

The state system has served our nation over nearly two centuries, and has remained consistently steadfast through both crises and economic prosperity. State regulation continues to evolve with the financial services space, and state supervisors are actively seeking ways to streamline and modernize supervision. States regulators encourage community banks to share resources to maintain compliance, expand customers' access to products and services, and improve operational efficiency.[45] In addition to encouraging community-based banks to enter shared resource agreements, state regulators are crafting broader initiatives to modernize state supervision.

Introduced in May of 2017, CSBS' Vision 2020 promises that state supervisors will continue to strengthen our financial system by streamlining and simplifying licensing requirements, and harmonizing state supervision of non-banks. Vision 2020 also promises to address both bank and non-bank concerns by addressing de-risking due to regulatory uncertainty, allowing banks to provide services to non-banks, and for banks to easily partner with third party service providers. The states will continue to leverage an on-the-ground perspective to spot emerging risks, support innovation, and encourage coordination with federal regulators. As part

[43] USC 12 1812(a)

[44] 12 USC § 241

[45] *See* https://www.csbs.org/news/presentations/annualreports/Documents/Shared%20Resource%20Arrangements%20Whitepaper%20FINAL.pdf Conference of State Bank Supervisors, *Shared Resource Arrangements: An Alternative to Consolidation* (2016).

of Vision 2020, state regulators will collaborate with industry and gain insight into points of friction in licensing and multi-state regulation. However, for the local economies that comprise our national community to thrive, the burden of federal regulation on smaller institutions must be addressed.

Conclusion

Myself and the state regulators I represent appreciate the opportunity to present issues of importance to local credit communities. Community banks are vital to the economic health of local markets that are too often excluded from the federal policy development process.

The perspective of the states offers a nuanced, specific approach to policy. Although macro approaches to issues that affect the entire banking market are necessary, they simply cannot function if they do not take smaller and less-complex banks, which comprise most our country's institutions, into account.

Thank you for your time and continued attention.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JEROME H. POWELL

Q.1. Governor Powell, in a speech in April, and echoed in your written testimony for this hearing, you have suggested changes that "allow boards of directors and management to spend a smaller portion of their time on technical compliance exercises and more time focusing on the activities that support sustainable economic growth." The issues at Wells Fargo seem to indicate that bank boards do need to play a more active oversight role, and compliance is especially important to ensure that activities aren't happening in the bank that can cause consumer, employee and reputational harm.

Do you think the lesson from the Wells Fargo episode is that the Board should have been less involved in Bank oversight?

A.1. The Federal Reserve Board (Board) strongly agrees with your assertion that boards need to play an active role in bank oversight. As supervisors, we need to refocus our expectations to redirect boards' time and attention toward fulfilling their core responsibilities, including oversight of bank compliance.

In my April speech, the reference to "technical compliance" exercises was a recognition that over the years, the Board has issued supervisory guidance that in the aggregate include hundreds of expectations for boards and senior management concerning a broad range of topics. Some of these expectations are outdated or redundant, some are overly prescriptive or improperly focused, and many fail to differentiate between the roles of boards and senior management.

Consequently, many boards feel compelled to devote a significant amount of time to satisfying these expectations rather than focusing on their core responsibilities, such as guiding the development of a firm's strategy and risk appetite, overseeing senior management and holding them accountable, supporting the stature and independence of the independent risk management and internal audit functions, and adopting effective governance practices.

To that end, the Board recently proposed new guidance for large financial institutions, such as Wells Fargo, identifying the key attributes of effective boards of directors, and more clearly distinguish between the roles and responsibilities of boards and senior management. In particular, the proposal emphasizes a board's responsibility to hold senior management accountable for, among other things, adhering to the firm's strategy and risk appetite and remediating material or persistent deficiencies in risk management and control practices. The Board also proposed to eliminate or revise supervisory expectations for boards included in certain existing Board Supervision and Regulation letters to ensure that guidance is aligned with the Board's current consolidated supervisory frameworks for both smaller and larger firms.

Q.2. The Treasury Report released on June 12 recommended that the FDIC be removed from the process to approve banks' living wills. Governor Powell, do you believe that the FDIC should remain part of the process?

A.2. I do. The Board and Federal Deposit Insurance Corporation (FDIC) have developed a strong and productive working relationship in their oversight of the living will process. Each agency has made important contributions and brought relevant experience to the process. The FDIC is the agency that acts as the receiver, or liquidating agent, for failed federally insured depository institutions and that perspective has been highly valuable to the process.

Q.3. A working paper by Federal Reserve Board economists concluded that "optimal [tier 1] bank capital levels in the United States range from just over 13 percent to over 26 percent [relative to risk-weighted assets]." Current capital ratios for the largest U.S. GSIBs are between 8 and 11.5 percent. In your oral testimony, you said:

> Higher capital requirements increase bank costs, and at least some of those costs will be passed along to bank customers and shareholders. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth through the cycle. Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through-the-cycle credit availability, and economic growth. And to accomplish that goal, it is essential that we protect the core elements of these reforms for our most systemic firms in capital, liquidity, stress testing, and resolution.

To get optimal results, it seems that capital requirements should be increased further. Do you agree?

A.3. No. I do not believe that current capital requirements are too low. I believe that the combination of bank capital standards and stress tests has raised overall levels of capital to appropriately high levels. Capital requirements are one of the strongest prudential tools available for maintaining a stable financial system, although there is a tradeoff between the increased resiliency arising from higher levels of bank capital and the associated increase in costs, some of which are passed along to bank customers and shareholders. The paper referenced in the question attempts to estimate the costs and benefits associated with various capital levels but many assumptions are required of the analysis. Changes to the assumptions could result in either higher or lower levels of optimal bank capital. The paper is a staff working paper that does not represent the views of other Federal Reserve staff or the Board.

Through various post-crisis reforms, including strengthened regulatory capital rules that improved the quality and quantity of regulatory capital as well as supervisory stress testing, regulatory capital at large banks is at its highest level in decades. Additionally, the largest and most complex U.S. and foreign banks are required to maintain sufficient amounts of long-term debt, which can be converted to equity during resolution, thereby further increasing their loss absorbing capacity. The 2017 supervisory stress test projections suggest that, in the aggregate, the U.S. banks subject to the stress test would experience substantial losses under a hypothetical stress scenario but could continue lending to businesses and house-

holds. This speaks to the resiliency of the current U.S. regulatory regime and financial system.

Q.4. As a response to questions from several senators you said that you support changes to the Volcker rule. That said, the Treasury Report recommends changes to the Volcker Rule and changes to capital and liquidity requirements, stress tests, and other enhanced prudential standards. What would be the impact on financial stability if changes were made to weaken both rules to limit proprietary trading in bank holding companies and enhanced prudential standards, including capital and liquidity rules, stress tests, and others, applicable to the largest bank holding companies?

A.4. Material weakening of the post-crisis regulatory framework would not support a strong and stable banking system or economy. However, there may be some targeted changes to streamline regulations and reduce burdens that can be made without compromising the underlying goals and benefits of the regulations. For example, the Board is pursuing further tailoring of regulations, including the Volker Rule and capital regulations, to reduce burdens for smaller firms while maintaining the benefits of the regulations for U.S. financial stability and safety and soundness.

The Volcker Rule seeks to prevent financial institutions with access to the Federal safety net—FDIC insurance and the Board discount window—from engaging in proprietary trading and to limit their ability to invest in hedge funds and private equity funds. The goal of capital and liquidity regulation is to ensure the safety and soundness of the banking system and to protect financial stability for the whole economy. The crisis revealed that the pre-crisis capital and liquidity regulatory framework was insufficient. The regulatory changes to this framework that have been made post-crisis are critical to the safety and soundness of the financial system as well as broader financial stability.

Q.5. This week, the House approved the FY 2018 Financial Services and General Government Appropriations bill. Included in this bill is the provision from the CHOICE Act to bring all independent financial regulatory agencies' budgets under the appropriations process. What would be the impact on the Federal Reserve System if its budget for nonmonetary policy activities were appropriated?

A.5. The impact of this change could be quite serious. Congress wisely led the way in establishing political independence as a cornerstone of central bank independence.

The Board should be and is accountable to the American people and their elected representatives. The Board is a prudent steward of taxpayer resources, and is transparent about our operations.

The Board's monetary policy, supervisory, and financial stability functions have always been closely connected and have become even more tightly connected following the financial crisis. Robust supervisory and financial stability programs, with steady and reliable funding, are a crucial support for the Board's monetary policymaking. During the financial crisis, the deep knowledge and expertise of banking supervisors was critical to the Board's efforts to assess and address the challenges facing the financial system. Our examiners at the major banking firms, coupled with extensive data collection, provide critical insights relevant to the judgments of

policymakers on many questions that are extremely important in the conduct of monetary policy, such as the assessment of overall conditions in credit markets, evidence of imbalances in particular sectors or markets, signs of emerging liquidity pressures or indications of a withdrawal from risk-taking. Accurate and early readings on such issues are very useful to the Board in determining the appropriate stance of monetary policy.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM JEROME H. POWELL

Q.1. Some have called for the FDIC to be removed from the living will process. Do you believe the FDIC should be removed from this process?

A.1. The Federal Reserve Board (Board) does not support removing the Federal Deposit Insurance Corporation (FDIC) from the living will process. The Board and FDIC have developed a strong and productive working relationship in their oversight of the living will process. Each agency has made important contributions and brought relevant experience to the process. The FDIC is the agency that acts as the receiver, or liquidating agent, for failed federally insured depository institutions and that perspective has been highly valuable to the process.

Q.2. Many of us have come to recognize that the Orderly Liquidation Authority is an incredibly important part of the Wall Street Reform and Consumer Protection Act. Could you please explain in plain terms why OLA is so important?

A.2. A key lesson we learned from the financial crisis was that we needed a better way to deal with a large financial firm that fails. In the crisis, Government authorities were faced with the choice between a Government bailout of a failing large financial firm (for example, AIG), or a chaotic and disorderly collapse of the firm (for example, Lehman Brothers). The Orderly Liquidation Authority (OLA) in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides the Government with a workable framework for the orderly resolution of a large financial firm that fails—thus reducing the need for Government bailouts in any future financial crisis.

OLA has a number of key strengths as a resolution regime. First, it allows the FDIC, as resolution authority, to move quickly to reorganize the failed firm and prevent a disorderly unraveling of the financial contracts of the failed firm. Second, it enables tire FDIC to coordinate effectively with tire foreign regulators of the cross-border operations of the failed firm. Third, it allows tire FDIC to provide temporary funding to stabilize the failed firm's operations if necessary. Critically, it does not allow for Government capital injections and requires that taxpayers suffer no losses from the resolution.

The primary beneficiary of an OLA resolution would be the U.S. financial system and, by extension, taxpayers. In an OLA resolution, the shareholders of the failed firm would bear full losses. Long-term creditors of the failed firm would bear any additional losses. But there would be mechanisms to minimize excessive

shocks to the financial system and the economy that could negatively impact Main Street. Market discipline would be maintained and taxpayers protected.

Bankruptcy should be the preferred route for a failing firm. We have made great strides through the living will process to make our largest banking firms easier to resolve under the traditional bankruptcy code. However, given the uncertainties around how financial crises unfold, it is prudent to keep OLA as a backstop resolution framework.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM JEROME H. POWELL

Q.1. Chair Gruenberg and Governor Powell, you've both talked about the Volcker Rule and the complexity that comes along with this rule. And in the past, Comptroller Curry had suggested that we could exempt community banks entirely. After having conversations with many of my community banks I agree with Mr. Curry and believe they should be entirely exempt from Volcker Rule compliance. Following these lines, I have introduced a bill with Senator Moran that would exempt community banks with less than $10 billion from compliance.

Q.1.a. Is this a bill that both the FDIC and the Federal Reserve would support at this juncture?

Q.1.b. Does eliminating the Volcker Rule for banks with less than $10 billion pose any real risk to our financial system?

Q.1.c. Absent Congress passing legislation related to the Volcker Rule, does the FDIC or the Federal Reserve have any plans to make any changes on their own to the Volcker Rule?

A.1.a.–c. The Volcker Rule is an area where relief for smaller institutions would be helpful. The risks identified by the Volcker Rule exist almost exclusively in larger financial institutions. Community banks rarely engage in any of the activities prohibited by the Volcker Rule.[1] Accordingly, the Federal Reserve Board (Board) supports exempting community banks with total consolidated assets of less than $10 billion from the statutory provisions. Moreover, in the event where the trading or investment funds activity of a community bank might raise concerns that could be addressed through our normal examination process.

As part of the rules implementing the Volcker Rule, the agencies charged with implementing that statutory provision endeavored to minimize compliance burdens for banking entities by reducing the compliance program and reporting requirements applicable to banking entities with $10 billion or less in total consolidated assets. This was based in part on information that indicated that banking entities of this size generally have little or no involvement in prohibited proprietary trading or investment activities in covered funds. Exempting banking entities of this size from the Volcker Rule would provide relief for thousands of community banks that incur ongoing compliance costs simply to confirm that their activities and investments are indeed exempt from the

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[1] See The Volcker Rule: Community Bank Applicability (Dec. 10, 2013), available at: *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a4.pdf.*

statute. At the same time, an exemption at this level of assets would not be likely to increase risks to U.S. financial stability. The vast majority of activity and investment that the Volcker Rule addresses takes place at the largest and most complex financial firms, whose failure could have a significant effect on the stability of the financial system. Moreover, even with an exemption, the Federal banking agencies could continue to use existing prudential authority to address unsafe and unsound practices at a community bank that engaged in imprudent trading or investment activities.

The Board is working with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodity Futures Trading Commission, and the Securities and Exchange Commission to identify areas of the implementing regulations that could be simplified. The core premise of the Volcker Rule is relatively straightforward: that financial institutions with access to the Federal safety net—Federal Deposit Insurance Corporation insurance and the Board's discount window—should not engage in proprietary trading. The Volcker Rule's statutory provisions, however, are complex, which has led to a complex rule. There are some ways to streamline and simplify the Volcker Rule while adhering to the underlying goals. For example, the Volcker Rule could be focused on larger banks that engage in more material trading activities. Supervisors have taken some steps to mitigate compliance burdens for smaller firms, but a change to the law to exempt smaller firms would be a cleaner and more comprehensive way to reduce burdens for smaller firms. Even without a statutory change, there may be ways to streamline and simplify the interagency Volcker Rule regulation to reduce burdens without sacrificing key objectives, and the Board is exploring possibilities.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JEROME H. POWELL

Each of you serve at agencies that are members of the Financial Stability Oversight Council (FSOC). Insurance has been regulated at the State level for over 150 years—it's a system that works. But FSOC designations of nonbank systemically important financial institutions (SIFIs) have made all of you insurance regulators, despite the fact that you are bank regulators at your core.

Strong market incentives exist for insurers to hold sufficient capital to make distress unlikely and to achieve high ratings from financial rating agencies, including incentives provided by risk sensitive demand of contract holders and the potential loss of firms' intangible assets that financial distress would entail. Additionally, insurance companies are required by law to hold high levels of capital in order to meet their obligations to policyholders. Bottom line: Insurance companies aren't banks, and shouldn't be treated as such.

In March, my colleagues and I on the Senate Banking Committee sent a letter to Treasury Secretary Mnuchin indicating our concerns regarding the FSOC's designation process for nonbanks. I support efforts to eliminate the designation process completely.

I was pleased that President Trump issued a "Presidential Memorandum for the Secretary of the Treasury on the Financial

Stability Oversight Council" (FSOC Memorandum) on April 21, 2017, which directs the Treasury Department to conduct a thorough review of the designation process and states there will be no new nonbank SIFI designations by the FSOC until the report is issued. Relevant decisionmakers should have the benefit of the findings and recommendations of the Treasury report as they carry out their responsibilities with respect to FSOC matters.

Please answer the following with specificity:

Q.1. What insurance expertise do you and your respective regulator possess when it comes to your role overseeing the business of insurance at FSOC?

A.1. The Federal Reserve System contains a significant amount of insurance expertise and resources with prior experience in the insurance industry. Staff who participate in the development of policy concerning and supervision of insurance companies subject to Federal Reserve Board (Board) supervision include former State insurance regulators, practitioners from insurance advisory services, catastrophe modeling specialists, and analysts from credit rating agencies that cover insurance companies, as well as life and property/casualty actuaries and accountants versed in U.S. Statutory Accounting Principles.

In its consolidated supervision of insurance firms, the Board remains committed to tailoring its supervisory approach to the business of insurance. The Board's supervisory program, complementary to and in coordination with the States in their protection of policyholders, continues to be tailored to consider the unique characteristics of the firms and their insurance operations.

Board principals at the Financial Stability Oversight Council (FSOC) are briefed by these experts, or senior staff that oversee them, in advance of FSOC discussions on insurance matters.

Q.2. Do you support the Senate Banking Committee's recent legislative effort, the Financial Stability Oversight Council Insurance Member Continuity Act, to ensure that there is insurance expertise on the Council in the event that the term of the current FSOC independent insurance member expires without a replacement having been confirmed?

A.2. The independent member with insurance expertise has provided important contributions to the work of the Council. However, membership in the Council is a matter for Congress to decide.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COTTON FROM JEROME H. POWELL

Q.1. President Trump issued an Executive order in February establishing Core Principles for Regulating the United States Financial System. One of the principles is to prevent taxpayer-funded bailouts. Presumably that includes considering what could cause a disruption to the financial system. One potential cause is a requirement that banks publicly publish granular details of a complex liquidity regulatory metric called the Liquidity Coverage Ratio (LCR). Regulators already receive information daily to monitor a firm's liquidity position, but now the Fed is requiring banks to

publicly disclose these complex and technical liquidity details. If misunderstood, the disclosure could destabilize markets.

How is this requirement in keeping with the President's core principles? And how will the Fed manage through the next financial crisis and get banks to meet the funding needs of households and small business when meeting such needs will hurt banks' LCR?

A.1. The purpose of the Liquidity Coverage Ratio (LCR) public disclosure requirements is to provide market participants broad information about the liquidity risk profile of large banking organizations to support market discipline and encourage covered companies to take adequate steps to appropriately manage their liquidity positions. In addition, during times of stress, public disclosures can enhance stability by providing relevant information about firms. Without information about the liquidity strength of their counterparties, market participants may assume the worst about their counterparties and draw back from the market, exacerbating the problem. Thus, the LCR public disclosure requirements are consistent with enhancing financial stability and the principle of preventing taxpayer-funded bailouts.

To serve this purpose, the information disclosed must be sufficiently informative and timely. In order to mitigate potential financial stability and firm-specific risks related to the disclosure of real-time liquidity information, the LCR public disclosure rule requires covered companies to disclose average values of broad categories of liquidity sources and uses over a quarter, with a 45-day lag after the end of the quarter. In addition, as part of its LCR disclosures, a covered company is required to disclose a qualitative discussion of its LCR results to facilitate the public's understanding of its liquidity risk profile and ensure that the LCR disclosures are not misunderstood by the public. The Federal Reserve Board (Board) will carefully monitor the implementation of these requirements going forward. If warranted, I would be willing to revisit aspects of the LCR disclosures that result in significant undesirable or unintended consequences.

The LCR rule is designed to ensure that large banking organizations can withstand idiosyncratic or market liquidity stress without pulling back from meeting the funding needs of households and small business or resorting to fire sales of illiquid assets. The LCR rule requires covered companies to hold a minimum amount of high quality liquid assets to meet outflows over a 30-day stress scenario. It encourages banking organizations to fund extensions of credit with longer term debt or relatively stable deposits rather than short-term wholesale funding. In addition, the calibration of the LCR rule treats transactions with retail clients and wholesale counterparties favorably relative to transactions with financial sector entities. Importantly, the LCR rule is designed to allow banking organizations to use high quality liquid assets when needed to meet liquidity stresses and does not require a company to reduce lending if it depletes its liquid assets.

A company must notify its supervisor when it has an LCR shortfall, and the supervisor will monitor and respond appropriately to the unique circumstances that are giving rise to the company's shortfall.

Q.2. How do the required data points for Liquidity Coverage Ratio (LCR) disclosure compare in both quantity and granularity to other mandatory public disclosures?

A.2. Consistent with the Board's longstanding commitment to public disclosure, firms are required to provide the public with various disclosures and reports that provide insight on their financial condition and risk management. The requirements of each report or disclosure are tailored to its purpose.

The LCR public disclosures have quantitative and qualitative risk management components. The quantitative LCR public disclosures are quarterly average amounts of broad categories of sources and uses of liquidity under the LCR rule. The LCR disclosures are contained in one summary level table that includes three categories for a firm's high quality liquid asset holdings, 11 categories of outflows, and 7 categories of inflows, and the covered company's LCR ratio.

The LCR disclosures are less granular than disclosures of borrowing from the Board's discount window, which includes transaction-specific information about a bank's business decision to borrow at the window including the amounts borrowed and the collateral provided to secure each loan.

The LCR public disclosures are both less numerous and less granular than the qualitative and quantitative disclosures that bank holding companies with total assets greater than $50 billion are required to make about their capital adequacy and risk profile.[1] These disclosures address the composition of capital, measures of capital adequacy, and specific information about a range of granular exposure types, such as general credit risk, securitization, equity risk, and interest rate risk. They are described in 10 tables in the regulatory capital rule and typically require quarter-end values rather than quarterly averages. In addition, bank holding companies that must calculate risk-weighted assets for market risk must disclose a range of risk measures for each material portfolio of covered positions on a quarterly basis, as well as more granular information about specific risks and qualitative risk management information.[2]

The LCR public disclosures are also less numerous and less granular than the Board's FR Y–9C Consolidated Financial Statement for Holding Companies, which collects basic financial data and requires firms to provide a balance sheet, an income statement, and detailed supporting schedules.[3] Typically this data is as of quarter-end.

Q.3. The Basel III capital requirements increase the risk-weighting of Mortgage Service Rights (MSR) held by banks from 100 percent to 250 percent. Mortgage servicing is a stable and important revenue stream, especially for smaller banks, and allows banks to preserve a vital customer interface after they have sold the originated mortgage on the secondary market.

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[1] See 12 CFR 213.61. Certain large and internationally active bank holding companies must make the public disclosures described in 13 tables in 12 CFR 217.173.

[2] See 12 CFR217.212.

[3] See *https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDal8cbqnRxZRg==*.

Basel III increases the risk-weighting for MSRs by a factor of 2.5 can you please justify this significant increase in capital required of banks to hold mortgage servicing assets, and detail the methodology used to quantify the risk associated with MSRs?

A.3. The Board recognizes community banks' concerns with respect to the burden and complexity of certain aspects of the U.S. regulatory capital framework, including the current treatment of mortgage servicing assets (MSAs). As described in the report on the review of the Economic Growth and Regulatory Paperwork Reduction Act, the Federal banking agencies are jointly developing a proposal to simplify certain aspects of the regulatory capital framework, including the treatment of MSAs, while maintaining safety and soundness of the banking system.

The Board and the other Federal banking agencies have long limited the inclusion of MSAs in regulatory capital due to the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions. These limitations help protect banks from sudden fluctuations in the value of MSAs and from the inability to quickly divest these assets at their full estimated value during periods of financial stress. In developing the current regulatory capital rule, the Federal banking agencies took into consideration statutory limitations related to MSAs, invited public comment on the proposed regulatory capital treatment of MSAs, and addressed industry comments in the final rule. In addition, the Federal banking agencies considered whether the capital rule appropriately reflects the risk inherent in banking organizations' business models. Prior to issuing the capital rule, the Federal baking agencies conducted a pro-forma economic impact analysis that showed that the vast majority of small banking organizations would meet the rule's minimum capital requirements on a fully phased in basis, including the treatment of MSAs.

A study by the Federal banking agencies, together with the National Credit Union Administration, similarly concluded that MSA valuations are inherently subjective and subject to uncertainty because they rely on assessments of future economic variables (see the July 2016 Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets). The results of the study support a conservative treatment of MSAs for purposes of regulatory capital.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR WARNER FROM JEROME H. POWELL

Q.1. Gov. Powell, there seems to be developing consensus that there are improvements that can be made to the Volcker Rule's implementing rule such that the policy goals of prohibiting proprietary trading are preserved, while potential unintended consequences, such as illiquidity in the fixed income markets, are avoided or minimized. Can you please describe a) whether the Federal Reserve shares this view; and b) how the Federal Reserve may, along with the other four agencies responsible for implementing the Volcker Rule, be approaching this issue to protect taxpayers while minimizing adverse consequences for the markets?

A.1. The core premise of the Volcker Rule is relatively straightforward: that financial institutions with access to the Federal safety net—Federal Deposit Insurance Corporation insurance and the Federal Reserve Board (Board) discount window—should not engage in proprietary trading. The Volcker Rule's statutory provisions, however, are complex, which has led to a complex rule. While many changes to the Volcker Rule would require amendment to the statute, there may be ways to streamline and simplify the interagency Volcker Rule regulation to reduce burdens without sacrificing key objectives. The Board is exploring possibilities and is working with the other agencies.

Q.2. Cybersecurity regulation is receiving increased emphasis by all financial institution regulators. How do your agencies coordinate with each other to harmonize the promulgation of new cybersecurity regulations? With the increased use of the NIST Cybersecurity Framework by both Federal agencies and the private sector, how do your agencies intend to achieve greater alignment between the framework and your own regulatory initiatives?

A.2. The Federal Reserve is an active participant in the Financial and Banking Information Infrastructure Committee (FBIIC),[1] which coordinates efforts to improve the reliability and security of the financial sector infrastructure. Federal Reserve staff chair a harmonization subcommittee of the FBIIC focused on achieving greater harmonization of cyber requirements and examination approaches across FBIIC member entities. We intend to achieve greater alignment with National Institute of Standards and Technology (NIST) by using the subcommittee to map the cybersecurity requirements of the FBIIC member agencies to NIST and analyzing any gaps and differences. The Board also coordinates our examination of cybersecurity risks with the other Federal banking agencies through the Federal Financial Institutions Examination Council (FFIEC).[2] The FFIEC agencies are actively sharing the lessons learned from our individual examinations to promote greater consistency in supervisory practices and to reduce unnecessary regulatory burden on supervised institutions.

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[1] The FBIIC consists of representatives from the Department of the Treasury, American Council of State Savings Supervisors, Commodity Futures Trading Commission, Conference of State Bank Supervisors, Consumer Financial Protection Bureau, Farm Credit Administration, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Federal Reserve Bank of Chicago, Federal Reserve Bank of New York, Federal Reserve Board, National Association of Insurance Commissioners, National Association of State Credit Union Supervisors, National Credit Union Administration, North American Securities Administrators Association, Office of the Comptroller of the Currency, Securities and Exchange Commission, and Securities Investor Protection Corporation.

[2] The FFIEC is an interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, and to make recommendations to promote uniformity in the supervision of financial institutions. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR WARREN FROM JEROME H. POWELL

Q.1. At the hearing, you stated that you did not support changing "risk-based capital" standards for the country's biggest financial institutions. Do you support changing any capital, leverage, or liquidity standards for banks with more than $500 billion in assets? If so, please describe which standards you support modifying and why.

A.1. The safety and soundness of large banks is crucial to the stability of the U.S. financial system. To clarify, I do not support reducing risk-based capital requirements for firms with total consolidated assets of more than $500 billion. The Federal Reserve Board (Board) does review and update its regulations on an ongoing basis to ensure that they are achieving their intended objectives, to address developments in the banking industry, and to limit regulatory burden. In addition, the Board is considering revising certain requirements for firms subject to its Comprehensive Capital Analysis and Review, which would include firms with more than $500 billion in total assets. Specifically, the Board is contemplating ways to better integrate the Board's regulatory capital rule and the capital requirements related to the annual supervisory stress test in a manner that simplifies the Board's overall approach to capital regulation. With respect to other requirements applicable to these firms, the Board also intends to review the current calibration of its enhanced supplementary leverage ratio standards in order to mitigate possible adverse incentives or market distortions that it may create.

Q.2. The common argument in favor of reducing capital standards for large financial institutions is that it will increase lending and economic growth. I am aware of research showing that well-capitalized institutions actually provide more loans than less-well capitalized competitors. Can you provide any empirical research that demonstrates that the opposite is true?

A.2. As stated in my testimony, stronger capital requirements increase bank costs, and at least some of those costs are passed along to customers. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth. Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through the cycle credit availability and economic growth.

Existing economic research provides mixed results regarding the link between bank capital requirements and economic growth. There are studies on both sides of the issue, some suggesting that higher capital levels increase economic growth and others suggesting the opposite. Recent studies focusing on the costs and benefits of bank capital suggest that heightened capital requirements are good for economic growth up to some point, but would have a negative impact on social welfare beyond that point.

While there are several studies which suggest that raising capital standards reduces bank lending, these studies typically do not address the broader impact of capital standards on economic

growth. For example, Furfine[1] analyzes data on large U.S. commercial banks between 1989 and 1997 and concludes that a 1-percentage point increase in capital standards reduces loan growth by 5.5 percent. Berrospide and Edge[2] find a more modest impact. Using U.S. bank holding company data from 1992 to 2009, the authors conclude that a 1-percentage point increase in capital requirements reduces loan growth by roughly 1.2 percentage points. Other studies tell a similar story using non-U.S. data. For instance, Francis and Osborne[3] find, using U.K. data, that a 1-percentage point increase in capital requirements reduces bank lending by approximately 1.2 percent. Finally, Martynova's[4] survey of the literature—mostly of studies using non-U.S. data—shows that an increase in capital requirements by 1 percentage point reduces loan growth by 1.2 to 4.6 percentage points.

There is a growing body of research regarding the costs and benefits of bank capital that addresses the impact of capital standards on economic growth. A number of studies, including the Basel Committee on Banking Supervision,[5] the Bank of England,[6] the Federal Reserve Bank of Minneapolis,[7] and Firestone *et al.*[8] suggest that higher bank capital requirements (up to a point) are good for long-term credit availability and economic growth, and only at levels of capital beyond that point is social welfare decreased. While the optimal level of capital varies between studies, the basic framework is the same.

A variety of assumptions are required of all studies in the literature, and changes to the assumptions could result in either higher or lower levels of optimal bank capital. The current calibration of our risk-based capital requirements for U.S. banks is roughly in line with the optimal level of capital found under a wide range of these studies.

Q.3. You have said that you support providing banks with more "transparency" into the stress test process. The goal of the stress test is to gauge how banks would fare in times of severe economic distress. Historically, the source of that economic distress is unforeseen, as we witnessed during the 2008 crisis. Indeed, the very reason there is economic distress is that banks and regulators have failed to anticipate the source or severity of that distress. In light of that, please explain how it is consistent with the goal of the stress tests to provide banks with more advance knowledge of what kinds of stresses they can expect to face?

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[1] Furfine, Craig (2000). "Evidence on the Response of U.S. Banks to Changes in Capital Requirements." BIS Working Papers No. 88.

[2] Berrospide, Jose M. and Rochelle M. Edge (2010). "The Effects of Bank Capital on Lending: What Do We Know, and What Does It Mean?" Federal Reserve Board Finance and Economics Discussion Series 2010–44.

[3] Francis, William B. and Matthew Osborne (2012). "Capital Requirements and Bank Behavior in the United Kingdom: Are There Lessons for International Capital Standards?" Journal of Banking and Finance, 36, 803–816.

[4] Martynova, Natalya (2015). "Effect of Bank Capital Requirements on Economic Growth: A Survey." DNB Working Paper No. 467.

[5] Basel Committee on Banking Supervision (2010). "An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements."

[6] Brooke, Martin *et al.* (2015). "Measuring the Macroeconomic Costs and Benefits of Higher U.K. Bank Capital Requirements." Bank of England Financial Stability Paper No. 35.

[7] Federal Reserve Bank of Minneapolis (2016). "The Minneapolis Plan to End Too Big To Fail."

[8] Firestone, Simon, Amy Lorenc, and Ben Ranish (2017). "An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the United States." Federal Reserve Board Finance and Economics Discussion Series 2017–034.

A.3. Capital stress tests, which play a critical role in bolstering confidence in the capital position of the U.S. firms in the wake of the financial crisis, have become one of the most important features of our supervisory program in the post-crisis era. Stress tests better ensure that large firms have sufficient capital to continue lending through periods of economic stress and market turbulences, and that they are sufficiently capitalized for their risk profile.

The Board's annual Comprehensive Capital Analysis and Review, or CCAR, is the binding capital constraint for many of the largest firms, and their concerns about transparency are warranted. The Board has made a wide variety of information available about our stress testing process, and is committed to finding ways to safely enhance the transparency of that process. However, because of the concerns you raise in your question and other issues discussed below, we have not disclosed the full details of our stress testing models, nor have we provided firms with our stress scenarios in advance of the stress testing cycle.

One implication of releasing all details of the models is that firms could use them to guide modifications to their businesses that change the results of the stress test without changing the risks faced by the firms; that is, full disclosure could encourage firms to "manage to the test." In the presence of such behavior, the stress test could give a misleading picture of the actual vulnerabilities faced by firms. Further, such behavior could increase correlations in asset holdings among the largest banks, making the financial system more vulnerable to adverse financial shocks. Another implication is that full model disclosure could incent banks to simply use models similar to the Board's, rather than build their own capacity to identify, measure, and manage risk. That convergence to the Board's model would create a "model monoculture," in which all firms have similar internal stress testing models which may miss key idiosyncratic risks faced by the firms.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM JEROME H. POWELL

Q.1. I'm a proponent of tailoring regulations based off of the risk profiles of financial institutions, as opposed to having strict asset thresholds that do not represent what I believe is the smart way to regulate. But, my question here is really about the importance of ensuring that we have a system that is rooted in fundamental, analytical, thoughtful regulation so that we can achieve and execute on goals, whether balancing safety and soundness with lending and growth, or encouraging more private capital in the mortgage market to protect taxpayers and reform the GSEs.

Q.1.a. Do you think that we should use asset thresholds as a way to regulate—yes or no? If no, can you provide me with the metrics or factors by which a depository institution should be evaluated? If yes, please explain.

Q.1.b. Section 165 of Dodd-Frank requires enhanced supervision and prudential standards for banks with assets over $50 billion. This applies to any bank that crosses the asset threshold, without regard to the risks those banks pose based upon the complexity of

the business model. This includes heightened standards on liquidity and capital under the Liquidity Coverage Ratio (LCR) and the Comprehensive Capital Analysis and Review (CCAR) which have a various assumptions built in that may drive business model.

i. I understand under these two regulatory regimes, banks have changed certain lending behaviors because of the assumptions Federal regulators have made regarding certain classes of assets and deposits. Can you provide some examples of how the LCR and CCAR have changed the types of loans, lending, and deposits your institution holds?

ii. Construction lending by banks over the $50 billion threshold has been a source of concern, namely because these enhanced prudential standards have treated construction loans punitively. This includes construction lending for builders of apartments, warehouses, strip malls, and other projects that may have varying risk profiles associated with them. However, under the CCAR and DFAST assumptions, the regulators have assigned all these categories of lending the same capital requirements. The result is an overly broad capital requirement for varying loans that have different risks, a capital requirement that may be greater for some loans and lower for others, influencing the decision of many banks over the $50 billion threshold to hold less of these assets due to the punitive capital requirements associated with them. Have you seen a similar corresponding issue with construction loans because of the heightened prudential standards?

iii. Under the CCAR regulations, Federal regulators routinely assign risk weights to certain assets that Bank Holding Companies have on their balance sheets. These risk weights often time changes the costs associated with holding certain investments, such as Commercial Real Estate. Has this changed the type of assets that institutions hold, or caused institutions to alter their business plans because of the regulatory capital costs? If so, can you provide examples of this?

iv. Do you think that regulators, on a general basis, get the risks weights right?

v. Fed Governor Tarullo, has argued that the $50 BB threshold is too low in terms of an asset threshold for enhanced prudential standards; does this number make sense? Why do we need such arbitrary thresholds? Shouldn't we get away from these thresholds and move toward a regulatory system that evaluates substance and activities of an institution as opposed to an arbitrary number? Why can't we do that?

- Does Title I allow the Fed to treat a $51 BB bank in a similar manner to a $49 BB bank for the purposes of enhanced prudential standards?

A.1. In all of our efforts, our goal is to establish a regulatory framework that helps ensure the resiliency of our financial system, the availability of credit, economic growth, and financial market efficiency. The Federal Reserve has been working for many years to make sure that our regulation and supervision is tailored to the size and risk posed by individual institutions.

The failure or distress of a large bank can harm the U.S. economy. The recent financial crisis demonstrated that excessive risk-taking at large banks makes the U.S. economy vulnerable. The crisis led to a deep recession and the loss of nearly nine million jobs. Our regulatory framework must reduce the risk that bank failures or distress will have such a harmful impact on economic growth in the future.

The Federal Reserve Board (Board) has already implemented, via a regulation that was proposed and adopted following a period of public notice and comment, a methodology to identify global systemically important banking organizations (GSIBs), whose failure could pose a significant risk to the financial stability of the United States.[1] The "systemic footprint" measure, which determines whether a large firm is identified as a GSIB, includes attributes that serve as proxies for the firm's systemic importance across a number of categories: size, interconnectedness, complexity, cross-jurisdictional activity, substitutability, and reliance on short-term wholesale funding.

There are many large financial firms whose failure would pose a less significant risk to U.S. financial stability, but whose distress could nonetheless cause notable harm to the U.S. economy (*i.e.,* large regional banks). The failure or distress of a large regional bank could harm the U.S. economy in several ways: by disrupting the flow of credit to households and businesses, by disrupting the functioning of financial markets, or by interrupting the provision of critical financial services, including payments, clearing, and settlement. Economic research has documented that a disruption in the flow of credit through banks or a disruption to financial market functioning can affect economic growth.[2] Some level of tailored enhanced regulation is therefore appropriate for these large regional banks.

The application of tailored enhanced regulation should consider the size, complexity, and business models of large regional banks. The impact on economic growth of a large regional bank's failure will depend on factors such as the size and geographic distribution of the bank's customer base and the types and number of borrowers that depend on the bank for credit. Asset size is a simple way to proxy for these impacts, although other measures may also be appropriate. For large regional banks with more complex business models, more sophisticated supervisory and regulatory tools may be appropriate. For example, the Board recently tailored our Comprehensive Capital Analysis and Review (CCAR) qualitative assessment to exclude some smaller and less complex large regional banks, using asset size and nonbank assets to measure size and complexity, respectively.[3] In other contexts, foreign activity or

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[1] Board of Governors of the Federal Reserve System (2015), "Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies," final rule, Federal Register, vol 80 (August 14), pp. 49082–49116.

[2] For evidence on the link between bank distress and economic growth, see Mark A. Carlson, Thomas King, and Kurt Lewis (2011) "Distress in the Financial Sector and Economic Activity," The B.E. Journal of Economic Analysis & Policy: Vol. 11: Iss. 1 (Contributions), Article 35. For evidence on the link between financial market functioning and economic growth, see Simon Gilchrist and Egon Zakrajsek (2012), "Credit Spreads and Business Cycle Fluctuations," American Economic Review, Vol. 102 (4): 1692–1720.

[3] Board of Governors of the Federal Reserve System (2017), "Amendments to the Capital Plan and Stress Test Rules; Regulations Y and YY," final rule, Federal Register, vol 82 (February 3), pp. 9308–9330.

short-term wholesale funding may be another dimension of complexity to consider. Any characteristics or measures that are used to tailor enhanced regulation for large regional banks should be supported with clear analysis that links them with the potential for the bank's failure or distress to cause notable harm to the U.S. economy.

The Board currently has only limited authority to tailor the enhanced prudential standards included in section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In particular, Congress required that certain enhanced prudential standards must apply to firms with $10 billion in total assets, with other standards beginning to apply at $50 billion in total assets.

I understand that Congress is currently considering whether and how to raise these statutory thresholds. The Board has supported increasing these thresholds. As an alternative to simply raising the thresholds, your question asks whether Congress should move away from an asset-size threshold. As my answer above noted, I believe that it would be logical to use a wider range of factors than asset size to determine the application of tailored enhanced regulation for large regional banks. The Board stands ready to work with Members of Congress to pursue either approach: raising the dollar thresholds, or providing for the Federal Reserve to decide which firms are subject to enhanced prudential standards.

Several parts of your question concern the impact of enhanced prudential standards, including the liquidity coverage ratio (LCR) and CCAR, on commercial real estate lending at banks with assets greater than $50 billion. A recent study that evaluates pre-and post-crisis lending by large bank holding companies above and below the $50 billion asset threshold found no noticeable difference in commercial real estate loan growth since the implementation of enhanced prudential standards.[4] Commercial real estate lending has consistently grown faster at the smaller banks all the way back to 2001, perhaps reflecting a structural competitive advantage held by smaller banks. In addition, the study notes that banks' lending standards for commercial real estate loans, as measured by the Federal Reserve's Senior Loan Officer Opinion Survey, are similar for banks above and below the $50 billion threshold.[5]

More broadly, post-crisis reforms to the supervision and regulation of the large banks were informed by the substantial body of research that has reached a consensus indicating that well-capitalized banks with strong liquidity positions are best able to support sustainable lending to creditworthy borrowers through the full business cycle. Indeed, overall bank lending has remained robust since post-crisis reforms began to be phased in—bank lending grew significantly faster than nominal GDP between 2013 and 2016.[6] As such, the strong capital and liquidity positions of U.S. banks could

[4] See Figure 6 from Cindy M. Vojtech (2017), "Post-Crisis Lending by Large Bank Holding Companies," FEDS Notes, Washington: Board of Governors of the Federal Reserve System, July 6, 2017. *https://www.federalreserve.gov/econres/notes/feds-notes/post-crisis-lending-by-large-bank-holding-companies-20170706.htm.*

[5] See Figure 7 from Vojtech (2017).

[6] See, Vojtech (2017).

be said to have contributed to a stronger recovery from the financial crisis in the United States compared with other countries.

That said, it is difficult to isolate the effect that specific regulations have had on banks' business decisions from other factors that affect those decisions. For instance, an important determinant of bank lending is the amount of demand for loans, and banks undoubtedly would have altered their lending standards to reflect a better understanding of the riskiness of certain business lines that were incorrectly perceived to be lower-risk prior to the financial crisis. To be sure, changes in regulation and supervision were designed to incentivize the banking industry to become safer and less prone to the type of systemic risks that built up during the mid-2000s, and we believe that those intended effects are occurring. A relatively new and growing literature on bank responses to specific post-crisis regulations, like CCAR, is not yet comprehensive enough to fully understand how banks have adapted to the new regulatory environment, but it does provide some early evidence that banks are taking regulations into account when making business decisions.[7] We remain vigilant, however, in research and monitoring efforts to understand and address any unintended effects of regulatory changes, and welcome discussions with the public and the industry about ways to address those challenges without undermining the increased safety and resiliency of the financial system.

Finally, you ask whether risk weights, including those implied by the Federal Reserve's CCAR supervisory stress test, are generally correct or whether they are overly broad, assigning the same capital requirement to loans with different risks. It is traditional risk weights, not CCAR, that group loans into broad categories. Those traditional risk weights do create an incentive for a bank to prefer the riskiest loans in a particular category, if a bank's only consideration were to minimize its regulatory capital requirement. However, in CCAR, the Federal Reserve's stress test models control for the most important risk drivers in a bank's portfolio, down to the level of the individual loan in some cases. For example, commercial real estate loans are treated differently depending on the remaining maturity of the loan, the loan-to-value ratio, and whether the loan is collateralized by an income-producing property or is a construction loan. In addition, unlike traditional risk weights, stress tests account for the income generated by the loans as well as the potential losses under stress. Of course, traditional risk weights, stress tests, and any other individual measure of risk will necessarily be imperfect. Assessing capital using multiple perspectives—from traditional risk weights and stress tests—should produce a more stable and reliable treatment of risk over the various stages of the credit cycle.

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[7] For example, a study that finds that the 2011 CCAR had a negative effect on the share of jumbo mortgage originations and approvals at banks subject to that exercise is Calero, Paul S. and Correa, Ricardo and Lee, Seung Jung, Prudential Policies and Their Impact on Credit in the United States (2017). BIS Working Paper No. 635. Available at SSRN: *https://ssrn.com/abstract=2967129.* Another recent study that finds that the stress tests have led to a reduction in bank lending to riskier borrowers is Acharya, Viral V. and Berger, Allen N. and Roman, Raluca A., Lending Implications of U.S. Bank Stress Tests: Costs or Benefits? (2017). Journal of Financial Intermediation, Forthcoming. Available at SSRN: *https://ssrn.com/abstract=2972919.*

Q.2. Governor Powell: Given the importance of international standards to both the United States and the global financial stability, would you agree with the U.S. Treasury Department's recommendation that there should be more transparency for the public into the agenda of the Basel Committee? If so, do you think the Federal Reserve Board could be leading voice at the Basel Committee to shine some light into the agenda of that body and its proposed standards? And if, as goes the old adage says, "there's no time like the present," do you see any reason why we can't start with more transparency on the proposal on the table relating to the finalization of the Basel III reforms?

A.2. The Board strongly supports transparency in the international standard setting process. Over the years, the Board has led efforts to increase transparency in the context of the Basel standards, and is generally pleased with the progress that has been made to date.

More remains to be done, however, and the Board will continue to use its influence to heighten openness around Basel standard setting, including the process for consideration of comments received through consultations and meeting agendas. The Basel Committee on Banking Supervision currently is studying approaches to increase external communication of work that is underway. The Board supports this effort and will be an active contributor to the deliberations.

Q.3. Governor Powell: A number of President Obama's regulators who helped devise the Volcker after the passage of Dodd-Frank have come out and called for additional legislative and regulatory changes to the law. Your former colleague Governor Tarullo has called for statutory changes and said the law is too complicated. Former Fed Governor Stein, again an Obama appointee, has called for its outright repeal. The Federal Reserve staff have concluded in a report that the rule is negatively impacting market liquidity. These are just a few of the calls for changes from respected Democratic regulators. Would you agree that we should revisit this provision of Dodd-Frank, which most people agree had nothing to do with the financial crisis and clarify that the statute does not impact legitimate market making? Can you provide me with specific legislative suggestions for how Congress can assist with your efforts to change Volker to cure its implementation issues?

Q.3.a. There are many unintended consequences from Volker, and in the recent Treasury report, one of those consequences that was highlighted is the prohibition on a covered fund sharing the name of a bank-affiliated manager—even if the manager and the fund do not use the name of the bank. As the report stated:

Q.3.a.i. "Although the prohibition on depository institutions sharing a name with the funds they sponsor is appropriate to avoid customer confusion as to whether the fund is insured, banking entities other than depository institutions and their holding companies should be permitted to share a name with funds they sponsor provided that the separate identity of the funds is clearly disclosed to investors."—Last Congress, H.R. 4096 was introduced to address this issue. Do you think that Congress should take up this measure, or are there ways by which the Fed or another regulatory body can address this issue?

Q.3.a.ii. Chair Yellen has indicated she has "some sympathy" for some of the changes that Treasury has proposed. Will the Fed address this technical, unintended consequence in what seems to be an over-broad application of the Volcker Rule? And soon—as I understand the compliance date is July 21st?

A.3.a.i.–ii. The core premise of the Volcker Rule is relatively straightforward: that financial institutions with access to the Federal safety net—Federal Deposit Insurance Corporation insurance and the Board discount window—should not engage in proprietary trading. The Volcker Rule's statutory provisions, however, are complex, which has led to a complex rule. While many changes to the Volcker Rule would require amendment to the statute, there may be ways to streamline and simplify the interagency Volcker Rule regulation to reduce burdens without sacrificing key objectives, and the Board is exploring possibilities.

The Board is working with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodities and Futures Trade Commission (CFTC), and Securities and Exchange Commission (SEC) (together, the agencies) to identify areas of the implementing regulations that could be simplified. There are, however, limits to addressing inefficiencies of the Volcker Rule through amendments of the implementing regulations. For example, a change to the statute to exempt smaller firms would be a cleaner and more comprehensive way to reduce burdens for smaller firms. Additional examples are the treatment of foreign excluded funds and the name-sharing restriction, discussed further below, which may require statutory changes to be addressed more fully than through regulatory amendment.

You also ask about the name-sharing restriction of the Volcker Rule. This provision is imposed by the statute. The statute prohibits a banking entity from sponsoring a covered fund and defines "sponsor" to mean "to share with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name." The statute also prohibits a banking entity from sharing the same name or variation of the same name with a covered fund that the banking entity organizes and offers. In particular, the statute provides as a requirement to permissibly organize and offer a covered fund that "the banking entity does not share with the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name."[8] The statute also defines the scope of the prohibition by defining the term "banking entity" to generally include any affiliate or subsidiary of an insured depository institution or any company that controls an insured depository institution. A change to the statute thus would be required to modify the scope of the namesharing provision, and any legislation is ultimately up to Congress to decide.

Finally, you ask whether the Federal Reserve will address the technical, unintended consequences in the Volcker Rule. While we are restricted from granting burden relief that is in contravention of the requirements of the statute, we have provided relief for some provisions. Most recently, certain foreign noncovered funds

[8] 12 U.S.C. 1851(d)(1)(G)(vi).

organized and offered outside the United States may have become subject to the Volcker Rule by virtue of typical corporate governance structures for funds sponsored by a foreign banking entity in a foreign jurisdiction or by virtue of investment by the foreign banking entity in the fond. In July, the agencies, in consultation with the SEC and the CFTC, issued a statement of policy that indicates the agencies would not propose to make a finding that a banking entity is out of compliance with respect to the provisions of the rule that may apply to such foreign noncovered funds for 1 year while the agencies consider available avenues to address this issue. This issue could potentially be solved either through regulatory or legislative action. We will explore potential regulatory solutions to this issue in the context of the broader regulatory changes that we are working on.

Q.4. Like community banks, there are a number of savings & loan holding companies that include small- and medium-sized insurance companies that serve the interests and needs of small farmers and businesses of all kinds. And, like community banks they provide critical financial services, in this case security from loss and loss prevention advice, that make it possible for small farms and other small businesses to exist, thrive, and employ. And, like community banks they are well regulated by their primary supervisor and are not systemically risky. Considering these facts, what are you doing to prevent and reduce unproductive regulatory burden on these insurers whose groups you supervise?"

A.4. The Board recognizes the importance of community banks and insurance companies in providing services to small businesses and farmers. As you know, the Dodd-Frank Act mandates that the Board supervise the consolidated entity of any insurance savings and loan holding company (ISLHC). In doing so, the unique characteristics, risks, and activities of each ISLHC are considered in the supervisory approach.

In order to mitigate regulatory overlap and burden in supervising these firms, the Board has been relying to the greatest extent possible on State insurance regulators' work related to the business of insurance. The Board has information sharing Memorandums of Understanding with every State insurance regulator. Supervision staff from Reserve Banks and the Board regularly meet with State insurance regulators to coordinate examination and inspection activities and share information relative to supervision. The Board and the National Association of insurance Commissioners continue to discuss State and Federal supervision, any ongoing enhancements to the respective supervisory programs, potential for coordination, and possible areas of overlap.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM MARTIN J. GRUENBERG

Q.1. The Treasury Report released on June 12 recommended that the FDIC be removed from the process to approve banks' living wills. Chair Gruenberg, what would the impact of this recommendation be if adopted?

A.1. There are significant benefits to having both the FDIC and Federal Reserve involved jointly in the resolution plan process.

The FDIC brings the unique perspective as the resolution authority responsible for winding down failed banks and ensuring market confidence. The Federal Reserve brings the important perspective of the bank holding company regulator.

The FDIC's review of living wills also supports the FDIC's responsibilities to wind-down a financial institution pursuant to the Orderly Liquidation Authority. The information and insight that the firms generate about their own structure, business models, and risks is a source of essential information and structural improvement that enables the agency to help avoid bailouts and protect the U.S. financial system.

Implementing the living will requirement over the past 7 years, the FDIC and the Federal Reserve have developed a close cooperative relationship. We issue joint guidance, hold joint meetings with firms, and our review teams train together and conduct their reviews in close collaboration.

This joint process has yielded significant benefits toward improving the resolvability of systemically important banking institutions in the United States. Removing either the FDIC or the Federal Reserve from the process would, in my view, significantly reduce the quality of the process and undermine the goal of improving the resolvability of these systemically important financial institutions.

Q.2. The largest banks have suggested that the results of the stress tests show that they have enough capital and that now is the time to loosen some of the Wall Street Reform capital and liquidity rules so that they can do more to lend and contribute to economic growth. Is that how capital requirements work? Is there a point when a bank has enough capital and it is appropriate to reduce the requirement?

A.2. Capital requirements establish a minimum amount of equity that a banking organization must hold to support its business activities. The largest banks have performed well in recent stress tests; however, reducing capital requirements may have an adverse impact on their ability to continue to conduct business during periods of stress. It is critical that a sufficient amount of equity capital is held at the largest banking organizations to help ensure that they have the loss absorbing capacity necessary to serve as financial intermediaries through the economic cycle. Strong capital positions support banks' ability to support economic activity through lending; for example, as noted in my testimony, large U.S. banking organizations are both better capitalized and have increased their lending to a greater extent than their European counterparts. Strong capital also serves as an important buffer during times of stress to reduce the probability of failure for banking organizations.

Q.3. Chair Greenberg, can you describe the cost benefit analysis currently conducted by the FDIC as part of its rulemaking process? Some have suggested that the independent financial regulatory agencies should do more cost benefit analysis. They have introduced proposals in Congress or made recommendations to increase the requirements for cost benefit analysis and to subject

independent agencies to OIRA review. What would be the impact of these proposals on FDIC rulemaking?

A.3. The FDIC believes that analysis of expected costs and benefits is an integral part of the rulemaking process that helps produce more effective regulations. As an independent agency, the FDIC is not subject to the provisions of Executive Order 12866 and OMB Circular A–4. However, our procedures are broadly consistent with the OMB circulars and adhere to our own 2013 Statement of Policy as well as a number of statutory mandates.

The Administrative Procedures Act (APA) establishes general requirements for a Notice and Comment process that helps to inform the design and analysis of each FDIC proposed or final rule. Consistent with both best practice and the OMB circulars, the preamble of each FDIC proposed and final rule addresses: the policy objectives of the rule, its likely economic effects, comments submitted by the public and the industry, and reasonable and possible alternatives to the rule.

These practices help to ensure that the FDIC Board is well informed about the costs and benefits of each rule. By highlighting these considerations in the preamble, the rationale of each rule is made transparent to the public and the parties most affected. Recent audits of our rulemaking process by the Government Accountability Office (GAO) have identified no material weakness in our analytical processes.

Subjecting independent agencies like the FDIC to review by the Office of Information and Regulatory Affairs within the Office of Management and Budget would compromise the independence of the rulemaking process. This would impair the agencies' ability to respond quickly to emerging risks and to meet statutory deadlines for rulemaking. The resulting delays can be expected to increase the risk of financial instability and create uncertainty among affected entities.

Recent proposals to increase requirements for cost benefit analysis could also impose unrealistic standards to quantify the effects of each rule. The expected benefits of many FDIC rules are difficult to quantify. They frequently center on reducing the likelihood and severity of future financial crises. Long-term financial stability, in turn, depends critically on behavioral factors such as public confidence and market liquidity that are prone to volatility, and therefore are difficult to model with precision.

Despite these challenges, there is no question that the potential benefits of stability-enhancing rules are substantial. Recent experience clearly shows that a financial crisis can have a devastating effect on real economic activity as well as on the banking industry itself. Estimates vary as to the total cumulative loss in gross domestic product (GDP) compared to potential output during and after the latest crisis, but these estimates generally exceed $10 trillion.[1]

Requiring a strict quantification of the likely effects of each rule would limit the ability of the independent financial regulatory agencies to apply their ample expertise, experience and judgment

[1] See Atkinson, Tyler; Luttrel, David; and Rosenblum, Harvey, *"How Bad Was It? The Costs and Consequences of the 2007–09 Financial Crisis,"* Federal Reserve Bank of Dallas, Staff Paper No. 20, July 2013. *https://www.dallasfed.org/assets/documents/research/staff/staff1301.pdf.*

to promote long-term financial stability. We expect that the end result would be a more volatile financial system that is less consistent in its ability to support U.S. economic activity.

Q.4. In his testimony, Acting Comptroller of the Currency Noreika suggested that the OCC be able to approve deposit insurance automatically when it charters a national bank. Currently, that authority lies with the FDIC. What do you think about this proposal?

A.4. From the FDIC's inception in 1933 through 1989, national banks and State member banks automatically received deposit insurance as a matter of law, upon receipt of certification by the FDIC from either the OCC or Federal Reserve. In reaction to the banking crisis of the 1980s, and because the chartering authority does not have the same incentives as the deposit insurer, Congress enacted legislation to protect the Deposit Insurance Fund (DIF). First, in 1989, FIRREA authorized the FDIC to comment on charter applications of national and State member banks. Then, in 1991, FDICIA required institutions to apply for and be granted Federal deposit insurance by the FDIC.[2]

These changes in authority were a direct result of the chartering activity in the years prior to the crisis of the late 1980s and early 1990s. For example, from 1982–85, well over 800 national bank charters were granted compared to about 400 State bank charters.[3] However, just over half (51 percent) of all national banks chartered from 1980–87 were located in the Southwest, which was one of the regions most affected by bank failures during the crisis.[4] Further, of the approximate 2,800 new banks (national and State chartered) chartered between 1980 and 1990, more than 16 percent had failed by 1994, compared with 7.6 percent of banks that were already in existence at year-end 1979—a failure rate that was more than twice as high.[5] In the southwest, 33.3 percent of banks chartered from 1980–90 failed through 1994, compared to 21.4 percent of banks that were already in existence at year-end 1979.[6] These higher failure rates of banks chartered under the more relaxed chartering regime of the 1980s substantially increased costs to the DIF.

Although chartering authorities should account for a proposed bank's potential to operate successfully, the chartering authority is not responsible for the resolution of a failed bank, and the analyses of the agencies regarding risk to the DIF can differ. Risk to the Deposit Insurance Fund is a statutory factor to be considered by the FDIC in evaluating deposit insurance applications, and by each of the Federal banking agencies in evaluating notices of change of control of an institution.

As steward of the Fund, the FDIC has a fiduciary duty to administer the DIF, in large part by maintaining a comprehensive understanding of the risk profile of insured institutions and ensuring that, with respect to all insured institutions, appropriate supervisory and regulatory actions are taken when necessary, regardless of institution size, chartering authority, or primary Federal

[2] History of the Eighties, Lessons for the Future, Volume 1, p. 110.
[3] History of the Eighties, Lessons for the Future, Volume 1, p. 108.
[4] History of the Eighties, Lessons for the Future, Volume 1, p. 109.
[5] History of the Eighties, Lessons for the Future, Volume 1, pp. 31–32.
[6] History of the Eighties, Lessons for the Future, Volume 1, pp. 31–32.

regulator (PFR). Requiring all banks to apply formally to the FDIC for deposit insurance enables the potential costs of failure to be-taken into account during the chartering process and serves to protect the DIF.

Q.5. This week, the House approved the FY 2018 Financial Services and General Government Appropriations bill. Included in this bill is a provision from the CHOICE Act to bring all independent financial regulatory agencies' budgets under the appropriations process. What would be the impact on the FDIC if its budget was appropriated?

A.5.

- Congressional control of funding could reduce the FDIC's flexibility to address unforeseen and unfunded emergencies and exigent circumstances in the banking system.

The FDIC must be able to act independently in the public interest to maintain public confidence and promote the safety and soundness of the banking system and the DIF. This requires that the FDIC, as deposit insurer, be able to make difficult decisions in a timely manner and maintain focus on the mission to protect the stability of our banking system. Sometimes this means recognizing risks, or even losses, when they occur rather than allowing potentially destabilizing risks to compound.

The FDIC's current funding structure allows the agency to respond appropriately and promptly in response to unforeseen emergencies and exigent circumstances. For example, the FDIC can change the size of its resolution and examination staff in response to changes in markets and bank risk-taking.

- Subjecting the FDIC to the annual appropriations process could undercut efforts to promote safety and soundness.

History shows us that when financial regulators are constrained in their ability to rein in inappropriate risk, the consequences can be dire. For example, in the early 1980s, the Federal Home Loan Bank Board (FHLBB) did not have control of either its funding levels or the purposes for which funds could be used. The FHLBB, therefore, could not allocate resources to increase examination staffing levels or to provide examination staff essential training to address changes in the savings and loan (S&L) industry. Unable to augment its examination staff, it was unable to prevent the worst of the S&L crisis. (*National Commission on Financial Institution Reform, Recovery and Enforcement, Origins and Causes of the S&L Debacle: A Blueprint for Reform,* July 1993, at p. 57.)

Q.6. Is there any evidence that Wall Street Reform is the primary cause of driving of consolidation among community banks?

A.6. Consolidation is a long-term banking industry trend that dates back to the mid-1980s. The number of federally insured bank and thrift charters has declined by two-thirds since 1985. Long-term consolidation in banking has taken place in the context of powerful historical forces—two banking crises and relaxation of restrictions on intra-State branching and interstate banking and branching.

More recently, a pickup in the pace of voluntary mergers and a very slow pace of *de novo* bank formation have contributed to continued consolidation. These trends are likely related to the historically low interest rates and slow growth in economic activity

experienced during this recovery. While 95 percent of community banks were profitable last year, they clearly face some economic headwinds. Low interest rates have contributed to narrow net interest margins, subpar levels of profitability, and low market premiums as reflected in price-to-book ratios for banks. These conditions have made it less attractive to start new banks and more attractive to acquire existing banks.

A 2016 study by Federal Reserve Bank of New York economists, Robert Adams and Jacob Gramlich, shows that at least 75 percent of the post-crisis decline in new bank formation could be attributed to economic factors, and would have occurred without any regulatory change.[7] Our expectation is that once interest rates normalize, we will begin to see the pace of bank mergers and new bank formation return to more normal levels, thereby slowing the pace of consolidation. We are already seeing an increase in new applications for deposit insurance, and have approved six of these applications over the past 10 months.

Q.7. After the financial crisis, the FDIC created the Division of Depositor and Consumer Protection. Your predecessor, Sheila Bair, stated that this division would complement the activities of the Consumer Financial Protection Bureau.

Please describe your experiences working with the CFPB to protect consumers at FDIC supervised banks. Do you think further limiting the institutions CFPB supervises for consumer compliance would advance the FDIC's mission to protect consumers and the Deposit Insurance Fund?

A.7. Since it was established in 2011, the FDIC and CFPB have developed and maintained a positive, constructive relationship to protect consumers at FDIC-supervised banks, both in terms of rulewriting and through supervision of institutions to identify, mitigate, and prevent consumer harm. Through the legally mandated consultation process and meetings at multiple levels with the CFPB, we have seen increased coordination and communication between the FFIEC member agencies since 2011. Additionally, the FDIC, FRB, OCC and NCUA maintain a "Memorandum of Understanding on Supervisory Coordination" (*https://www.fdic.gov/news/news/press/2012/pr12061a.pdf*) with the CFPB, which establishes mechanisms for cooperation between the Agencies in both supervision and enforcement, consistent with the Dodd-Frank Act. The FDIC and CFPB communicate regularly regarding supervisory activities, such as examination schedules and review of examination reports, regarding institutions where we share supervisory authority to ensure effective and coordinated supervision.

The CFPB's supervision for consumer compliance has not been an impediment to the FDIC's ability to carry out its mission to protect consumers and the Deposit Insurance Fund. In fact, the CFPB has been an effective partner with the FDIC in addressing problematic practices identified at supervised institutions through enforcement actions. In 2012, the FDIC and CFPB, along with the Utah Department of Financial Institutions, partnered in an

[7] Adams, Robert M. and Gramlich, Jacob (2016), *Where Are All the New Banks? The Role of Regulatory Burden in New Bank Formation, Review of Industrial Organization,* 48(2), pp, 181–208.

investigation of three American Express subsidiaries, which led to an enforcement action in which $85 million was refunded to 250,000 customers for illegal card practices. Additionally, our two agencies joined in another 2012 enforcement action, this time against Discover Bank (Discover) for deceptive telemarketing and sales tactics. Discover was ordered to return $200 million to more than 3.5 million consumers.

In addition, nonbank consumer financial firms are now subject to Federal supervision for the first time due to the CFPB's Dodd-Frank Act authority, creating a more level playing field between insured and supervised financial institutions and nonbank firms. On balance, this has benefited community banks, which have long been subject to Federal supervision.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HELLER FROM MARTIN J. GRUENBERG

Q.1. Does the FDIC welcome new industrial loan company (ILC) applications?

A.1. The FDIC welcomes all deposit insurance applications, including industrial loan companies. Regardless of charter type, each filing is reviewed under the framework of statutory factors found in Section 6 of the FDI Act:

- Financial History and Condition
- Adequacy of Capital Structure
- Future Earnings Prospects
- General Character of Management
- Risk to Deposit Insurance Funds
- Convenience and Needs of Community
- Consistency with Powers in FDI Act

As stated in the FDIC's Statement of Policy on Applications for Deposit Insurance, in general, the applicant will receive deposit insurance if all of these statutory factors plus the considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969 are resolved favorably.

Q.2. Do you believe that the FDIC has all the tools and resources to manage and oversee current and new ILCs properly?

A.2. The FDIC believes that it has the statutory, regulatory, and supervisory frameworks necessary to oversee ILCs. Each institution is subject to the statutes and regulations applicable to other insured institutions, including those related to affiliate and insider transactions, consumer protection, community reinvestment, anti-tying, and others. Further, with respect to FDIC-supervised ILCs, the institutions are supervised in the same manner as other institutions in that supervisory strategies are customized to the risk profile of the institution.

While there is generally no Federal Reserve Board-supervised holding company for an ILC, the FDIC has the authority to examine the affairs of any affiliate, including the parent and its subsidiaries, as maybe needed to disclose the relationship between the ILC and the affiliate, and the affiliate's effect on the institution.

And, similar to other insured institutions, the FDIC can prohibit an insured ILC from engaging in activities with an affiliate or any third party that may cause harm to the ILC.

In the event supervisory concerns are noted, the FDIC may pursue the same enforcement powers authorized with respect to any other insured institution. Parent companies of nonbank banks are considered institution-affiliated parties under the FDI Act and may be directly subject to enforcement actions by the FDIC. As with other FDIC-supervised institutions, section 38 of the FDI Act authorizes the FDIC to obtain guarantees of capital plans from the nonbank bank's parent company in certain circumstances. The FDIC's Board may terminate a depository institution's insured status after a hearing if the institution violates a condition or written agreement imposed by the FDIC in connection with the approval of an application or other request by the depository institution.

Additionally, the FDIC has pursued strategies to mitigate risks related to the parent company structure, including various parent company and operating agreements. These agreements may address a variety of circumstances regarding supervision, corporate governance, and financial support of the insured institution.

Q.3. Do you believe that new ILCs should be insured by the FDIC if they meet underlying statutory factors for deposit insurance?

A.3. The FDIC welcomes all deposit insurance applications, including industrial loan companies. Regardless of charter type, each filing is reviewed under the framework of statutory factors found in Section 6 of the FDI Act:

- Financial History and Condition
- Adequacy of Capital Structure
- Future Earnings Prospects
- General Character of Management
- Risk to Deposit Insurance Funds
- Convenience and Needs of Community
- Consistency with Powers in FDI Act

As stated in the FDIC's Statement of Policy on Applications for Deposit Insurance, in general, the applicant will receive deposit insurance if all of these statutory factors plus the considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969 are resolved favorably.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM MARTIN J. GRUENBERG

Q.1. Some have called for the FDIC to be removed from the living will process. Do you believe the FDIC should be removed from this process?

A.1. There are significant benefits to having both the FDIC and Federal Reserve involved jointly in the resolution plan process.

The FDIC brings the unique perspective as the resolution authority responsible for winding down failed banks and ensuring market confidence. The Federal Reserve brings the important perspective of the bank holding company regulator.

The FDIC's review of living wills also supports the FDIC's responsibilities to wind-down a financial institution pursuant to the Orderly Liquidation Authority. The information and insight that the firms generate about their own structure, business models, and risks is a source of essential information and structural improvement that enables the agency to help avoid bailouts and protect the U.S. financial system.

Implementing the living will requirement over the past 7 years, the FDIC and the Federal Reserve have developed a close cooperative relationship. We issue joint guidance, hold joint meetings with firms, and our review teams train together and conduct their reviews in close collaboration.

This joint process has yielded significant benefits toward improving the resolvability of systemically important banking institutions in the United States. Removing either the FDIC or the Federal Reserve from the process would, in my view, significantly reduce the quality of the process and undermine the goal of improving the resolvability of these systemically important financial institutions.

Q.2. Many of us have come to recognize that the Orderly Liquidation Authority is an incredibly important part of the Wall Street Reform and Consumer Protection Act. Could you please explain in plain terms why OLA is so important?

A.2. The Orderly Liquidation Authority (OLA) is an essential backstop for protecting taxpayers—and avoiding bailouts—in circumstances when the bankruptcy process cannot handle the orderly failure of a systemically important financial institution, putting the stability of the U.S. financial system at risk.

During the financial crisis, policymakers lacked the tools for managing the failure of a potentially systemic financial institution and—when faced with that possibility—were forced to choose between two bad options: taxpayer bailouts or systemic disruption in bankruptcy.

The Dodd-Frank Act established a framework for helping to ensure that a potentially systemic financial institution can fail in an orderly way. Bankruptcy is the statutory first option under the framework—and the Act established the living will process whereby firms demonstrate how they can fail, in bankruptcy, without threatening U.S. financial stability.

While significant progress has been made through this process, we cannot rule out the possibility that in the future circumstances may arise where the bankruptcy process might not be able to handle the orderly failure of a systemically important financial institution. Title II of the Dodd-Frank Act established the Orderly Liquidation Authority as a backstop in such cases. OLA would allow the FDIC to wind-down and liquidate a failed financial firm—in an orderly way. This authority would protect taxpayers and avoid a repeat of the bailouts and financial disruption that occurred before OLA's enactment.

The Orderly Liquidation Authority provides the FDIC several authorities—not available under bankruptcy—that are broadly similar to those the FDIC has to resolve banks. They include the authority to establish a bridge financial company, to stay the termination of certain financial contracts, to provide temporary

liquidity that may not otherwise be available, and to coordinate with domestic and foreign authorities ahead of a resolution to better address any cross-border impediments. The critical abilities to plan in advance and to move quickly to deploy a team of professionals experienced in financial institution resolution in order to stabilize the failed financial institution are additional advantages the FDIC can bring to bear. The tools available under the OLA would enable the FDIC to carry out the process of winding down and liquidating the firm, while ensuring that shareholders, creditors, and culpable management are held accountable. By law, taxpayers cannot bear any losses. Losses must be paid for out of the assets of the failed firm and, if necessary, through assessments on large financial institutions.

It is clear that without these authorities, we would be back in the same position as 2008, with the same set of bad choices.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM MARTIN J. GRUENBERG

Chair Greenberg and Governor Powell, you've both tallied about the Volcker Rule and the complexity that comes along with this rule. And in the past, Comptroller Curry had suggested that we could exempt community banks entirely. After having conversations with many of my community banks I agree with Mr. Curry and believe they should be entirely exempt from Volcker Rule compliance. Following these lines, I have introduced a bill with Senator Moran that would exempt community banks with less than $10 billion from compliance.

Q.1. Is this a bill that both the FDIC and the Federal Reserve would support at this juncture?

Q.2. Does eliminating the Volcker Rule for banks with less than $10 billion pose any real risk to our financial system?

Q.3. Absent Congress passing legislation related to the Volcker Rule, does the FDIC or the Federal Reserve have any plans to make any changes on their own to the Volcker Rule?

A.1.–3. The agencies are currently reviewing the Volcker Rule to identify and reduce unnecessary complexity and burden. The agencies could establish a regulatory safe harbor for banking organizations that meet certain activities-based criteria. As long as a banking organization met the safe harbor requirements, it would not be required to prove compliance with the proprietary trading restrictions of the Volcker Rule. This would eliminate compliance concerns for smaller banking organizations, including most community banks with less than $10 billion in assets, provided that they genuinely do not engage in proprietary trading.

Establishing such a safe harbor through regulation may be a better approach than a statutory exemption. While most community banks do not engage in activities covered by the Volcker Rule, such an exemption based solely on asset size could create an arbitrage opportunity for consultants and others to promote risky, otherwise impermissible, activities to small banks.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM MARTIN J. GRUENBERG

Each of you serve at agencies that are members of the Financial Stability Oversight Council (FSOC). Insurance has been regulated at the State level for over 150 years—it's a system that works. But FSOC designations of nonbank systemically important financial institutions (SIFIs) have made all of you insurance regulators, despite the fact that you are bank regulators at your core.

Strong market incentives exist for insurers to hold sufficient capital to make distress unlikely and to achieve high ratings from financial rating agencies, including incentives provided by risk sensitive demand of contract holders and the potential loss of firms' intangible assets that financial distress would entail. Additionally, insurance companies are required by law to hold high levels of capital in order to meet their obligations to policyholders. Bottom line: Insurance companies aren't banks, and shouldn't be treated as such.

In March, my colleagues and I on the Senate Banking Committee sent a letter to Treasury Secretary Mnuchin indicating our concerns regarding the FSOC's designation process for nonbanks. I support efforts to eliminate the designation process completely.

I was pleased that President Trump issued a "Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council" (FSOC Memorandum) on April 21, 2017, which directs the Treasury Department to conduct a thorough review of the designation process and states there will be no new nonbank SIFI designations by the FSOC until the report is issued. Relevant decisionmakers should have the benefit of the findings and recommendations of the Treasury report as they carry out their responsibilities with respect to FSOC matters. Please answer the following with specificity:

Q.1. What insurance expertise do you and your respective regulator possess when it comes to your role overseeing the business of insurance at FSOC?

A.1. The FDIC has an insurance industry monitoring team within its Complex Financial Institution branch, which is responsible for the monitoring of insurance companies designated as systemically important. Collectively, the team has over 20 years of insurance industry experience both from working for major U.S. insurers and covering the insurance industry as a private sector analyst. Other core areas of expertise within the team include investment banking and regulatory oversight of U.S. broker dealers during the 2008 financial crisis. In addition to the monitoring team, in 2016, the FDIC added an insurance specialist within its Legal Division to help further its work with resolution plans filed by systemically important insurers, orderly liquidation authority, and any insurance issues coming before the FSOC. The specialist has nearly 20 years of insurance expertise and served at the U.S. Department of Treasury, both in legal and policy capacities, including as senior advisor to the FSOC's current independent member with insurance expertise, immediately prior to joining the FDIC.

In addition to its insurance-focused staff, the FDIC has insurance experience gained through the execution of its core missions.

Among other duties, the FDIC regulates State-chartered banks that are not members of the Federal Reserve System. The FDIC has executed supervisory Memoranda of Understanding with State insurance authorities covering supervisory and examination responsibilities with regard to insured State-chartered nonmember banks with insurance affiliates. The FDIC also coordinates with insurance regulators, as appropriate. Some FDIC-regulated banks sell insurance products through licensed agent and broker affiliates, and while the FDIC's focus is the safety and soundness of the bank, its examiners are familiar with bank-sold insurance. The FDIC may also be appointed as the receiver of failed insured depository institutions (IDIs). In that capacity, the FDIC has engaged with State insurance regulators and insurance receivers in those instances where cooperation is appropriate in resolving the IDI, and has gained practical experience with insurance receivership issues. The FDIC has also pursued and litigated insurance claims against insurance companies as part of its receivership responsibilities and has experience on insurance coverage matters.

Q.2. Do you support the Senate Banking Committee's recent legislative effort, the Financial Stability Oversight Council Insurance Member Continuity Act, to ensure that there is insurance expertise on the Council in the event that the term of the current FSOC independent insurance member expires without a replacement having been confirmed?

A.2. The FDIC has not taken a position on the Financial Stability Oversight Council Insurance Member Continuity Act and has no objection to it.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSE FROM MARTIN J. GRUENBERG

Q.1. Has the CFPB effectively coordinated with the FDIC on rulemaking and enforcement actions? If not, how could coordination be improved?

A.1. As required by statute, the CFPB regularly consults with the FDIC and other prudential regulators during the course of its rulemakings. We have found the consultations to be meaningful and substantive on significant rulemaking efforts. In particular, we have found the CFPB to be interested in our perspective as the primary Federal supervisor for the majority of the Nation's community banks.

With regard to enforcement, coordination between the FDIC and the CFPB has been effective. The two agencies have issued some joint and some concurrent enforcement actions in cases where both agencies had authority over a particular matter. Coordination is managed through ongoing communications at the regional level and the Washington Office level. The regions share information related to schedules for supervisory actions, findings that may impact supervision, supervisory letters, and reports of examination. Much of this sharing is performed in accordance with the Memorandum of Understanding on Supervisory Coordination issued on May 19, 2012 at *https://www.fdic.gov/news/news/press/2012/pr12061a.pdf.*

At the Washington Office level, coordination is accomplished via a recurring meeting between leadership in supervision and enforcement at each agency.

Q.2. As you know, the CFPB may be moving forward on a rulemaking for Section 1071 of Dodd-Frank, which granted the CFPB the authority to collect small business loan data. I've heard some concerns that implementing Section 1071 could impose substantial costs on small financial institutions and even constrict small business lending.

Q.2.a. Are you concerned how a Section 1071 rulemaking could hurt small business access to credit?

A.2.a. As you note, Section 1071 of the Dodd-Frank Act requires the CFPB to collect small business loan data. The CFPB is currently in the process of gathering information prior to beginning the rulemaking process. As a result, it is too early in the process for the FDIC to make a judgment regarding the potential impact such future rulemaking may have on small business access to credit. The FDIC is currently engaged in a research effort to better understand small business lending by insured institutions, which may provide useful insight and context for future consideration of the impact of this rulemaking effort.

Q.2.b. Has the FDIC coordinated with the CFPB to ensure that implementing these requirements does not constrict small business access to credit?

A.2.b. The CFPB is currently in the process of gathering information prior to beginning the rulemaking process. No requirements have, as yet, been proposed.

Q.3. The agencies' EGRPRA report highlights newly streamlined call reports for banks with less than $1 billion in assets. However, I'm told by community banks in my State with under $1 billion in assets that these changes will not help them because the streamlined call report form just removes items that few community banks needed to report in the first place.

Q.3.a. What more can the FDIC do to reduce the regulatory paperwork burden on community banks regarding call reports and more broadly?

A.3.a. Effective March 31, 2017, the Federal banking agencies, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), implemented a new streamlined FFIEC 051 Call Report for eligible small institutions, initially defined, in general, as institutions with domestic offices only and less than $1 billion in total assets. Such institutions represent about 87 percent of all insured depository institutions. Eligible small institutions have the option of filing the FFIEC 051 Call Report or continuing to use the FFIEC 041 Call Report otherwise applicable to all institutions, regardless of size, with domestic offices only. Some burden-reducing changes to the FFIEC 041 and FFIEC 031 versions of the Call Report, the latter of which applies to institutions with foreign offices, also took effect as of March 31, 2017. Nearly 3,500 or slightly more than two thirds of the approximately 5,100 eligible small institutions filed the FFIEC 051 Call Report for the first quarter of 2017. Eligible small institutions that did not file the FFIEC 051 as of

March 31, 2017, may begin reporting on this new version of the Call Report as of June 30, 2017, or as of later report dates in 2017.

The FFIEC 051 report was created by: (1) removing certain existing schedules and data items from the FFIEC 041 report and replacing them with a limited number of data items in a new supplemental schedule, (2) eliminating certain other existing FFIEC 041 data items, and (3) reducing the reporting frequency of certain FFIEC 041 data items. These actions resulted in the removal of approximately 950 or about 40 percent of the nearly 2,400 data items in the FFIEC 041. Of the data items remaining from the FFIEC 041, the agencies reduced the quarterly reporting frequency for approximately 100 data items in the proposed FFIEC 051 to either semiannual or annual.

The agencies recognize that not all community institutions eligible to file the FFIEC 051 have seen a substantial reduction in burden by switching to this new version of the Call Report. Approximately 300 of the data items removed from the FFIEC 041 to create the FFIEC 051 were data items for which all institutions with assets less than $1 billion were exempt from reporting. Other items not included in the FFIEC 051 applied to institutions of all sizes, but may not have applied to every community institution due to the nature of each institution's activities. For example, in creating the FFIEC 051, the agencies removed from the FFIEC 041 the data items on Schedule RC–L, Derivatives and Off-Balance Sheet Items, in which about 800 eligible institutions that have derivative contracts had been required to separately report the gross positive and negative fair values of these contracts by underlying exposure. On the other hand, the agencies reduced from quarterly to semiannual the reporting frequency in the FFIEC 051 of Schedule RCC, Part II, Loans to Small Businesses and Small Farms, which bankers have cited as one of the more burdensome Call Report schedules, and Schedule RC–A, Cash and Balances Due from Depository Institutions, which applies only to institutions with $300 million or more in total assets. About 90 percent of institutions with less than $1 billion in total assets have data to report in Schedule RC–C, Part II. Nearly all of the more than 1,400 institutions with between $300 million and $1 billion in assets report dollar amounts in Schedule RC–A.

In addition, during the banker outreach activities the agencies conducted as part of their community bank Call Report burden-reduction initiative, bankers indicated that they routinely review the Call Report instructions for data items for which they have previously had no amounts to report to determine whether this remains the case. The reduction in the number of data items in the FFIEC 051 report compared to the FFIEC 041 report means that bankers will not need to review as many instructions for data items that are not applicable to their institutions, thereby reducing reporting burden.

In their ongoing communications to the industry about the new streamlined report and the Call Report burden-reduction initiative itself, the FFIEC and the bankingagencies have emphasized that the introduction of the FFIEC 051 Call Report in March 2017 was not the end of their streamlining efforts and that they would be issuing additional burden-reducing Call Report proposals in 2017.

In this regard, the banking agencies, under the auspices of the FFIEC, published a Federal Register notice on June 27, 2017, that requests comment for 60 days on further proposed burden-reducing revisions to the three versions of the Call Report. These revisions are proposed to take effect March 31, 2018.

These proposed revisions in the current proposal resulted from the review of responses from Call Report users at FFIEC member entities to the middle portion of a series of nine surveys of groups of Call Report schedules requiring users to explain their need for and use of the data items in these schedules. The FFIEC and the agencies also considered comments regarding the Call Report received during the EGRPRA review, feedback and suggestions received during banker outreach activities, and comments on the agencies' August 2016 FFIEC 051 Call Report proposal. The agencies' current Call Report proposal would remove, raise the reporting threshold for, or reduce the reporting frequency of approximately 7 percent of the data items in the FFIEC 051 Call Report for eligible small institutions. The proposal includes similar actions affecting 10 percent and 12 percent of the much larger number of data items in the FFIEC 041 and FFIEC 031 Call Reports, respectively.

The Federal Register notice for the current Call Report proposal notes that the agencies plan to propose further burden-reducing changes resulting from their analysis of the responses to the final portion of the nine user surveys. The FFIEC and the agencies expect to issue this next proposal for public comment later this year. These proposed revisions also would have a planned effective date of March 31, 2018, but the actual effective date would be dependent on industry feedback.

In addition, in their August 2016 Federal Register notice proposing the streamlined FFIEC 051 Call Report for eligible small institutions, the agencies stated their commitment to explore alternatives to the $1 billion asset-size threshold that, at present, generally determines an institution's eligibility to file the FFIEC 051 Call Report. In beginning this effort this quarter, the FFIEC member entities will be evaluating Call Report data from institutions of various sizes in excess of $1 billion, particularly with respect to institutions' involvement in the complex and specialized activities for which only limited information is collected in the FFIEC 051 report compared to the more detailed data on these activities currently reported in the FFIEC 041 report. The FFIEC's goal would be to ensure that any proposed expansion of the eligibility to file the FFIEC 051 Call Report would not result in a loss of data critical to effective supervision and the conduct of FFIEC member entities' other missions. Any proposal to expand eligibility for the FFIEC 051 report would be published in the Federal Register for public comment.

Q.3.b. Do any of these changes require statutory authorization?

A.3.b. No, the burden-reducing changes to the Call Report that the agencies have implemented and are continuing to propose do not require statutory authorization.

Q.4. Our financial system has become increasingly consolidated, as community banks and credit unions either close their doors or merge with larger institutions.

Q.4.a. Are you concerned about this pattern? Why?

Q.4.b. What services can these smaller institutions provide that larger institutions cannot provide?

A.4.a.–b. Consolidation is a long-term banking industry trend that dates back to the mid-1980s. The number of federally insured bank and thrift charters has declined by two-thirds since 1985. Long-term consolidation in banking has taken place in the context of powerful historical forces—two banking crises and relaxation of restrictions on intra-State branching and interstate banking and branching. Since the financial crisis, voluntary mergers and a very slow pace of *de novo* bank formation have contributed to continued consolidation. These trends are likely related to the historically low interest rates and slow growth in economic activity that have been experienced during the post-crisis period.

While 95 percent of community banks were profitable last year, they clearly face some economic headwinds. Low interest rates have contributed to narrow net interest margins, subpar levels of profitability, and low market premiums as reflected in price-to-book ratios for banks. These conditions have made it less attractive to start new banks and more attractive to acquire existing banks. Our expectation is that once interest rates normalize, we will begin to see the pace of bank mergers and new bank formation return to more normal levels, thereby slowing the pace of consolidation. We are already seeing an increase in new applications for deposit insurance, and have approved 6 of these applications over the past 10 months.

It should be pointed out that the consolidation of community bank charters does not necessarily diminish the influence of community banks in their local market. More than three-quarters of the community banks that have been acquired since the end of 2015 were acquired by other community banks. After declining steadily in the years leading up to the crisis, the community bank share of industry loans has remained steady since 2007 at just over 16 percent. On a merger-adjusted basis, annual growth in total loans at community banks has exceeded growth at noncommunity banks for five consecutive years.

The FDIC is acutely aware of the importance of community banks to the U.S. financial system and our economy. In 2012, we initiated a community bank research initiative that has resulted in a comprehensive review of this sector and a continuing series of research papers designed to better understand how it is performing over time.[1] While community banks hold 13 percent of industry assets, they hold 43 percent of small loans to farms and businesses. Community banks hold more than three-quarters of FDIC-insured deposits in over 1,200 U.S. counties, making them the lifeline to mainstream banking for rural counties, small towns, and urban neighborhoods across the country.

[1] See FDIC, Community Banking Initiative, Research and Reports. *https://www.fdic.gov/regulations/resources/cbi/research.html.*

As relationship lenders, community banks have an ability to tailor their services to the needs of their customers. They play a unique role in small business lending, real estate lending, and the vitality of their local economies that large institutions often are unable to fill. The FDIC carries out its regulatory and supervisory responsibilities with this in mind.

Q.5. Multiple anecdotes from constituents make it clear that there are several Nebraska counties where consumers cannot get a mortgage, due to CFPB regulations such as TRID and the QM rule. What is the best way to address this problem from a regulatory standpoint?

A.5. As a general matter, we have not seen a QM rule-related effect on access to mortgage credit, Likewise, preliminary results from examinations on TRID show that banks are successfully complying with the rule.

QM status involves important safeguards for lenders, borrowers, and the system, including basic underwriting standards and protections against products that proved to be particularly risky in the crisis, such as option ARMs, negatively amortizing loans, and certain balloon loans. Most of our institutions had already been making loans consistent with the QM standard prior to the rule being promulgated, as noted in a GAO study titled "Mortgage Reforms: Actions Needed to Help Assess Effects of New Regulations," GAO–15–185 (June 2015).

In addition, changes by the CFPB to the definitions of "small creditor" and "rural" further expanded the eligibility of community banks and allowed additional flexibility to comply with the Ability to Repay (ATR)/QM Rule. For example, such entities may offer balloon QM loans and are not constrained by QM debt-to-income limits. The vast majority of FDIC supervised institutions are small creditors and qualify as "rural" under the rules.

Additionally, the FDIC and the other prudential bank regulators have issued guidance saying that, to the extent insured depositories are making non-QM loans, as long as the loan is made in a safe and sound manner, such loans will not be subject to criticism solely on the basis of being a non-QM loan. We are seeing reports in the trade press that non-QM lending is growing.[2]

TRID was promulgated in part because of longstanding industry concerns regarding required disclosures for mortgage transactions. Required disclosures under TILA and RESPA overlapped, which confused and overwhelmed consumers without providing needed clarity on details of the loan transaction. Concerns were also raised that consumers did not easily understand loan cost or pricing information.

Since both the QM rule and the TRID rule went into effect, the merger-adjusted growth in 1-to-4 family mortgages made by community banks has improved (continuing a trend that began in 2010) and has consistently outperformed noncommunity banks.

[2] According to a May 12, 2017, article in *Inside Nonconforming Markets,* there has been an increase in the amount of non-QM mortgage lending leading to a re-emergence of mortgage-based securities backed by non-QM loans. This has helped lower interest rates for the product, according to this article.

Q.6. Are there concrete ways in which you believe the CFPB has improperly tailored regulations to match the unique profile of smaller financial institutions?

A.6. During the consultation process, we have generally found the CFPB to be interested in the FDIC's perspective as the primary Federal supervisor of the majority of the Nation's community banks. In our view, major rules typically take into account the profile of smaller financial institutions and make adjustments intended to address differences between community bank business models and business models of other institutions. For example, the CFPB established and then significantly broadened the definitions of "small creditor" and "rural" lender, allowing the majority of community banks to qualify for multiple exceptions contained in the new mortgage rules. The CFPB, through its rulemakings, has extended a number of accommodations that reflect the profile of smaller financial institutions, including:

- A broader safe harbor for a small creditor's Qualified Mortgage (QM) loans kept in portfolio for 3 years.
- A significantly expanded exemption from the requirement to escrow for higher-priced mortgage loans for small creditors operating in rural or underserved areas; a small creditor now qualifies for this exemption if it makes just one mortgage loan in a rural area in the past year. In addition, these small creditors are able to offer QMs that have balloon payment features without regard to the 43 percent debt-to-income (DTI) limit in the standard QM.
- An exemption for small servicers from the more process- and paperwork-intensive requirements of the new servicing rules, including those related to early intervention, continuity of contact, certain loss mitigation, the provision of periodic statements, and the requirement to maintain written policies and procedures.
- A *de minimis* exception allowing occasional mortgage loan originators to participate fully in a bank's profit-sharing plan; this exception is particularly helpful to the management and staff of smaller financial institutions that on occasion need to step in and cover for full-time loan originators.

Q.7. My understanding is that very few banks have opened since the passage of Dodd-Frank.

Q.7.a. Why do you believe this is the case?

A.7.a. New or *de novo* bank formation has always been cyclical. *De novo* activity dropped to historically low levels after the last financial crisis in the 1980s and early 1990s, before recovering as the economy improved. *De novo* activity has surged in economic upswings, such as those of post-World War II, the mid-1990s, and the early 2000s. But in the recent post-crisis period, the pace of new bank formation has slowed to historic lows, averaging around one *de novo* institution per year since 2010.

There are a number of factors that have slowed new bank formation. For potential bank investors, the opportunity to acquire failed or underperforming institutions represents an alternative to starting new banks. In periods with high levels of problem banks and

failures and low price-to-book ratios, acquisitions may represent a more economical way for interested investors to acquire the operations of troubled banks, including loan and deposit platforms, personnel, and back office operations. These factors have likely increased the pace of voluntary mergers in recent years even as the annual number of crisis-related failures has fallen.

Profitability ratios have also not been conducive to new bank formation in the post-crisis period. During this period, community bank earnings have recovered, and 95 percent of community banks had positive earnings in 2016. But historically low interest rates and narrow net interest margins have kept bank profitability ratios (return on assets and return on equity) well below pre-crisis levels, making it relatively unattractive to start new banks. A recent study by economists at the Federal Reserve suggests that economic factors alone—including a long period of zero interest rates—explain at least three quarters of the post-crisis decline in new charters.[3] The authors conclude:

> The large, recent decline in new bank formation has been noted by industry observers, policymakers, and the public press. Concern has been expressed by some that the decline may be due to burdensome regulation. This paper addresses the hypothesis by investigating the factors that have led to the dramatic decline in new charters. Interest rates are known drivers of banking profitability, and regression results suggest that these rates—plus other nonregulatory influences such as weak banking demand—would have caused approximately 75 percent or more of the decline in new charters absent any regulatory effect. These nonregulatory effects have been under-emphasized in the popular press.

To the extent that this model is accurate, one would expect the rate of new applications to rise as interest rates and other economic indicators normalize. We have seen an increase in *de novo* activity accompanying the recent interest rate increases by the Federal Reserve. The FDIC has approved deposit insurance for six *de novo* banks in the past 10 months, and is receiving increasing expressions of interest by groups considering starting a new bank.

Q.7.b. What potential impacts does this have on our financial system?

A.7.b. The entry of new banks helps to preserve the vitality of the community banking sector. The dearth of new bank formation since the financial crisis is therefore a matter of concern to the FDIC and a focus of our attention.

Community banks are critically important to the U.S. financial system. FDIC research documents that community banks today account for approximately 13 percent of the banking assets in the United States, and approximately 44 percent of all small loans to businesses and farms made by all banks in the United States. These statistics may understate the importance of community banks because most of the small business lending by large banks is credit card lending. In fact, community banks are generally the lenders with the first-hand knowledge about the small business seeking a loan. Furthermore, FDIC research has also found that community banks are the only banking offices in more than 20

[3] Adams, Robert M. and Gramlich, Jacob (2016), "Where Are All the New Banks? The Role of Regulatory Burden in New Bank Formation," *Review of Industrial Organization,* 48(2), pp. 181–208.

percent of counties within the United States, meaning that the only physically present banking institution for thousands of rural communities, small towns, and urban neighborhoods is a community bank. As a result, community banks matter significantly in providing basic banking services and credit to consumers, farms, and small businesses across the United States.

Q.7.c. Is there anything more the FDIC can do to encourage the opening of new banks?

A.7.c. The FDIC welcomes applications for deposit insurance, and is committed to working with any group with an interest in starting an insured depository institution. We have seen indications of increased interest in *de novo* charter applications in recent quarters.

FDIC has undertaken a number of initiatives to encourage deposit insurance applications, including the following:

- Issued two sets of answers to frequently asked questions associated with the FDIC's Statement of Policy on Applications for Deposit Insurance to provide transparency and to aid applicants in developing proposals. Topics include; pre-filing meetings, processing timelines, capitalization, and business plans.
- Provided an overview of the deposit insurance application process during a conference of State bank supervisory agencies, and hosted an interagency training conference to promote coordination among State and Federal banking agencies in the review of applications.
- Returned the period of enhanced supervisory monitoring of newly insured depository institutions to 3 years from 7 years.
- Designated subject matter experts or applications committees in the FDIC regional offices to serve as points of contact for deposit insurance applications.
- Initiated industry outreach meetings to ensure industry participants are well informed about the FDIC's application process, and are aware of the tools and resources available to assist organizing groups. Outreach meetings were held in all six of the FDIC's Regions.
- Consolidated application-related resources on the FDIC's public website to provide better and more efficient access to applicable materials for organizers and other interested parties.
- Issued a deposit insurance application handbook for public comment. This publication serves as a guide for organizing groups and incorporates lessons shared by *de novo* banker panelists during the outreach events. The publication also addresses the timeframes within which applicants may expect communication from the FDIC regarding the application review process.
- Issued for public comment a procedures manual for processing and evaluating deposit insurance applications. The manual contains expanded instructions for FDIC staff as they evaluate and process deposit insurance applications, and addresses each stage of the insurance application process: from pre-filing activities to application acceptance, review, and processing; preopening activities; and postopening considerations. Making

these expanded instructions public is meant to enhance the transparency of FDIC's evaluation processes.

Further, several initiatives are underway and will be completed later this year. Among these, FDIC is conducting additional training for internal staff that, in part, addresses deposit insurance applications. FDIC will also be considering the need for additional answers to frequently asked questions associated with the FDIC's Statement of Policy on Applications for Deposit Insurance.

Q.7.d. Is there anything more Congress should do to encourage the opening of new banks?

A.7.d. The FDIC believes that new bank formation is primarily driven by economic conditions and the interest rate environment, as these are factors that heavily influence overall economic activity within a market and the profitability of a proposed institution. As conditions improve, we expect to see renewed interest in new bank formation. In fact, the FDIC has approved a number of applications in recent months, and has seen indications of additional interest on the part of organizing groups.

As such, we believe the appropriate statutory and regulatory structure is in place. Further, we believe the various initiatives undertaken by the FDIC with respect to deposit insurance applications will aid interested parties in pursuing the formation of additional insured depository institutions.

Q.8. I'm concerned that our Federal banking regulatory regime relies upon too many arbitrary asset thresholds to impose prudential regulations, instead of relying on an analysis of a financial institution's unique risk profile.

Q.8.a. Should a bank's asset size be dispositive in evaluating its risk profile in order to impose appropriate prudential regulations?

A.8.a. The use of dollar thresholds has always been an integral part of bank regulation, but this is only one consideration within a comprehensive process in assessing institution risk. Establishing cohorts based on asset size provides benefit for supervisors. For example, regulatory Call Reports group institutions based on asset size, loan review processes establish dollar thresholds for review samples, and community and large bank thresholds are established for analytical purposes. Use of asset size allows regulators to conduct comparative analysis of institutions based on standardized reporting requirements.

However, it is important to note that these thresholds are a starting point, and are only one of many factors considered in assessing the risk profile of an institution. It is essential that regulators are granted flexibility within statutory requirements to tailor supervisory programs based on risk identified to apply more robust standards and review to those institutions with complex business models and less to less complex institutions, regardless of asset size.

Q.8.b. If not, what replacement test should regulators follow instead of, or in addition to, an asset-based test?

A.8.b. As mentioned above, establishment of asset thresholds is a long-standing principle within supervisory frameworks. This metric

is not a standalone measure of risk, but acts as one input in assessing risk at individual institutions or industry-wide. The concept of risk-based supervision is critical in implementing an effective supervisory program, which allows for efficient allocation of resources to address emerging risk within the industry. The risk-focused examination process attempts to assess an institution's ability to identify, measure, evaluate, and control risk. If management controls are properly designed and effectively applied, they should help ensure that satisfactory future performance is achieved. In a rapidly changing environment, a bank's condition at any given point in time may not be indicative of its future performance. The risk-focused examination process seeks to strike an appropriate balance between evaluating the condition of an institution at a certain point in time and evaluating the soundness of the bank's processes for managing risk.

Regulators may also identify business lines or products that show building risk features and conduct horizontal reviews to assess potential systemic risks posed.

Large institutions are subject to enhanced supervision given that a relatively small number of insured institutions represent a significant majority of industry assets. This risk-focused view is a well-established concept embedded in existing supervisory frameworks.

Q.9. Both Mr. Noreika and Governor Powell testified on the need to further tailor the Volcker Rule. Do you agree? Why or why not?

A.9. I understand that certain aspects of the Volcker Rule may be complicated, particularly for smaller banking organizations. I think that it is important for the agencies to review the Volcker Rule to identify and reduce unnecessary complexity and burden. There is a lot that can be done in this area through the rulemaking process and I believe that the agencies should exhaust the rulemaking process before seeking statutory change. For example, the agencies could look at providing a safe harbor to banking organizations that meet certain activities-based criteria. As long as a banking organization met. the safe harbor requirements, it would not be required to prove compliance with the proprietary trading restrictions of the Volcker Rule. This would greatly reduce compliance concerns for most smaller banking organizations.

RESPONSE TO WRITTEN QUESTION OF SENATOR WARNER FROM MARTIN J. GRUENBERG

Q.1. Cybersecurity regulation is receiving increased emphasis by all financial institution regulators. How do your agencies coordinate with each other to harmonize the promulgation of new cybersecurity regulations? With the increased use of the NIST Cybersecurity Framework by both Federal agencies and the private sector, how do your agencies intend to achieve greater alignment between the framework and your own regulatory initiatives?

A.1. The FDIC, the Federal Reserve Board, and the Office of the Comptroller of the Currency (the Federal banking agencies) have not issued any cybersecurity regulations. The Federal banking agencies have, however, coordinated to publish a joint advance

notice of proposed rulemaking on Enhanced Cyber Risk Management Standards in October 2016. The agencies are considering the comments received.

The FDIC, as a member of the Federal Financial Institutions Examination Council (Council), collaborates with the Board of Governors of the Federal Reserve System, the Consumer Finance Protection Bureau, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the State Liaison Committee to harmonize any new cybersecurity guidance, policies and procedures. The Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the examination of financial institutions and to make recommendations to promote uniformity in the supervision of financial institutions. The Council's Task Force on Supervision meets monthly, and each agenda includes a discussion of cybersecurity issues.

- In June 2013, the FFIEC announced the creation of the Cybersecurity and Critical Infrastructure Working Group to enhance communication on these areas among the FFIEC members. This working group has created work programs and other tools to coordinate the members' cybersecurity examinations.
- On June 30, 2015, the Council released a Cybersecurity Assessment Tool (Assessment) in response to requests from the industry for assistance in determining preparedness for cyber threats. The Assessment was updated in May 2017, to address industry feedback after use. Institution use of the Assessment is voluntary. The Assessment incorporates cybersecurity-related principles from the FFIEC Information Technology (IT) Examination Handbook and regulatory guidance, and concepts from other industry standards, including the NIST Cybersecurity Framework. Appendix B of the assessment provides a mapping of the Assessment to the NIST Cybersecurity Framework.

The FDIC, as a member of the Financial and Banking Information Infrastructure Committee (FBIIC), is evaluating ways to further align guidance, exam procedures, and tools (like the Assessment) with the NIST Cybersecurity Framework. For example, the Committee has received industry feedback on the value of creating a common cybersecurity lexicon, based on NISI material, which would be used consistently across agencies.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR WARREN FROM MARTIN J. GRUENBERG

Q.1. The House of Representatives recently passed the Financial Institutions Bankruptcy Act of 2017 (FIBA), which amends the bankruptcy code to allow big financial institutions to elect a new "Subchapter V" bankruptcy process. While the legislation does not repeal Title II of the Dodd-Frank Act, many argue that if FIBA or similar legislation is enacted, Congress can safely repeal Title II.

Q.1.a. Do you agree with that view?

A.1.a. No. While we support efforts to improve the Bankruptcy Code with respect to the resolution of a large, complex financial institution with global operations, given the uncertainties

surrounding any particular failure scenario, a backstop is required for circumstances when failure in bankruptcy might threaten the financial stability of the United States. The Orderly Liquidation Authority (OLA) of Title II of the Dodd-Frank Act is an essential backstop for protecting taxpayers, avoiding bailouts, and ensuring that financial firms can fail in an orderly way.

While FIBA or similar legislation may help improve failure in bankruptcy, it does not address all the key obstacles that could threaten orderly resolution of a potential systemic financial institution. For example, FIBA provides no liquidity or DIP financing should the institution lack, or be unable to secure, sufficient resources on its own. Title II, by contrast, provides the Orderly Liquidation Fund (OLF)—a dedicated, back-up source of liquidity not capital to be used, if necessary, in the initial stage of resolution until private funding can be accessed. This ensures that the institution will not have to resort to fire sales of assets to raise liquidity, which, in turn, would have systemic effects. This marks a critical difference between Title II and an amended Bankruptcy Code. No taxpayer funds may be used to repay any borrowings from the OLF. Repayments must come from the assets of the filed institution or through assessments on large financial institutions. Other key obstacles include the inability of a bankruptcy court to engage in cross-border cooperation and pre-failure planning. Development of cross-border relationships with key foreign jurisdictions are a key element to avoiding systemic effects where financial institutions engage in highly interconnected global operations—such as facilitating payments and processing the foreign exchange transactions that are vital to international finance.

The OLA enables the FDIC to address these obstacles if necessary, in circumstances when failure in bankruptcy could not.

Finally, it is important to note that many bankruptcy experts share the view that Title II should continue to remain available even if the Bankruptcy Code is amended. The National Bankruptcy Conference, a voluntary, nonpartisan, organization of 60 of the Nation's leading bankruptcy judges, professors, and practitioners, stated in their letter to Congress in response to FIBA:[1]

> . . . we are concerned that the bankruptcy process might not be best equipped to offer the expertise, speed and decisiveness needed to balance systemic risk against other competing goals in connection with resolution of a SIFI [systemically important financial institution]. Likewise, bankruptcy might not be the best forum in which to foster cooperation by non-U.S. regulators of foreign subsidiaries whose adverse actions could prevent the orderly resolution of the firm. Consequently, the Conference believes a regulator supervised resolution regime with resolution tools similar to those contained in OLA [Orderly Liquidation Authority] should continue to be available even if special provisions are added to the Bankruptcy Code with respect to the resolution of SIFIs.

Q.1.b. If not, what do you think the risks would be to taxpayers, the financial system, and the economy of repealing Title II even if FIBA or similar legislation were enacted?

A.1.b. During the financial crisis, policymakers lacked the tools for managing the failure of a potentially systemic financial institution, and—when faced with that possibility—were forced to choose

[1] *http://nbconf.org/wp-content/uploads/2015/07/NBCLetter-re-Resolution-of-Systemically-Important-Financial-Institutions-March-17-2017.pdf.*

between two bad options: taxpayer bailouts or systemic disruption in bankruptcy.

It is clear that without the Title II OLA, we would be back in the same position as 2008, with the same set of bad choices.

Q.2. The FDIC closely monitors the health of the banking industry.

Q.2.a. How would you describe the performance of so-called regional banks (those with between $50 billion and $500 billion in assets) in the last 5 years?

A.2.a. Banks with assets between $50 billion and $500 billion accounted for 0.5 percent of all banks and 30 percent of total industry assets over the last 5 years. In aggregate, this peer group has been as profitable as the overall industry with an average pre-tax return on assets (ROA) of 1.47 percent compared to 1.48 percent for the industry.[2]

This peer group had higher revenues (as a percent of total assets) than the overall industry, in part due to a higher average net interest margin.

These banks experienced loan growth greater than the industry 5-year average at 5.3 percent while the industry grew only 4.6 percent. Regarding capital, their leverage capital ratio is above the industry average while their total risk weighted capital ratio is slightly below the industry average.

Q.2.b. How does that performance compare to community banks (banks with under $10 billion in assets), mid-size banks (those with between $10 billion and $50 billion in assets), and the biggest banks (those with more than $500 billion in assets)?

A.2.b. Banks with assets less than $10 billion accounted for 98 percent of all banks and 19 percent of total industry assets over the last 5 years. With an average pre-tax ROA of 1.34 percent, this peer group was somewhat less profitable on a pre-tax basis than those banks with assets between $50 billion and $500 billion. These banks experienced a 5-year average loan growth rate of 5.8 percent, higher than banks with total assets between $50 billion and $500 billion and higher than the industry average. These banks have a leverage capital ratio considerably higher than the industry average.

Banks with assets between $10 billion and $50 billion accounted for 1.1 percent of all banks and 10 percent of total industry assets over the last 5 years. With an average pre-tax ROA of 1.79 percent, this peer group was more profitable on average than those banks with assets between $50 billion and $500 billion. This group had the highest 5-year average loan growth at 7.9 percent, well above the industry average. These banks, as with those with total assets between $50 billion and $500 billion, have a leverage capital ratio slightly higher than the industry average.

Banks with assets greater than $500 billion (the four largest FDIC-insured banks) accounted for 0.06 percent of all banks and 41 percent of total industry assets over the last 5 years. With

[2] We use pre-tax ROA to compare profitability across size groups because many community banks are organized as Subchapter S Corporations (35 percent of all banks with assets less than $10 billion at year-end 2016). Subchapter S Corporations pass income and tax obligations of the corporation through to shareholders. As a result, comparing net income on a pre-tax basis avoids overstating the relative profitability of Subchapter S Corporations.

an average pre-tax ROA of 1.49 percent, this peer group has been as profitable as those banks with assets between $50 billion and $500 billion. However, these banks have not grown their loan portfolios as rapidly as the other groups and are well below the industry average with a 5-year average of 2.3 percent. These banks have a leverage capital ratio considerably less than the industry average.

Q.2.c. Do you see evidence that being subject to tailored enhanced prudential standards has precluded regional banks from competing against banks of other sizes?

A.2.c. Banks subject to enhanced prudential standards are a diverse group with business models that yield differing measures of performance. However, with a pre-tax ROA essentially the same as the overall industry, loan growth greater than the industry average, and with an overhead expense ratio (as a percent of total assets) less than that of banks with assets below $50 billion, there is no evidence at the aggregate level that this peer group is having difficulty competing against banks that are not subject to enhanced prudential standards.

Q.3. At the Banking Committee hearing, you testified that you favored maintaining the $50 billion threshold for enhanced prudential standards rather than raising it or replacing it with a set of qualitative requirements. What are the risks of raising or replacing the threshold?

A.3. The use of dollar thresholds as a supervisory tool has always been an integral part of the regulatory process. It is beneficial to use quantitative measures to assess and monitor risk on an ongoing basis. Such measures allow for supervisors to effectively and efficiently identify potential outliers and assign resources as needed to further analyze potential exposure. Establishing thresholds allows for effective comparative analysis among institutions, portfolios, business lines, or other operations of a financial institution to identify, monitor, and react to risk.

In our judgment, the concept of enhanced regulatory standards for the largest institutions is sound and is consistent with our approach to bank supervision. It is appropriate to take into account differences in the size and complexity of banking organizations when assessing risk and developing regulatory standards, and the concept of risk-based supervision is a key tenant of an effective supervisory program. Asset thresholds are a starting point in terms of the overarching supervisory process and represent only one of many tools used in assessing risk of large institutions. It is important to maintain flexibility in our ability to apply supervisory standards. Clearly, there is a range of risk posed by the institutions with total assets over $50 billion, and the regulators' goal is to tailor processes to address more complex and higher risk activities. From the perspective of a deposit insurer, the most expensive failure in the most recent financial crisis was that of an institution with $32 billion in assets that resulted in losses to the deposit insurance fund of approximately $12.8 billion.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM MARTIN J. GRUENBERG

Q.1. I'm a proponent of tailoring regulations based off of the risk profiles of financial institutions; as opposed to having strict asset thresholds that do not represent what I believe is the smart way to regulate. But, my question here is really about the importance of ensuring that we have a system that is rooted in fundamental, analytical, thoughtful regulation so that we can achieve and execute on goals, whether balancing safety and soundness with lending and growth, or encouraging more private capital in the mortgage market to protect taxpayers and reform the GSEs.

Q.1.a. Do you think that we should use asset thresholds as a way to regulate—yes or no? If no, can you provide me with the metrics or factors by which a depository institution should be evaluated? If yes, please explain.

A.1.a. The use of dollar thresholds has always been an integral part of bank regulation, but this is only one consideration within a comprehensive process in assessing institution risk. Establishing cohorts based on asset size provides benefit for supervisors. For example, regulatory Call Reports group institutions based on asset size, loan review processes establish dollar thresholds for review samples, and community and large bank thresholds are established for analytical purposes. Use of asset size allows regulators to conduct comparative analysis of institutions based on standardized reporting requirements.

However, it is important to note that these thresholds are a starting point, and only one of many factors considered in assessing the risk profile of an institution. It is essential that regulators are granted flexibility within statutory requirements to tailor supervisory programs based on risk identified to apply more robust standards and review to those institutions with complex business models and less to less complex institutions, regardless of asset size.

Q.1.b. Section 165 of Dodd-Frank requires enhanced supervision and prudential standards for banks with assets over $50 billion. This applies to any bank that crosses the asset threshold, without regard to the risks those banks pose based upon the complexity of the business model. This includes heightened standards on liquidity and capital under the Liquidity Coverage Ratio (LCR) and the Comprehensive Capital Analysis and Review (CCAR) which have a various assumptions built in that may drive business model.

Q.1.b.i. I understand under these two regulatory regimes, banks have changed certain lending behaviors because of the assumptions Federal regulators have made regarding certain classes of assets and deposits. Can you provide some examples of how the LCR and CCAR have changed the types of loans, lending, and deposits your institution holds?

Q.1.b.ii. Construction lending by banks over the $50 billion threshold has been a source of concern, namely, because these enhanced prudential standards have treated construction loans punitively. This includes construction lending for builders of apartments, warehouses, strip malls, and other projects that may have varying risk profiles associated with them. However, under the CCAR and

DFAST assumptions, the regulators have assigned all these categories of lending the same capital requirements. The result is an overly broad capital requirement for varying loans that have different risks, a capital requirement that maybe greater for some loans and lower for others, influencing the decision of many banks over the $50 billion threshold to hold less of these assets due to the punitive capital requirements associated with them. Have you seen a similar corresponding issue with construction loans because of the heightened prudential standards?

Q.1.b.iii. Under the CCAR regulations, Federal regulators routinely assign risk weights to certain assets that Bank Holding Companies have on their balance sheets. These risk weights often time changes the costs associated with holding certain investments, such as Commercial Real Estate. Has this changed the type of assets that institutions hold, or caused institutions to alter their business plans because of the regulatory capital costs? If so, can you provide examples of this?

A.1.b.i.–iii. FDIC Quarterly Banking Profile reports show that asset and loan growth has been generally strong post crisis. For full-year 2016, total loans and leases increased by $466 billion. Loan growth rates in the past 3 years are approaching those reported prior to the recession, and larger banks are the primary driver of loan growth trends for the industry.

Many of the principles and standards required by the Dodd-Frank Act address issues that are within the existing scope of Federal banking agencies authority. For example, the agencies have the ability to: establish regulatory capital requirements, liquidity standards, risk-management standards, and concentration limits; to mandate disclosures and regular reports; and to conduct stress tests. These are important safety and soundness authorities that the agencies have exercised by regulation and supervision in the normal course and outside the context of section 165.

Banks and bank holding companies are subject to risk-based capital rules separate and distinct from CCAR. The risk-weights were assigned deliberatively based on notice and comment, and the risk-based capital rules divide exposure types into broad risk weight categories. This is intended to assign lower capital charges to low-risk credit exposures and higher capital charges to high-risk credit exposures. For example, the capital rules do impose a higher risk weight for certain acquisition, development or construction loans. However, commercial real estate lending remains robust across the banking industry which indicates that banking organizations are not dissuaded as a result of the risk weight. Unfunded commitments to make commercial real estate loans also are exhibiting robust growth, suggesting that there continues to be momentum for future commercial real estate lending growth.

Q.1.b.iv. Do you think that regulators, on a general basis, get the risks weights right?

A.1.b.iv. The risk-based capital rules provide a relative basis to separate lower risk activities from higher risk activities. The risk weights were assigned deliberatively based on notice and comment, and the risk-based capital rules divide exposure types into broad risk weight categories. This is intended to assign lower

capital charges to low-risk credit exposures and higher capital charges to high-risk credit exposures. Careful consideration is given to the tradeoff between the number of risk weight categories and risk sensitivity of the framework versus the desire to reduce unnecessary complexity.

In general, the risk weights are designed to apply on a portfolio level so that, in the aggregate, low-risk and high-risk assets can be differentiated for risk-based capital purposes. The risk weights are subject to regular review to assure they are appropriately capturing relative risk.

Q.1.b.v. Fed Governor Tarullo, has argued that the $50 BB threshold is too low in terms of an asset threshold for enhanced prudential standards; does this number make sense? Why do we need such arbitrary thresholds? Shouldn't we get away from these thresholds and move toward a regulatory system that evaluates substance and activities of an institution as opposed to an arbitrary number? Why can't we do that?

A.1.b.v. Please refer to A.1.a. above.

Q.1.b.vi. Does Title I allow the Fed to treat a $51 BB bank in a similar manner to a $49 BB bank for the purposes of enhanced prudential standards?

A.1.b.vi. The thresholds established in the enhanced prudential standards legislative framework establish a starting point by which to apply more robust standards to larger institutions, and it is critical that regulators have sufficient flexibility in applying these standards based on risk. Over the past 7 years, the FDIC and other agencies have used that flexibility to tailor requirements for firms over $50 billion.

Q.2.a. Since Section 29 of the Federal Deposit Insurance Act establishing brokered deposits was enacted in 1989; the has remained unchanged despite significant changes in the industry, technology and the financial regulatory structure, including the passage of Gramm-Leach-Bliley and Dodd-Frank. Furthermore, since 1989, the FDIC has written a series interpretive letters and FAQs that have significantly expanded the scope of deposits required to be classified as brokered, going well beyond the types of relationships and deposits that concerned Congress when adopting Section 29. Yet in the FDIC's report stemming from Section 1506 of Dodd-Frank, the FDIC concluded that no statutory updating was necessary. In light of the significant legal, technological and marketplace changes that have occurred over the past quarter century, why has the FDIC refused to re-examine its positions regarding what is a brokered deposit?

A.2.a. We recognize that what constitutes a brokered deposit is fact specific and needs to take account of changes in technology and the marketplace. In an effort to be responsive to the unique and evolving ways in which banks can gather deposits, FDIC staff continues to engage the industry. Through advisory opinions, staff is able to provide interpretations on new issues for example—whether deposits placed in new ways stemming from legal, technological, and marketplace changes would be considered brokered deposits.

As background, Section 29 was enacted in 1989 as part of FIRREA to restrict troubled institutions from accepting deposits from a third party (a deposit broker). The legislative history of Section 29 reflects that many of the thrifts that failed during the S&L crisis relied on volatile funding, such as brokered deposits controlled by a few individuals, which could be quickly withdrawn, potentially destabilizing the institution. Further, many of these institutions attempted to grow themselves out of trouble with high cost brokered deposits. As a result, the institutions increased asset yields by taking on greater risks in order to balance the higher cost of funding, which ultimately resulted in a higher number of failures and higher costs to the insurance funds.

In 2011, pursuant to the Dodd-Frank Act, the FDIC conducted, and subsequently submitted to Congress, a study on core deposits and brokered deposits. Based upon the study, which included public input and review of statistical analysis, the FDIC concluded that the brokered deposit statute continues to serve an important function. The key findings from the study include that: (1) banks that use brokered deposits have a higher growth rate and higher subsequent nonperforming loan ratios, which are both associated with a higher probability of failure; (2) deposits gathered through third parties or by offering high interest rates may leave the bank quickly; and (3) brokered deposits tend to increase the losses to the DIF when a bank fails.

In 2015, in an effort to assist the industry and provide information on identifying and accepting brokered deposits (as provided by the statute, regulations, published advisory opinions, and the study) in one place, the FDIC issued Frequently Asked Questions (FAQs). That same year, staff held an industry call to discuss the FAQs and to respond to questions raised by the industry after the FAQs were issued. More than 1,400 industry participants listened to the call, and after gathering feedback, the FDIC requested comment on proposed updates to the original FAQs. After consideration of the public input (written comments and meetings with key stakeholders), the FDIC issued an updated set of FAQs in 2016. The FDIC intends to update the FAQs on a periodic basis, as needed.

Q.2.b. Do you believe that legislation is needed to address present-day issues with Section 29?

A.2.b. The brokered deposit statute provides an essential function and is sufficiently flexible to allow the FDIC to adapt to and address present-day issues. Based on the FDIC's 2011 study, deposits placed through third parties and high interest rate deposits still present similar concerns to those existing in 1989. As noted in the study, "brokered deposits are correlated with behaviors that increase the risk of failure."[1] The study also notes that on average, banks that accept brokered deposits typically rely on lower shares of core deposit funds than banks that do not, and, as a result, they face a higher probability of default in their loan portfolios.

The findings of the FDIC study are consistent with other reviews. For example the Comprehensive Study on the Impact of the

[1] See FDIC's *Study on Core Deposits and Brokered Deposits,* at p. 47.

Failure of Insured Depository Institutions[2] noted that material loss reviews[3] reflecting the most commonly reported contributing causes of failures of banks during the 2008–2009 financial crisis were "the institutions' management strategy of aggressive growth that concentrated assets in CRE and ADC loans, often coupled with inadequate risk management practices for loan underwriting, credit administration, and credit quality review." According to this study, a number of these IDIs also relied on "volatile funding sources" to support their growth.

In contrast, the Acquisition, Development, and Construction Loan Concentration Study[4] found that "some institutions with ADC concentrations were able to weather the recent financial crisis without experiencing a corresponding decline in their overall financial condition. The factors that contributed to their survival validate the point that regulators have emphasized and reiterated for years—a well-informed and active Board, strong management, sound credit administration and underwriting practices, and adequate capital are important in managing ADC concentrations in a safe and sound manner." In addition, the banks in the study "did not rely on brokered deposits to fund growth . . . "

The FDIC's statistical analyses also show that brokered deposits are an indicator of higher risk appetite. Banks with significant reliance on brokered deposits typically have more rapid growth rates and higher subsequent nonperforming loan ratios, which are both associated with a higher probability of failure. In addition, brokered deposits tend to increase the FDIC's losses when a bank fails. A traditional brokered deposit that remains at a bank when it fails has no franchise value. Bidders have repeatedly told the FDIC that they are not interested in paying for brokered deposits and the FDIC, as a result, does not seek bids for brokered deposits. While many brokered deposits do not usually pass to the acquiring institution (AI) when a bank fails, AIs have sometimes accepted certain deposits without paying a premium. Last, gathering deposits through a third party may attract volatile funding that may quickly leave the bank if the bank reduces its deposit rates or if a competitor offers more attractive terms. Because high rate or volatile deposits are not attractive to potential purchasers and do not add to a bank's franchise value, this results in higher losses to the DIF and, in the long run, higher premiums for surviving institutions.

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[2] See Table 6, Page 50, Federal Deposit Insurance Corporation, Office of the Inspector General, *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions,* EVAL–13–002, January 2013, *https://www.fdicig.gov/reports13/13-002EV.pdf.*

[3] Section 38(k) of the FDI Act, as amended, provides that if the Deposit Insurance Fund incurs a "material loss" with respect to an insured depository institution, the Inspector General of the appropriate regulator (which for the OCC is the Inspector General of the Department of the Treasury) shall prepare a report to that agency, identifying the cause of failure and reviewing the agency's supervision of the institution.

[4] Federal Deposit Insurance Corporation, Office of Inspector General, *Acquisition, Development, and Construction Loan Concentration Study,* EVAL–13–001, October 2012, *https://www.fdicig.gov/reports13/13-001EV.pdf.*

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEITKAMP FROM MARTIN J. GRUENBERG

Q.1. As part of the EGRPRA process, regulators identified access to timely appraisals—especially in rural America—as a major challenge for small lenders. Yet the report itself did little to address residential appraisal requirements.

Q.1.a. Do you share my concerns that the appraisal system in rural America is broken?

A.1.a. The FDIC shares concerns about appraisal issues in rural America. During the Economic Growth and Regulatory Paperwork Reduction Act process, a frequently commented upon issue was the scarcity of appraisers in rural areas and resultant delays or problems completing transactions because of the lack of appraisers. This was a particular concern of bankers at our Kansas City outreach session, which was focused on rural banking issues. Also at that session, there were what appeared to be some misinterpretations of the monetary thresholds set forth in the interagency appraisal regulations, with some bankers thinking that the regulations—or examiners—require appraisals even for transactions below the thresholds.

Additionally, in an effort to respond to these concerns and as described in the EGRPRA report, the FDIC, along with the other regulators, has taken steps to address appraisal issues raised by rural bankers.

Supervisory Expectations for Evaluations—On March 4, 2016, the FDIC, along with the OCC and the FRB, clarified supervisory expectations for real estate evaluations, which are addressed in FDIC FIL–16–2016. This guidance addresses questions raised during outreach meetings held pursuant to the EGRPRA, and advises institutions that the agencies' appraisal regulations allow the use of an evaluation in lieu of an appraisal for certain real estate-related transactions, including those below the $250,000 monetary threshold.

Advisory on Availability of Appraisers—On May 31, 2017, the FDIC, FRB, OCC, and NCUA issued an advisory on appraiser availability, which is addressed in FDIC FIL–19–2017. The advisory discusses two existing options that may help insured depository institutions and bank holding companies address appraiser shortages: temporary practice permits and temporary waivers.

Appraisal Threshold—The 2017 EGRPRA Report to Congress states the agencies will develop a notice of proposed rulemaking, or NPR, to raise the appraisal threshold for commercial real estate transactions from $250,000. This NPR was issued on July 18, and includes a question seeking comment on whether the appraisal threshold for residential real estate should be raised.

Q.1.b. In the EGRPRA report, you provide a "temporary waiver" option; however, most lenders view this as cumbersome and unworkable. How can you streamline this process and what steps have you taken to make this option accessible to lenders?

A.1.b. The aforementioned May 2017 *Interagency Advisory on the Availability of Appraisers* (Advisory) addresses existing options that may help relieve appraiser shortages in rural areas. One existing option is the authority under Title XI of the Financial

Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI) for the Appraisal Subcommittee (ASC), with the approval of the FFIEC, to grant temporary waivers of requirements for appraisals needing to be performed by licensed or certified appraisers.

The issuance of a temporary waiver would allow financial institutions lending in affected areas access to more individuals who would be considered eligible to complete the appraisals required under Title XI. Nevertheless, we have also heard views that the process for seeking temporary waivers appears cumbersome, and in the EGRPRA report, the FDIC and the other agencies have publicly stated that we will work with the ASC to streamline the process for the evaluation of temporary waiver requests. To that end, we are very interested in hearing ways to improve that process at our outreach sessions with rural bankers and rural bank supervisors. The agencies are reaching out to States to explain the waiver process and assist States in applying for the waivers.

Q.1.c. What concerns would you have with raising the residential exemption threshold—which was last modified in 1994—above its current limit of $250K?

A.1.c. As noted above, the NPR requests comment on the current residential appraisal threshold and whether it should be raised, consistent with consumer protection, safety and soundness, and reduction in unnecessary regulatory burden. The agencies view this as an open issue.

Q.2. On several occasions before this Committee Governor Tarullo stated that the dollar asset thresholds in Dodd-Frank such as the $50 billion threshold for SIFI designation, is far too high [sic].

Q.2.a. Do you believe regulators could effectively address systemic risk if the threshold were raised above $50 billion?

A.2.a. The $50 billion threshold applies to only a relatively few companies whose assets account for a large majority of industry assets. History has shown that the largest financial institutions may be vulnerable to sudden market-based stress. From the perspective of a deposit insurer, the most expensive failure in the FDIC's history occurred in the most recent financial crisis when an institution with $32 billion in assets failed, resulting in losses to the deposit insurance fund of approximately $12.8 billion.

Congress established the $50 billion threshold in section 165 of the Dodd-Frank Act. Congress also provided for significant flexibility in implementation of the enhanced prudential requirements. The agencies have made appropriate use of this flexibility thus far, and where issues have been raised by industry, we believe that we have been responsive.

In our judgment, the concept of enhanced regulatory standards for the largest institutions is sound, and is consistent with our longstanding approach to bank supervision. Certainly, degrees of size, risk, and complexity exist among the banking organizations subject to section 165, but all are large institutions. Some of the specializations and more extensive operations of regional banks require elevated risk controls, risk mitigations, corporate governance, and internal expertise than what is expected from community banks. We should be cautious about making changes to the statutory framework of heightened prudential standards that would

result in a lowering of expectations for the risk management of large banks.

Q.2.b. Are there specific provisions in Dodd-Frank which you believe are particularly costly or unnecessary for a certain subset of banks above the $50 billion threshold?

A.2.b. The agencies are currently reviewing the Volcker Rule to identify ways to address industry concerns about complexity and burden. There is a lot that can be done in this area through the rulemaking process and I believe that the agencies should exhaust the rulemaking process before seeking statutory change.

Q.2.c. Are there specific provisions in Dodd-Frank which you believe are necessary for all banks above $50 billion in assets that should be retained in order to mitigate systemic risk?

A.2.c. The ability to have information to help ensure the orderly failure of large institutions is critical for oversight of systemic institutions, and stress testing rules provide important insight into how large banks will respond to economic downturns, as well as providing supervisors with key insight into the effectiveness of an institution's internal risk management process. We believe the living will and stress testing requirements should be retained for banks over $50 billion, appropriately tailored to the size and complexity of each institution.

Q.2.d. What concerns do you have with having a purely qualitative test for identifying systemic risk?

A.2.d. Longstanding regulatory programs seek to utilize both qualitative and quantitative measures to identify systemic risk. Relying on qualitative measures alone would significantly limit the ability of regulators to identify and analyze systemic risk. Quantitative measures allow supervisors to effectively and efficiently identify potential outliers and assign resources as needed to further analyze potential exposure. Establishing thresholds allows for effective comparative analysis among institutions, portfolios, business lines or other operations of a financial institution to identify, monitor, and react to risk. Furthermore, establishing asset thresholds provides transparency to regulated institutions as to what regulations will apply to them and allows them to adequately prepare for the regulation in advance of the effective date.

RESPONSE TO WRITTEN QUESTION OF SENATOR CORTEZ MASTO FROM MARTIN J. GRUENBERG

Q.1. In his written testimony to the Committee, Mr. Noreika of the OCC suggested that Congress revolve the CFPB's authority to examine and supervise the activities of insured depository institutions with over $10 billion in assets with respect to compliance with the laws designated as Federal consumer financial laws. Mr. Noreika further suggested that Congress return examination and supervision authority with respect to Federal consumer financial laws to Federal banking agencies.

When I asked him about this recommendation at the hearing, he noted that, "what we're seeing in practice is that the CFPB is not enforcing those rules against the mid-size banks—the large-small

banks to the small-big banks. And so we do have a problem of both over- and under-inclusion. And so when we get up to the bigger banks, we have a little bit of overlap and overkill there. So we need some better system of coordination. And so when we get up to the bigger banks, we have a little bit of overlap and overkill there. So we need some better system of coordination."

- Does your experience suggest that the CFPB is failing to supervise and enforce consumer financial laws for "large-small banks" to the "small-big banks?" And is there "overkill" when it comes to CFPB supervision and enforcement of consumer financial laws for "bigger banks?"

A.1. The FDIC and CFPB coordinate regularly regarding supervisory activities regarding State nonmember institutions with assets over $10 billion to ensure effective and coordinated supervision. The FDIC and CFPB employ risk-based supervisory strategies tailored to the risk, complexity, and business model of supervised institutions. The CFPB has been an effective partner with the FDIC in addressing problematic practices identified at supervised institutions of various sizes through enforcement actions to address illegal conduct. In 2012, the FDIC and CFPB, along with the Utah Department of Financial Institutions, partnered in an investigation of three American Express subsidiaries, which led to an enforcement action in which $85 million was refunded to 250,000 customers for illegal card practices. Additionally, our two agencies joined in another 2012 enforcement action, this time against Discover Bank (Discover) for deceptive telemarketing and sales tactics. Discover was ordered to return $200 million to more than 3.5 million consumers. We are not aware of any situations where CFPB has failed to supervise or enforce consumer financial laws for "large-small banks" or "small-big banks."

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM J. MARK McWATTERS

Q.1. Credit unions' primary mission is to serve their customers especially in areas underserved by other financial institutions. During your time on the board, have NCUA supervision teams identified and corrected any consumer protection issues? What do you believe is NCUA's role to ensure that the credit unions you regulate protect their customers?

The NCUA ensures credit unions protect their members through a variety of methods. They include:

- Providing substantive guidance and regular outreach to credit unions about Federal consumer financial laws and protections;
- Examining credit unions for compliance with consumer financial protection laws and regulations and requiring credit unions to take appropriate steps to address deficiencies and violations found as a result of the examination;
- Resolving and investigating consumer complaints about credit unions;
- Developing consumer financial protection policies and programs that allow credit unions to meet the financial needs of their members in a cost-efficient and effective manner;

- Promoting and developing financial literacy resources for both consumers and credit unions, that educate consumers about their financial protections; and
- Increasing consumer access to credit union services with, as appropriate, the approval of new credit union charters and field of membership expansion requests.

Given the above responsibilities and efforts, the NCUA has identified and worked to correct numerous consumer financial protection issues since joining the NCUA Board in August 2014. The majority of Federal consumer financial protection laws violations cited by the NCUA during the period from August 2014 to June 2017 involved the Truth in Lending Act, the Equal Credit Opportunity Act, and the Real Estate Settlement Procedures Act. The NCUA required credit unions to address these violations, as appropriate, by revising or implementing new credit union policies and procedures, increasing staff training or by imposing other administrative remedies.

The NCUA's role in ensuring that credit unions protect their members recognizes that a core credit union mission is to provide affordable financial services, benefiting both credit union members and their communities. The NCUA is dedicated to supporting credit union efforts to fulfill this mission, which is unique among financial institutions, and to comply fully with consumer financial protection laws and regulations. In addition to the Federal financial regulator responsibilities listed above, the NCUA has an important role in ensuring that consumer financial protections do not have the unintended consequences of limiting access and imposing unnecessarily burdensome costs on credit unions and their members.

Q.2. This week, the House approved the FY 2018 Financial Services and General Government Appropriations bill. Included in this bill is a provision from the CHOICE Act to bring all independent financial regulatory agencies' budgets under the appropriations process. What would be the impact on the NCUA if its budget was appropriated?

A.2. Placing the NCUA's budget under the annual appropriations process would require the Agency to make a multitude of systems and process changes, many of which are outlined below. The cumulative impact of these changes would be an increase in the fees assessed to the Federal credit unions as the NCUA made the conversion to the Federal appropriations process.

A particularly significant change would remove the NCUA Board's authority to determine independently its annual operating budget. The established Federal budget process does not allow for Federal agencies to engage stakeholders in its budget development, in the way that NCUA does. The budget process used by the NCUA provides for direct input from the credit union system, and is a process which is very nimble when changes are needed. The Board holds public meetings to discuss the budget and makes the proposed budget publicly available for stakeholder comments prior to final adoption of the budget. The Board has the authority to make adjustments to its budget during the course of the year, which for some Federal agencies requires a more time-consuming reprogramming process. The extent of direct stakeholder input and the

nimbleness of process are not hallmarks of the Federal appropriations process.

On an administrative level, subjecting the NCUA to the Federal appropriations process would require the agency to make numerous systems and process changes, including the following:

- The NCUA would need to move to a Federal fiscal year, subject to the terms and conditions of an appropriation (fixed period of availability, fixed amount of availability, reprogramming and transfer limitations set by the Congress in annual appropriations acts). The NCUA's operating budget and its Share Insurance Fund now operate on a calendar-year business cycle.
- The NCUA's Operating Fund is currently accounted for under commercial accounting standards set by the Financial Accounting Standards Board (FASB). The appropriations process limits an agency's "Budget Authority," not its level of expenditure, during the fiscal year, whereas the NCUA operates with controls on its expenditures. The NCUA would need to adjust its financial management systems and processes to better recognize and record commitments and obligations of funds prior to expenditure and train staff accordingly. This would be a significant undertaking, affecting almost all nonpayroll transactions in the agency, including travel.
- The NCUA would need to modify its billing process for operating fees it collects from Federal credit unions. The NCUA would likely need to adjust the timing for the collection of these fees, and it would need to create additional billing and refund processes with respect to the fees to adjust for changes made when the appropriation is enacted, assuming the annual appropriations were not enacted prior to the start of the fiscal year.
- The NCUA would experience transition costs for systems changes (accounting system, budget system, and travel system), business process changes, and training. In addition, certain one-time charges likely would be needed to account for transactions under Federal budget procedures versus the current commercial accounting standards. An example of this is the treatment of the note (borrowing) between the Operating Fund and the Share Insurance Fund for the purchase of the NCUA's Central office in the early 1990s. The outstanding amount of the note is about $8.9 million. Agencies receiving appropriations are generally prohibited from having capital leases or agreements such as this, unless the full amount of the lease (or, in this case, the note) is funded up-front with current appropriations.
- The NCUA would need to hire additional staff familiar with the appropriations process.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM J. MARK MCWATTERS

Each of you serve at agencies that are members of the Financial Stability Oversight Council (FSOC). Insurance has been regulated at the State level for over 150 years—it's a system that works. But

FSOC designations of nonbank systemically important financial institutions (SIFIs) have made all of you insurance regulators, despite the fact that you are bank regulators at your core.

Strong market incentives exist for insurers to hold sufficient capital to make distress unlikely and to achieve high ratings from financial rating agencies, including incentives provided by risk sensitive demand of contract holders and the potential loss of firms' intangible assets that financial distress would entail. Additionally, insurance companies are required by law to hold high levels of capital in order to meet their obligations to policyholders. Bottom line: Insurance companies aren't banks, and shouldn't be treated as such.

In March, my colleagues and I on the Senate Banking Committee sent a letter to Treasury Secretary Mnuchin indicating our concerns regarding the FSOC's designation process for nonbanks. I support efforts to eliminate the designation process completely.

I was pleased that President Trump issued a "Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council" (FSOC Memorandum) on April 21, 2017, which directs the Treasury Department to conduct a thorough review of the designation process and states there will be no new nonbank SIFI designations by the FSOC until the report is issued. Relevant decisionmakers should have the benefit of the findings and recommendations of the Treasury report as they carry out their responsibilities with respect to FSOC matters.

Please answer the following with specificity:

Q.1. What insurance expertise do you and your respective regulator possess when it comes to your role overseeing the business of insurance at FSOC?

A.1. I do not have a background in insurance, but, as a financial attorney with significant experience in corporate finance and mergers and acquisitions, and as a certified public accountant, I have a strong background in understanding the risks firms face when they deploy funds in financial markets. In addition, I have a deep understanding of the developments and factors that were important in the most recent financial crisis through my service on the Troubled Asset Relief Program Congressional Oversight Panel.

As a fully participating member of the TARP Congressional Oversight Panel, we investigated the Treasury Department's implementation of the TARP program and how the $700 billion of TARP money was deployed. But in doing that, we also investigated the fundamental causes of the financial crisis—who was at fault and why. We were required to report to Congress every month. The reports were usually about 100 to 150 pages long. The longest report was on the American International Group, Inc. (AIG), an American multinational insurance corporation, and it was around 350 pages.

Through that work, I gained a strong appreciation for the role that insurance companies can play and risks they can pose in our financial system. For example, I came to understand that the magnitude of AIG's operations and the company's far-flung linkages across the global financial system led to multiple rounds of exceptional assistance from the Government. Only Fannie Mae and Freddie Mac, institutions in Government conservatorship, received

more assistance during this period. The Panel had to pay particular attention to AIG because it occupied a unique position in the financial system and because of the significant investment of taxpayer dollars required to avert the company's collapse. In addition to the Panel's June 2010 report, which focused solely on AIG, the Panel also held a hearing, in which I fully participated, to explore the rescue of AIG, its impact on the markets, and the outlook for the Government's significant investment in the company.

Although credit unions and insurance companies appear to be very different, they create value by managing the risk of their assets and liabilities. The channels through which distress at insurance companies would transmit or amplify risk have mostly to do with the interconnections and exposures to other financial institutions, rather than insurance operations.

I am very familiar with these interconnections. The design of the Council ensures that each member of the FSOC will bring a unique perspective to the FSOC's deliberations, informed by our particular areas of expertise and experience. In my case, that is a long career in and around the financial services industry and considerable experience in examining the features in the financial landscape that led to the financial crisis. The institutional structure of the Council ensures that a broad array of views about the financial system are considered in matters related to financial stability. Issues presented to the Council about insurance companies are, for the most part, about their connections and exposures to other financial institutions.

The NCUA does not have insurance underwriting experts on staff. However, the NCUA does have experts in asset-liability management, capital market activity, interest-rate risk, and derivatives. As such, many NCUA employees, through their everyday work, have a deep understanding of the financial policy matters that are common to financial institutions that manage their assets by participating in credit markets.

Further, many NCUA employees have considerable financial market experience, both from employment in the private sector and in other Government agencies such as the Federal Reserve, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and the Department of the Treasury. They bring this experience to bear on credit union issues primarily, but their knowledge, experience, and training enables them to understand and comment knowledgeably on a wide variety of financial policy issues beyond the regulation of credit unions.

It is also worth noting that NCUA, like the FDIC for banks, is the insurer of credit union deposits, maintaining the National Credit Union Share Insurance Fund. As such, NCUA is familiar with many of the issues facing other insurers.

Q.2. Do you support the Senate Banking Committee's recent legislative effort, the Financial Stability Oversight Council Insurance Member Continuity Act, to ensure that there is insurance expertise on the Council in the event that the term of the current FSOC independent insurance member expires without a replacement having been confirmed?

A.2. It is important that the FSOC have continuous access to a member with insurance expertise on the Council, just like it is important for the FSOC to have continuous access and input from regulators with banking industry experience or credit union experience. I would support legislation to ensure that the FSOC's insurance expertise is maintained during transitions.

Q.2.a. I served on the board of Heritage Trust Federal Credit Union, a great institution based in Charleston. During my time at Heritage Trust, we wanted to make loan decisions based on more than what people looked like on paper. We were able to do so because we had such close relationships with our members. Our loan delinquency rate was only 2 percent, I might add.

I've been on the other side of the equation: I received my first car loan from a credit union. It wasn't a handout—it was a hand up. The credit union sat me down and we talked about the importance of staying on top of my finances, the obligations associated with taking a loan, and how I could pay it back.

As community banks and credit unions close up shop, we lose that personal touch.

Regulatory burdens are driving the consolidation. I think too many regulators are acting without an eye to the consequences of their actions on economic growth.

But the NCUA's approach has been refreshing.

After my friend, and now Director of the Office of Management and Budget, Mick Mulvaney introduced legislation mandating more budget transparency at the NCUA, you made it happen.

You reduced the number of exams for well-capitalized credit unions, meaning they can hire more loan officers than compliance lawyers.

You've also engaged in rulemaking on field-of-membership issues in economically distressed areas, which I think is encouraging. Please answer the following with specificity:

What kind of economic cost-benefit analysis does the NCUA engage in?

A.2.a. As an independent agency, the NCUA is not required to conduct formal cost-benefit analyses. As a matter of course, however, we always try to develop information and analyses that help us consider the relevant direct and indirect potential costs, as well as the direct and indirect potential benefits.

That said, it's well understood that cost-benefit analyses contain at least as much art as science, and reasonable people can and do disagree about net benefits. One of my goals is to ensure that the agency's rulemakings are reasonable and cost-effective. As we consider a rule's intended effects and try to analyze potential areas of unintended consequences, if we don't think there are net positive benefits, we don't make the rule.

Although we have no specific cost-benefit analysis requirement, other Federal statutes do require us to develop analyses and reports that help us to develop a more complete picture of the costs and benefits of the rules we make. These include: (1) the Administrative Procedure Act which, among other things, requires Federal agencies to afford proper notice and comment as part of issuing a regulation; (2) the Regulatory Flexibility Act, which requires Federal agencies to prepare an analysis of any significant economic

impact a regulation may have on a substantial number of small entities; and (3) the Paperwork Reduction Act, which applies to rulemakings in which an agency creates a new burden on regulated entities or increases an existing burden.

Q.3. What credit union specific proposals in the Treasury Department's recent report on regulatory relief should Congress pursue to help grow the economy?

A.3. I believe that, of the Treasury Department proposals, the credit union-specific recommendation that would have the largest impact on economic growth is the proposal to revise the risk-based capital requirement for credit unions with assets in excess of $10 billion dollars or eliminate the requirement all together for credit unions satisfying a 10 percent simple leverage, or net worth, test. Eliminating the arbitrary restrictions on asset accumulation that may hinder credit union lending is an important and useful step that would, in my opinion, help to pave the way for future economic growth.

Q.4. What specific revisions to the NCUA-issued risk-based capital rule that is slated to go into effect January 1, 2019, are you considering or pursuing?

A.4. The NCUA Board has not taken action to change amend or repeal the capital rule scheduled to take effect January 1, 2019. However, I do intend to revisit this rule and consider whether it should be substantially amended or repealed.

Q.5. Do you believe that the CFPB should consult with the NCUA when it is writing rules that impact credit unions? Do you think this coordination has been sufficient up until this point?

A.5. Yes, the CFPB should and does consult with the NCUA when it is writing rules that affect credit unions. The NCUA's Office of Consumer Financial Protection and Access coordinates and works with the CFPB on rulemaking and related matters affecting credit unions. This consultative process allows the NCUA to inform the CFPB how credit unions differ from other financial institutions, how a "one-size-fits-all" approach is not always appropriate, and how certain provisions may inadvertently disadvantage credit unions and their members. This process can, but does not often, result in regulatory language or changes to address the NCUA's comments and concerns.

Although the consultations are very informative, they do not generally result in regulatory relief for credit unions, as appropriate, for certain matters. With this goal in mind, on May 24, 2017, I wrote to Director Cordray outlining three areas where some type of relief for credit unions from the CFPB's proposed or final regulations is justified. These three subject areas involve the Home Mortgage Disclosure Act, the Unfair, Deceptive and Abusive Acts or Practices Act and CFPB's proposed rule regarding payday, title and other high-cost installment loans. I also recently met with Director Cordray to discuss this letter and additional matters of concern to the NCUA, credit unions and their members.

In addition, on July 6, 2017, I wrote to Director Cordray asking for consideration of an exemption of federally insured credit unions from the examination and enforcement provisions of section 1025

of the Consumer Financial Protection Act of 2010. I believe the NCUA should be allowed to act as the primary agency responsible for the examination and enforcement of the consumer financial protection laws for the six federally insured credit unions with assets greater than $10 billion. These credit unions are currently subject to the CFPB's exclusive examination and primary enforcement authority. The exemption I requested would continue to provide robust consumer financial protections for these credit union members and allow the CFPB to focus on the larger investor-owned, for-profit financial providers. The CFPB also would retain secondary enforcement authority to examine or take an enforcement action against these credit unions if it determines the NCUA is not adequately enforcing the consumer financial protection laws. In his July 21, 2017, reply to me, Director Cordray expressly rejected my requested exemption as inconsistent with the Dodd-Frank Act. I continue to believe, however, that the CFPB has such exemption discretion under the Dodd-Frank Act.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSE FROM J. MARK McWATTERS

Q.1. As you know, in 2016, 70 U.S. Senators and 329 U.S. Representatives separately wrote the CFPB, asking that it better tailor regulations to match the unique profile of small financial institutions. Unfortunately, as you pointed out in a May 24, 2017, letter to CFPB Director Richard Cordray on various regulatory issues, the CFPB's tailor efforts have failed to provide sufficient regulatory relief for smaller financial institutions. For example, in the letter, you said that the CFPB could "alleviate the compliance burden of credit unions with respect to the Unfair, Deceptive, and Abusive Acts of Practices (UDAAP) requirements of [Dodd-Frank] without sacrificing consumer protection."

Q.1.a. How has the CFPB's exercise of UDAAP authority increased the compliance burden of credit unions?

A.1.a. Credit unions seek to be in full compliance with consumer financial protection laws and regulations, including Unfair, Deceptive, and Abusive Acts or Practices. The struggle to stay abreast of the increasing number of consumer financial protection requirements increases the burdens of credit unions, particularly those that have limited numbers of staff and resources. In addition, the CFPB's assertions in legal and enforcement actions that certain behavior is considered to be "abusive," without providing a clear definition of the meaning of this term, results in credit unions having difficulty determining what specific behavior is noncompliant.

Q.1.b. How should the CFPB alleviate the compliance burden regarding the UDAAP authority? For example, should the CFPB conduct a rulemaking on its UDAAP authority?

A.1.b. As I indicated in my May 24, 2017, letter to Director Cordray, the CFPB should promptly issue clear, transparent guidance that is reasonable, objective, and specifically tailored for the credit unions so that they can comply fully with the laws and meet the needs of members in a cost efficient and effective manner. I also recently met with Director Cordray to discuss this letter and

additional matters of concern to NCUA, credit unions and their members.

Q.1.c. Your letter also highlighted disclosure requirements under the Home Mortgage Disclosure Act (HMDA) as a key regulatory burden on credit unions. How have HMDA requirements burdened credit unions?

A.1.c. The Home Mortgage Disclosure Act provides valuable mortgage lending information and is an important tool for identifying housing needs and remedying credit discrimination. Credit unions that meet HDMA reporting thresholds have increased recordkeeping and reporting responsibilities. The activities require credit unions to expend resources for data gathering, retention, and reporting of a large number of data points mandated by law and regulation. An increase in the number of HMDA data points that credit unions are required to report about, particularly those that currently are not routinely disclosed as part of the mortgage lending process, increases a credit union's reporting burden.

Q.1.d. How could the CFPB better tailor HMDA requirements?

A.1.d. The CFPB should consider raising the various HMDA reporting thresholds to a more substantive asset and transaction volume level to reduce the reporting burden on smaller credit unions. In addition, it should exempt credit unions from collecting and reporting the additional 14 data points imposed solely by the CFPB's regulatory changes.

Q.1.e. Are there other concrete ways in which you believe the CFPB has improperly tailored regulations to match the unique profile of credit unions? Does any of these changes require statutory authorization?

A.1.e. The NCUA is not aware that the CFPB has acted "improperly" in tailoring regulations to address the credit union industry. However, I believe that it could do more to provide regulatory relief to credit unions. For example, the CFPB's proposed rule on Payday, Vehicle Title and Certain High-Cost Installment Loans would, if issued as proposed, impose requirements on Federal credit unions that issue Payday Alternative Loans under the NCUA's regulation. The NCUA crafted its Payday Alternative Loans regulation to permit Federal credit unions to issue safe small-dollar, short-term credit to members in need, protecting those borrowers from the predatory lending market. The CFPB should fully exempt the NCUA's Payday Alternative Loans made by Federal credit unions in accordance with the NCUA regulations.

Q.1.f. Has the CFPB effectively coordinated with the NCUA on rulemakings and enforcement actions? If not, how could coordination be improved?

A.1.f. The NCUA's Office of Consumer Financial Protection and Access coordinates and works closely with the CFPB on rulemaking and related matters. This consultative process allows the NCUA to inform the CFPB how credit unions differ from other financial institutions, how a "one-size-fits-all" approach is not always appropriate, and how certain proposed provisions may inadvertently disadvantage credit unions and their members. This process can, but does not often, result in regulatory language or changes to address

the NCUA's comments and concerns. The CFPB provides advance notice of its interpretation of major consumer financial protection policy matters.

The Dodd-Frank Act requires the CFPB and each prudential regulator to coordinate on supervision activity. The NCUA and the CFPB operate under three Memoranda of Understanding covering the supervision of, information sharing about and handling of complaints against credit unions with total assets over $10 billion. Coordination among the agencies could be improved with earlier notification of potential CFPB enforcement activities.

In addition, on July 6, 2017, I wrote to Director Cordray asking for consideration of an exemption of federally insured credit unions from the examination and enforcement provisions of section 1025 of the Dodd-Frank Act. I believe the NCUA should be allowed to act as the primary agency responsible for the examination and enforcement of the consumer financial protection laws for the six FICUs with assets greater than $10 billion. These credit unions are currently subject to the CFPB's exclusive examination and primary enforcement authority for consumer financial protection laws. The exemption I requested would continue to provide robust consumer financial protections for these credit union members and allow the CFPB to focus on the larger investor-owned, for-profit financial providers. The CFPB also would retain secondary enforcement authority to examine or take enforcement action against these credit unions if it determines the NCUA is not adequately enforcing consumer financial protection laws. In his July 21, 2017, reply to me, Director Cordray expressly rejected my requested exemption as inconsistent with the Dodd-Frank Act. I continue to believe, however, that the CFPB has such exemption discretion under the Dodd-Frank Act.

Q.2. As you know, the CFPB may be moving forward on a rulemaking for Section 1071 of Dodd-Frank, which granted the CFPB the authority to collect small business loan data. I've heard some concerns that implementing Section 1071 could impose substantial costs on small financial institutions and even constrict small business lending.

Q.2.a. Are you concerned how a Section 1071 rulemaking could hurt small business access to credit?

A.2.a. Yes, I am concerned that given the CFPB's overly broad HMDA rulemaking activity, a Section 1071 rulemaking requiring the collection of business lending data might have the unintended consequence of limiting small business access to credit. However, I also appreciate the intent of Section 1071 which amends the Equal Credit Opportunity Act to require financial institutions to compile, maintain, and report information concerning credit applications made by women-owned, minority-owned, and small businesses. We intend to monitor this rulemaking and offer input to ensure it does not interfere with appropriate access to credit.

Q.2.b. Has the NCUA coordinated with the CFPB to ensure that implementing these requirements does not constrict small business access to credit?

A.2.b. The CFPB is currently seeking industry and public comment on the small business financing market and privacy concerns

related to the disclosure purposes of Section 1071. The NCUA intends to consult with the CFPB on information provided on these topics by the credit union industry and the CFPB's Credit Union Advisory Council. We will also work with the CFPB in an attempt to ensure that any Section 1071 data collection requirements do not restrict access to credit or raise privacy concerns.

RESPONSE TO WRITTEN QUESTION OF SENATOR WARNER FROM J. MARK McWATTERS

Q.1. Cybersecurity regulation is receiving increased emphasis by all financial institution regulators. How do your agencies coordinate with each other to harmonize the promulgation of new cybersecurity regulations? With the increased use of the NIST Cybersecurity Framework by both Federal agencies and the private sector, how do your agencies intend to achieve greater alignment between the framework and your own regulatory initiatives?

A.1. The NCUA is a voting member of the Federal Financial Institutions Examination Council, which is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions and to make recommendations to promote uniformity in the supervision of financial institutions. The NCUA actively participates on multiple FFIEC IT-related committees.

The FFIEC was established on March 10, 1979, pursuant to title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Public Law 95–630. In 1989, title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 established The Appraisal Subcommittee within the Examination Council.

In addition to the NCUA, the voting FFIEC members include the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau. The State Liaison Committee is also a voting member. The State Liaison Committee includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

With respect to cybersecurity regulation, in 2001, each financial institution regulator adopted guidelines for safeguarding customer information to implement certain provisions of the Gramm-Leach-Bliley Act. The GLB Act required the NCUA Board to establish appropriate standards for federally insured credit unions relating to administrative, technical, and physical safeguards for member records and information. These safeguards are intended to: insure the security and confidentiality of member records and information, protect against any anticipated threats or hazards to the security or integrity of such records, and protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any member.

The guidelines require credit unions to have an information security program and establish a risk management framework, which is an approach that has held up very well over time. The guidelines

strike an effective balance between the necessary regulatory structure to protect member information and flexibility to avoid a "one-size-fits-all" or overly prescriptive approach to address ever-changing technology issues and related threats, such as those posed by the current cyber threat environment.

The NCUA works within the FFIEC construct to maintain an Information Technology Handbook as the official source of information technology regulatory guidance for financial institutions. The IT Handbook is a series of guidance booklets designed for examiners and financial institutions. The IT Handbook development process is collaborative and contributors consider numerous third-party standards, related controls, and practices most appropriate to financial institutions.

In 2015, the FFIEC agencies also jointly developed the Cybersecurity Assessment Tool for financial institutions to assess their risk profiles and level of cybersecurity preparedness. FFIEC members developed the Assessment to help institutions' management identify their risks and determine their cybersecurity preparedness. The Assessment provides a repeatable and measurable process that financial institutions' management may use to measure their cybersecurity preparedness over time. In developing the assessment tool, the FFIEC leveraged best practices from the IT Handbook, the National Institute of Standards and Technology Cybersecurity Framework, and industry-accepted cybersecurity practices.

The NCUA and the other FFIEC agencies collaborated with NIST to review and provide input on mapping the FFIEC assessment tool to the NIST Cybersecurity Framework, to ensure consistency with NIST Cybersecurity Framework principles, and to highlight the complementary nature of the two resources. The FFIEC has published this mapping on its website. The NIST cybersecurity framework addresses all types of infrastructures including public utilities whereas the FFIEC assessment tool is specific to financial institutions.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ROUNDS FROM J. MARK MCWATTERS

Q.1. The Consumer Financial Protection Bureau has been aggressively expanding its authority into areas more effectively regulated by others—including the turf of the National Credit Union Administration. I believe that the agency best suited to develop regulations tailored to credit unions is the agency exclusively focused on credit unions—your agency. You recently sent a letter to CFPB Director Richard Cordray highlighting areas where the Bureau's broadsword approach to regulation could potentially harm credit unions and the members they serve. In that letter, you urged Director Cordray to expand the Bureau's use of Section 1022 exemption authority for credit unions, something I support.

Could you describe the Bureau's receptiveness to meaningful collaboration with other Federal regulatory agencies? And more specifically, have you had the opportunity to discuss with Director Cordray the excellent points you raised in your letter?

A.1. CFPB has demonstrated a willingness to listen to reasonable requests for adjustments to its regulations. In addition, the

NCUA's Office of Consumer Financial Protection and Access coordinates and works closely with CFPB on rulemaking and related matters. This consultative process allows the NCUA to inform CFPB how credit unions differ from other financial institutions, how a "one-size-fits-all" approach is not always appropriate, and how certain provisions may inadvertently disadvantage credit unions, and their members. This process can result in regulatory language or changes to address NCUA comments and concerns.

Last month, I met with Director Cordray and discussed the matters raised in my May 24, 2017, letter and additional matters of concern to the NCUA, credit unions and their members. Although the conversation was informative, it did not result in any progress on the matters detailed in my letter—namely regulatory relief for credit unions for certain Home Mortgage Disclosure Act and Unfair, Deceptive, and Abuse Acts or Practices matters.

In addition, on July 6, 2017, I wrote to Director Cordray asking for consideration of an exemption of federally insured credit unions from the examination and enforcement provisions of section 1025 of the Consumer Financial Protection Act of 2010. I believe the NCUA should be allowed to act as the primary agency responsible for the examination and enforcement of the consumer financial protection laws for the six federally insured credit unions with assets greater than $10 billion. These credit unions are currently subject to CFPB's exclusive examination and primary enforcement authority for consumer financial protection laws. The exemption I requested would continue to provide robust consumer financial protections for these credit union members and allow CFPB to focus on the larger investor-owned, for-profit financial providers. CFPB also would retain secondary enforcement authority to examine or take an enforcement action against these credit unions if it determines the NCUA is not adequately enforcing consumer financial protection laws. In his July 21, 2017, reply to me, Director Cordray expressly rejected my requested exemption as inconsistent with the Dodd-Frank Act. I continue to believe, however, that the CFPB has such exemption discretion under the Dodd-Frank Act.

Q.2. As a voting member of the FSOC, you have a role to play in helping to make certain that regulations promulgated from a myriad of agencies do not conflict with each other. What do you believe the FSOC should be doing to create a regulatory environment that provides certainty of compliance for entities that are acting in good faith?

A.2. It is important that agency rules do not conflict so that regulated entities have clear guidelines for activities. Clear guidelines help to provide certainty of compliance for those entities that are making good faith efforts to comply. For the most part, the FSOC's primary duties relate to financial stability, not directly to the regulations and structures adopted by independent agencies for their regulated companies. This means that there is limited scope for the FSOC to engage with its member agencies on rules that do not materially affect the stability of the financial system as a whole. Instead, conflicts, when they do appear, are approached on a bilateral basis. More generally, however, the FSOC's inter-agency actions on its range of financial stability efforts are very helpful in improving

inter-agency communication and understanding of the issues each individual regulator faces. Enhanced communication and understanding among the regulators is important for minimizing the likelihood that agencies will adopt conflicting rules in the first place.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KENNEDY FROM J. MARK McWATTERS

Q.1. I have made it a top priority to provide regulatory relief for America's financial institutions. However, your agency has issued a new proposed regulation that would require thousands of hours of paperwork burdens and unnecessary costs for credit unions that have chosen to merge voluntarily. Why is your Government agency proposing more regulatory burdens at a time when the Trump administration and the Senate Banking Committee have a public mandate to reduce regulatory burdens?

A.1. The NCUA is very cognizant of the need to reduce regulatory burdens and has been doing so whenever possible. In that regard, the NCUA has issued a number of rules over the past months that would lessen regulatory burden on credit unions. For example, some of these burden-reducing rules include initiatives to:

- address fields of membership by, for instance, modifying and updating the definitions of local community, underserved areas and rural districts;
- enhance alternative capital by establishing a more flexible policy for low-income credit unions (of which a significant percentage are small) designed to provide greater clarity and confidence for investors;
- simplify member business loans by lifting limits on construction and development loans, replacing explicit loan-to-value limits with the principle of appropriate collateral, (eliminating the need for a waiver), exempting credit unions with assets under $250 million from certain requirements, and affirming that nonmember loan participations do not count toward the statutory member business lending cap;
- implement examination flexibility this year by extending the examination cycle for well-capitalized and well-managed credit unions to periods longer than the previous 12-month requirement;
- expand share insurance coverage on funds held on a pass-through basis, held on deposit at federally insured credit unions, and maintained by attorneys in trust for their clients to other types of escrow and trust accounts maintained by professionals on behalf of their clients;
- assist corporate credit unions by proposing a rule in June to reduce certain restrictions placed on the corporates during the financial crisis; and
- improve the processes by which credit unions appeal the NCUA's decisions by proposing uniform rules to govern this area.

The proposed merger rule increases the merger-related information available to the member-owners of Federal credit unions so they can make an informed decision about the merger, but does not significantly increase the regulatory burden on merging credit unions.

The NCUA has been informed by many credit unions and their members that the current merger regulation in place is insufficient to protect the member-owners of Federal credit unions. Michael Fryzel, a former NCUA Chairman and Board Member and the head of the NCUA transition team for the Trump administration, recently published an opinion that he believed the proposed merger rule was necessary to curb "abuses" in the merger process.[1]

Q.1.a. Why are you using your Government agency to interfere with free-market business decisions made by credit union boards of directors who were elected by their members?

A.1.a. The proposed merger rule does not interfere with the business decisions of Federal credit unions' leadership. In fact, it enhances free-market efficiency. Free markets function best when all participants in a transaction have access to all relevant information about the transaction. Members of merging Federal credit unions have a right to know how much of the credit union's net worth—which they own—will be used to compensate officials and staff, how much will transfer to the continuing credit union, and how much will be paid out to members in the form of a merger dividend or share adjustment. The proposed merger rule simply facilitates delivery of this information to the member-owners of Federal credit unions, critical information needed to understand all facets of the transaction. Member-owners of Federal credit unions cannot cast an informed vote on the merger without access to relevant information.

Q.1.b. How did you calculate the 8,832 hours or paperwork burden for your new proposed regulation?

A.1.b. To calculate the estimated burden, the NCUA determined the proposed rule adds 560 burden hours (2 hours for the changes to Part 708a plus 558 hours for the changes to Part 708b).[2] We then added the 560 new burden hours to the current burden of 8,272 hours for a total of 8,832 hours. The exact number of hours will depend on how many credit unions propose transactions covered under Parts 708a and 708b of NCUA's regulations. Based on the average number of voluntary mergers of Federal credit unions in the last 5 years, the NCUA estimated that one federally insured credit union per year will be subject to the changes to Part 708a of the NCUA's regulations and 138 federally chartered credit unions will be subject to the changes to Part 708b.

Q.2. I thought you would agree that consolidation is a healthy strategy to raise economies of scale and strengthen the competitiveness of American businesses. My understanding is that credit

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[1] *http://www.cutoday.info/THE-tude/A-New-Reg-CUs-Asked-For-It.*

[2] The full supporting statements for the changes to Parts 708a and 708b are available at *https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201705-3133-004* (708a) and *https://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201705-3133-006* (708b).

unions are engaging in voluntary mergers for the same competitive reasons that banks are consolidating—to gain scale.

Why is your Government agency deliberately slowing down voluntary mergers that would benefit thousands of credit union employees and hundreds of thousands of credit union members?

A.2. The proposed rule changes the required minimum member notice period from 7 days to 45 days. The NCUA's recent experience with several mergers indicates the current rule's 7-day minimum notice period is often insufficient to provide Federal credit union member-owners with sufficient time to digest the information they need to cast an informed vote and determine the fate of their institution. The addition of a few weeks to the merger process is minimally intrusive as compared to the great benefit it will provide members by giving them sufficient time to analyze the terms of the proposed merger, return their ballots, or make plans to attend the meeting where the merger will be explained.

Q.2.a. Would stopping voluntary mergers affect the competitiveness of the credit union movement?

A.2.a. The NCUA does not wish to stop voluntary mergers, and the proposed rule does not do so. The proposed rule simply provides for full disclosure to members in a reasonable timeframe.

Q.3. I am sure you would agree that small credit unions have less ability than larger institutions to absorb regulatory compliance costs, technology costs, and the severe impact of the accounting rule changes that will soon take effect.

Wouldn't your policy to discourage voluntary mergers actually cause small credit unions to lose capital and thus increase risks to the National Credit Union Share Insurance Fund?

A.3. It is not the NCUA's policy to discourage voluntary mergers. The proposed merger rule facilitates the NCUA's policy of making the voluntary merger process fair and transparent to the member-owners. The proposed rule ensures that members of merging Federal credit unions are provided with all information relevant to the merger transaction. This in no way discourages mergers that are good for the credit unions and their members. The NCUA will continue to monitor the health of small credit unions, as it does for all credit unions. When a credit union is facing declining capital, the NCUA works with the credit union's board and management to devise strategies to address the situation so that the credit union will not cause a loss to the Share Insurance Fund. The proposed merger rule does not change this approach.

Q.3.a. Wouldn't you agree that, in this context, voluntary mergers actually reduce risk to your fund and enable members to continue their relationship with a thriving credit union?

A.3.a. Yes, we agree. In most cases, voluntary mergers are advantageous to the merging credit unions, their members, and the Share Insurance Fund. Accordingly, as noted above, the proposed rule does not discourage or hamper voluntary mergers; it only seeks to make them fair and transparent to credit unions and their members through adequate disclosure.

Q.4. Several provisions in your new proposed regulation of voluntary mergers would add costs to credit unions but provide no

benefit to members. Why would NCUA require merging credit unions to "disclose all increases in compensation or benefits" for covered employees "during the 24 months before approving a merger agreement-regardless of whether the increases were made because of the merger"?

A.4. The NCUA respectfully disagrees that the proposed voluntary merger rule adds significant costs to the merger process and provides no benefits to members. The proposed rule recognizes the important status of a Federal credit union member as an owner of a not-for-profit financial cooperative. In recognition of the member's ownership interests, the proposal protects the member's right to receive full and fair disclosure of all relevant information prior to the merger vote. This is similar to the rights afforded to corporate shareholders.

At least one industry expert suggests that Federal credit unions lag behind other corporate entities, including State-chartered credit unions, in terms of being required to disclose material information to members.[3] The disclosure requirements in the proposed rule enable Federal credit union members to decide if a merger is in their best interests and determine if the merger presents any conflicts of interest for management officials resulting from merger-related financial arrangements paid by either the merging credit union or the continuing credit union.

Furthermore, the proposed rule ameliorates a common communications problem for members of merging Federal credit unions by creating an easy, inexpensive, and reliable mechanism for those members to communicate with one another about the merger. Accordingly, the NCUA believes the proposed rule provides significant benefits to members for this and other reasons.

The NCUA is specifically proposing to require the disclosure of any increase in compensation or benefits during the 24 months before a merger because those increases are frequently related to the merger. Setting this specific and limited, bright-line disclosure timeframe significantly simplifies the NCUA's current approach, which is to analyze board minutes over a potentially open-ended timeframe to determine the existence of any merger-related financial arrangements. This has been an area of confusion for some merging credit unions, and the proposed rule addresses this problem in a way that is fair, transparent, and easy for merging credit unions to implement.

Q.4.a. If these increases were not made because of a merger, why would your Government agency want to regulate free-market compensation and benefits?

A.4.a. The proposed voluntary merger rule does not regulate compensation and benefits. Rather, the proposed rule addresses the current lack of sufficient information being disclosed to members of a merging credit union.[4] Unless a particular compensation or

[3] See Lisa Freeman, *Opinion: Does the Voluntary Merger Rule Make Credit Unions Look Bad?,* Credit Union Journal (June 19, 2017) (available at *https://www.cujournal.com/opinion/does-the-voluntary-merger-rule-make-credit-unions-look-bad)* (quoting Eric Richard, former general counsel for the Credit Union National Association).

[4] Access to full and complete information is a key assumption in neoclassical economics and several noted economists have argued that the role of effective regulation is to eliminate infor-

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benefit arrangement presents a safety and soundness risk to the Federal credit union, the NCUA's policy is to respect the business decisions of Federal credit union boards and members regarding employee compensation, provided there has been full and fair disclosure.

Q.4.b. Why would you require such a violation of privacy for credit union employees?

A.4.b. The voluntary merger rule does not violate the privacy of Federal credit union employees. As owners of the Federal credit union, members have a right to all information relevant to a proposed merger vote, including proposed compensation arrangements for employees and senior management. This approach is consistent with general corporate practice. Furthermore, this approach, which limits disclosure to members in the context of a merger, is far less intrusive than the disclosure requirements for other nonprofits, including State-chartered credit unions, which must report compensation and benefits information annually on IRS Form 990, which is publicly available.

Q.5. You have attempted to justify your new proposed regulation of voluntary mergers by claiming it would provide "transparency" for credit union members. But when you require credit unions to disclose compensation and benefits that are not related to a merger, doesn't that "transparency" really violate the privacy of credit union employees?

A.5. As noted above, the proposed voluntary merger rule does not violate the privacy of Federal credit union employees. Federal credit unions are democratically owned, not-for-profit financial cooperatives. Their unique status as democratically owned institutions means that members have a right, as member-owners, to control and oversee credit union operations including employee compensation. The disclosure of employee compensation allows member-owners to more effectively fulfill their roles as the ultimate decision-makers of the credit union.

Q.6. One expert in the industry was recently quoted in The Credit Union Journal saying your new proposed regulation of voluntary mergers is, I quote: "One on the worst proposals in memory." This expert predicts that if NCUA slows down the natural consolidation in the credit union marketplace, there will be fewer voluntary mergers, but more involuntary mergers.

Q.6.a. Which is better: a voluntary merger or an involuntary merger?

A.6.a. It is important to distinguish the underlying causes and motivations for credit union mergers. There are essentially three types of merger scenarios that we've experienced historically, and they differ quite significantly from one another as to why they occur:

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mational asymmetries where possible. See Joseph E. Stigliz, *Information and the Change in the Paradigm in Economics,* Nobel Prize Lecture (Dec. 8, 2001) (available at *https://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2001/stiglitz-lecture.pdf*); see also Ronald H. Coase, *The Problem of Social Cost,* 3 J. Law & Econ. 1 (Oct. 1960) (the role of law is to reduce transaction costs to allow effective bargaining) (available at *http://www.law.uchicago.edu/files/file/coase-problem.pdf*).

1. Two viable credit unions that seek to combine for mutually agreed strategic reasons; or
2. A credit union that is having difficulties remaining viable that seeks to merge into a stronger continuing credit union in order to perpetuate access to credit and other services for its membership; or
3. A credit union operating under NCUA or State conservatorship, and that is not viable, being combined into a continuing credit union that has successfully bid to acquire the failing credit union. Please note, the NCUA does not officially use the term "involuntary merger." There are circumstances where the agency utilizes a merger as the means to resolve a failing institution when it is under conservatorship. These are sometimes informally referred to as an involuntary merger.

For mergers outlined in scenarios one and two above, the NCUA does not participate in the identification or selection process concerning voluntary mergers. The decision to merge is based on a business decision made by the respective credit unions' boards of directors. The NCUA's role in these situations is to ensure the required procedures are followed and that the combination does not pose a safety-and-soundness concern.

The types of compensation arrangements the disclosure proposal is intended to address in practice would typically apply to the merger of two relatively healthy institutions. Also, the NCUA does not believe the additional disclosure will have any material impact on the speed of mergers.

Q.6.b. Once a credit union reaches the point where they have no choice other than involuntary merger, hasn't a tremendous amount of capital already been lost at this point?

A.6.b. Not necessarily. Some credit unions aren't viable because of the inability to replace retiring management and/or insufficient interest to maintain a volunteer board of directors. Others aren't viable because of operational problems that don't always result in the loss of capital.

Q.6.c. Would you agree that involuntary mergers tarnish the reputation of the credit union industry as a whole?

A.6.c. Not necessarily. The resolution of a failed credit union through a merger is an effective means to ensure that service for the members of record can be preserved through combination into a viable institution willing to provide the same or better services. The reasons for individual credit union failures vary and do not necessarily reflect on the industry as a whole. The NCUA does not believe the proposed regulation will have a material impact on mergers or credit union failures.

Q.6.d. Do you agree or disagree that employees of a merging credit union have better employment prospects in a voluntary merger where they receive employment guarantees and improved benefits, compared to an involuntary merger where branches are closed and jobs are lost? Won't your new proposed regulation further deplete the capital of financially constrained small credit unions because your merger process will take so long?

A.6.d. A merger of two viable institutions, often motivated by economies of scale considerations, can involve cost-cutting measures like branch closures and layoffs. A merger of a weaker institution into a healthy one can result in improved employment prospects for employees of the weaker institution and maintenance—and sometimes expansion—of service facilities for the membership of the weaker institution. Each situation and scenario is unique. Thus, it is not always, or even typically, the case that one type of combination effectuates better results for employees. In addition, the NCUA does not believe the proposed regulation will have a material impact on the completion time of mergers.

Q.6.e. Who determines which credit unions receive involuntary mergers?

A.6.e. Voluntary mergers are business decisions of the involved credit unions. The NCUA's role is to review the safety and soundness of the combination and compliance with applicable rules and regulations, such as field of membership compatibility when the continuing institution is a Federal credit union. In those instances where the NCUA uses merger (or a purchase and assumption) to resolve a failed institution, the agency solicits bids from interested credit unions and selects the bid with the lowest cost to the Share Insurance Fund, with continued service to the membership whenever possible.

Q.6.f. What criteria do you use to select the surviving credit union in an involuntary merger?

A.6.f. In general, NCUA selects the bid with the lowest cost to the Share Insurance Fund while also seeking to preserve service to members. The process is addressed by NCUA Letters to Credit Unions 10–CU–11 and 10–CU–22.

Q.6.g. Isn't this why one industry consultant predicts that, I quote: "NCUA Regional Directors will become like banana republic dictators controlling their fiefdoms by rewarding their loyal cronies with the spoils of involuntary mergers"?

A.6.g. The voluntary merger process is a business decision made by the credit unions involved. For failing institutions, the NCUA has a duty to achieve a least-cost resolution, and the agency seeks to preserve the interests of the members. In resolving failing institutions, the NCUA has a fair process with appropriate checks and balances for inviting credit unions to bid and selecting the winning bidder.

Q.6.h. How do you ensure transparency in your selection of winners and losers in involuntary mergers?

A.6.h. The process is addressed by NCUA Letters to Credit Unions 10–CU–11 and 10–CU–22. The NCUA invites interested credit unions capable of safely acquiring a failing credit union to conduct due diligence and submit a bid. In general, the NCUA selects the bid with the lowest cost to the Share Insurance Fund while also seeking to preserve service to members.

Q.7. I am sure you are aware of the serious legal implications of attempting to exert political influence over a financial institution's examination.

Q.7.a. Have you or your staff ever given direction or guidance, or even the impression, that examiners should stop, slow or limit any credit union's growth through voluntary mergers?

A.7.a. Voluntary mergers are a business decision made by credit unions. The NCUA is required to review the safety and soundness of the transaction and compliance with applicable rules and regulations. The only time NCUA staff would intervene is if the proposed merger posed safety and soundness concerns or would violate a law or regulation.

Q.7.b. Have you or your staff ever given direction or guidance to supervisory staff in the chain of command to override the findings of an Examiner-in-Charge?

A.7.b. Our quality control process involves various layers of review. This can include a review of the examination report and areas of concern prior to, as well as after, the report's issuance. In addition, once the report has been issued, the agency has both an informal and formal appeals process. The quality control and—if it is pursued—the appeals process could result in the appropriate override of examination findings. These safeguards help ensure the final examination product is correct and reasonable. The NCUA also maintains a strict prohibition on retaliation. Our Inspector General independently investigates any alleged retaliation.

Q.7.c. How do you justify your Government agency targeting the fastest-growing credit unions and trying to slow their strategic growth?

A.7.c. The proposed amendment ensures member owners have access to the necessary information to make an informed decision related to their credit union when asked to vote in a voluntary merger membership vote. The NCUA is not attempting to slow credit unions' growth achieved through merger or any other appropriate means.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM J. MARK McWATTERS

Q.1. I'm a proponent of tailoring regulations based off of the risk profiles of financial institutions, as opposed to having strict asset thresholds that do not represent what I believe is the smart way to regulate. But, my question here is really about the importance of ensuring that we have a system that is rooted in fundamental, analytical, thoughtful regulation so that we can achieve and execute on goals, whether balancing safety and soundness with lending and growth, or encouraging more private capital in the mortgage market to protect taxpayers and reform the GSEs.

Q.1.a. Do you think that we should use asset thresholds as a way to regulate—yes or no? If no, can you provide me with the metrics or factors by which a depository institution should be evaluated? If yes, please explain.

A.1.a. Yes, when appropriate. Asset thresholds can represent a simple yet elegant proxy for ensuring a rule is targeting specific risks and activities. As a general rule, I agree that tailoring regulations based on risk profiles is appropriate. However, under certain

circumstances, the NCUA has found that using asset thresholds can be an effective way to reduce regulatory burden without the need for complex risk-based criteria. It has allowed the agency to exempt some institutions—typically, smaller ones—from complying with some rules, or provisions within a rule, without having to decipher a potentially complex set of applicability standards. However, in some cases simple asset thresholds may not sufficiently correlate to the targeted risks or activities, and therefore a more precise approach is warranted.

The NCUA formulates its financial regulations to include clear guiding principles that specify minimum risk management policies and programs necessary to conduct permissible activities in a safe and sound manner. By design, the NCUA's regulatory and supervisory expectations increase commensurate with the size, scope, and complexity of an institution's risk exposures.

Q.1.b. Section 165 of Dodd-Frank requires enhanced supervision and prudential standards for banks with assets over $50 billion. This applies to any bank that crosses the asset threshold, without regard to the risks those banks pose based upon the complexity of the business model. This includes heightened standards on liquidity and capital under the Liquidity Coverage Ratio (LCR) and the Comprehensive Capital Analysis and Review (CCAR) which have a various assumptions built in that may drive business model.

Q.1.b.i. I understand under these two regulatory regimes, banks have changed certain lending behaviors because of the assumptions Federal regulators provide some examples of how the LCR and the CCAR have changed the types of loans, lending, and deposits your institution holds?

A.1.b.i. Credit unions are not subject to standards pertaining to Comprehensive Capital Analysis and Review or Liquidity Coverage Ratio. The NCUA has instituted regulations governing capital planning and capital stress testing for those consumer credit unions with assets in excess of $10 billion. These requirements are deemed important to demonstrate that credit unions can prudently manage the risks under their strategic initiatives to serve their members. The NCUA set this asset threshold for compliance, as we deem these institutions systemically important to the National Credit Union Share Insurance Fund. We did not base our standards on those used to define financial institutions systemically important to the U.S. financial system.

We have not seen evidence that our capital planning and stress testing regulations have stifled growth. The stress testing requirements became effective in 2014. Since this time period loan growth has exceeded 9.8 percent and share (deposit) growth has exceeded 8.4 percent for the covered credit unions in aggregate. We believe this evidences healthy growth for financial institutions.

Q.1.b.ii. Construction lending by banks over the $50 billion threshold has been a source of concern, namely because these enhanced prudential standards have treated construction loans punitively. This includes construction lending for builders of apartments, warehouses, strip malls, and other projects that may have varying risk profiles associated with them. However, under the CCAR and DFAST assumptions, the regulators have assigned all these

categories of lending the same capital requirements. The result is an overly broad capital requirement for varying loans that have different risks, a capital requirement that may be greater for some loans and lower for others, influencing the decision of many banks over the $50 billion threshold to hold less of these assets due to the punitive capital requirements associated with them. Have you seen a similar corresponding issue with construction loans because of heightened prudential standards?

A.1.b.ii. Credit unions are not subject to standards pertaining to CCAR and LCR. Construction and development lending is not a key strategic element for those credit unions subject to our capital planning and capital stress testing requirements. Only one credit union subject to stress testing engages in this activity, and the total volume is negligible.[1] Even so, the NCUA evaluates the risks of all loans through processes that capture their underlying credit quality, not generalized capital assessments. As such, credit unions that would underwrite such loans prudently would exhibit less credit risk than those which adopt looser standards.

Q.1.b.iii. Under the CCAR regulations, Federal regulators routinely assign risk weights to certain assets that Bank Holding Companies have on their balance sheets. These risk weights often time changes the costs associated with holding certain investments, such as Commercial Real Estate. Has this changed the type of assets that institutions hold, or caused institutions to alter their business plans because of the regulatory capital costs? If so, can you provide examples of this?

A.1.b.iii. The NCUA's current risk-based net worth requirement is applicable only to federally insured credit unions with total assets greater than $50 million and whose risk-based net worth requirement exceeds 6 percent. Generally, we have not seen evidence that the NCUA's risk-weighted capital scheme has caused covered credit unions to alter their business plans. As of March 31, 2017, only 529 federally insured credit unions were subject to the risk-based net worth requirement, and only three failed the risk-based net worth requirement. Since the implementation of the NCUA's risk-based capital requirement in 2001, only a few credit unions have failed to maintain a sufficient level of net worth necessary to pass the test. Thus, regulatory capital standards for credit unions have not likely had a material impact on their asset composition or business plans, except for those few that took extreme risk positions.

Q.1.b.iv. Do you think that regulators, on a general basis, get the risks weights right?

A.1.b.iv. The overall goal for a risk-based capital system is to better relate risks to capital requirements and ensure institutions with significantly elevated levels of risk are required to hold commensurate levels of capital. In establishing risk weights, the goal is to ensure assigned weights properly reflect observed levels of risks for each asset type relative to other asset types and a given minimum benchmark level of capital. These goals are laudable. However, there are significant challenges in ensuring any broadly applicable risk weighting scheme is properly calibrated, does not

[1] Less than 0.02 percent for Navy Fed if you need the precise number.

create unintended consequences, and the overall benefits exceed the costs. Thus, I think there is still work to do in narrowing the scope of institutions that should be subject to risk-based standards and in ensuring the asset classes and risk weights are properly calibrated.

Q.1.b.v. Fed Governor Tarullo, has argued that the $50 BB threshold is too low in terms of an asset threshold for enhanced prudential standards; does this number make sense? Why do we need such arbitrary thresholds? Should we get away from these thresholds and move toward a regulatory system that evaluated substance and activities of an institution as opposed to an arbitrary number? Why can't we do that?

Does Title I allow the Fed to treat a $51 BB bank in a similar manner to a $49 BB bank for the purposes of enhances prudential standards?

A.1.b.v. Credit unions are not subject to CCAR or the $50 billion threshold established in the Dodd-Frank Act. The NCUA has adopted $10 billion as its threshold to subject credit unions to enhanced supervisory standards. We set this asset-based threshold based on the systemic risk of these institutions relative to the balance of the National Credit Union Share Insurance Fund. At this time, there are six credit unions subject to these enhanced standards.

The NCUA is contemplating raising the asset threshold. Any adjustment will follow careful scrutiny of the performance of our Share Insurance Fund and adoption of supervisory tools commensurate with prudent oversight of our largest credit unions.

For all credit unions, the NCUA adopts specific supervisory practices commensurate with the unique risks posed by each credit union. Accordingly, we would enhance supervision of those credit unions that exhibit higher risk profiles.

Q.2. While the NCUA has made it a priority over the past several years to provide regulatory relief to credit unions where warranted, it seems that even more can be done to allow them to continue to serve consumers. Are there areas where Congress could make changes that would allow credit unions to foster economic growth? Do you have specific recommendations for this body to consider?

A.2. Yes, the NCUA has several proposals to share with the Committee related to regulatory flexibility, field of membership requirements, member business lending, and supplemental capital:

Regulatory Flexibility—Today, there is considerable diversity in scale and business models among financial institutions. Many credit unions are very small and operate on extremely thin margins. They are challenged by unregulated or less-regulated competitors as well as by their limited economies of scale. They often provide services to their members out of a commitment to offer a specific product or service rather than a focus on any incremental financial gain.

The Federal Credit Union Act contains a number of provisions that limit the NCUA's ability to revise regulations and provide relief to such credit unions. Examples include limitations on the eligibility for credit unions to obtain supplemental capital, field-of-

membership restrictions, investment limits, and the general 15-year loan maturity limit, among others.[2]

To that end, the NCUA encourages Congress to consider providing regulators with enhanced flexibility to write rules to address such situations, rather than imposing rigid requirements. Such flexibility would allow the agency to effectively limit additional regulatory burdens, consistent with safety and soundness considerations.

The NCUA continues to modernize existing regulations with an eye toward balancing requirements appropriately with the relatively lower levels of risk smaller credit unions pose to the credit union system. Permitting the NCUA greater discretion with respect to scale and timing when implementing statutory language would help mitigate the costs and administrative burdens imposed on smaller institutions, consistent with congressional intent and prudential supervision.

The NCUA would like to work with Congress so that future rules can be tailored to fit the risk presented and even the largest credit unions can realize regulatory relief if their operations are well managed, consistent with applicable legal requirements.

Field-of-Membership Requirements—The Federal Credit Union Act currently permits only Federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership. We recommend Congress modify the Federal Credit Union Act to give the NCUA the authority to streamline field of membership changes and permit all Federal credit unions to grow their membership by adding underserved areas. The language of H.R. 5541, the Financial Services for the Underserved Act, introduced in the House during the 114th Congress by Congressman Ryan of Ohio, would accomplish this objective.

Allowing Federal credit unions with a community or single-common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could enable more credit unions to participate in programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of affordable financial services in distressed areas.

Congress may wish to consider other field of membership statutory reforms, as well. For example, Congress could allow Federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, Congress could simplify the "facilities" test for determining if an area is underserved.[3]

Other possible legislative enhancements could include elimination of the provision presently contained in the Federal Credit Union Act that requires a multiple-common-bond credit union to be

[2] 12 U.S.C. 1751 *et. seq.*

[3] The Federal Credit Union Act presently requires an area to be underserved by other depository institutions, based on data collected by the NCUA or Federal banking agencies. 12 U.S.C. 1759 (c)(2)(A)(ii). The NCUA has implemented this provision by requiring a facilities test to determine the relative availability of insured depository institutions within a certain area. Congress could instead allow the NCUA to use alternative methods to evaluate whether an area is underserved to show that although a financial institution may have a presence in a community, it is not qualitatively meeting the needs of an economically distressed population.

within "reasonable proximity" to the location of a group in order to provide services to members of that group.[4] An enhancement that recognizes the way in which people share common bonds today would be to provide for explicit authority for web-based communities as a basis for a credit union charter.

Member Business Lending—The NCUA reiterates the agency's long standing support for legislation to adjust the member business lending cap, such as S. 836, the Credit Union Residential Loan Parity Act, which Senators Wyden and Murkowski have introduced. This bipartisan legislation addresses a statutory disparity in the treatment of certain residential loans made by credit unions and banks.

When a bank makes a loan to purchase a one- to four-unit, non-owner-occupied residential dwelling, the loan is classified as a residential real estate loan. If a credit union were to make the same loan, it is classified as a member business loan and is, therefore, subject to the member business lending cap. To provide regulatory parity between credit unions and banks for this product, S. 836 would exclude such loans from the statutory limit. The legislation also contains appropriate safeguards to ensure strict underwriting and servicing standards are applied.

Supplemental Capital—The NCUA supports legislation to allow more credit unions to access supplemental capital, such as H.R. 1244, the Capital Access for Small Businesses and Jobs Act. Introduced by Congressmen King and Sherman, this bill would allow healthy and well-managed credit unions to issue supplemental capital that would count as net worth. This bipartisan legislation would result in a new layer of capital, in addition to retained earnings, to absorb losses at credit unions.

The high-quality capital that underpins the credit union system was a bulwark during the financial crisis and is key to its future strength. However, most Federal credit unions only have one way to raise capital: through retained earnings. Thus, fast-growing, financially strong, well-capitalized credit unions may be discouraged from allowing healthy growth out of concern it will dilute their net worth ratios and trigger mandatory prompt corrective action-related supervisory actions.

A credit union's inability to raise capital outside of retained earnings limits its ability to expand its field of membership and to offer more products and services to its membership and eligible consumers. Consequently, the NCUA has previously encouraged Congress to authorize healthy and well-managed credit unions to issue supplemental capital that will count as net worth under conditions determined by the NCUA Board. Enactment of H.R. 1244 would lead to a stronger capital base for credit unions and greater protection for taxpayers.

The NCUA stands ready to work with Congress on these proposals, as well as other options to provide consumers more access to affordable financial services through credit unions.

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[4] See 12 U.S.C. 1759(f)(1).

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM KEITH A. NOREIKA

Q.1. In response to Senator Menendez's question about regulatory concerns about the increase in auto loan delinquencies, you said that you "notice an uptick and you are certainly making our regulated entities aware of to keep track of." You continued by saying, "our job as regulators is to watch and manage credit risk and to flag where we are seeing increased risks."

Related to other OCC efforts to monitor increased credit risks, in 2013, the OCC updated guidance on leveraged lending, in part as a reaction to the credit bubble in markets for leveraged loans experienced during the crisis (as described by the Financial Crisis Inquiry Commission), and because of increasing concerns about escalating leveraged lending with deteriorating underwriting criteria in the years following the crisis. The recent Treasury Report recommends re-issuing the leveraged lending guidance because of concerns that it has harmed businesses. Do you agree with this recommendation that the OCC and other regulators should pull back the guidance, even in light of the impact of leveraged lending during the crisis and the concerns raised following it?

A.1. The interagency leveraged lending guidance was updated and re-issued in 2013. The updated guidance was issued in response to significant growth in the leveraged loan market and examinations identifying weaknesses in underwriting and risk management, such as liberal loan structures and deficient management information systems. Its primary purpose was to provide sound risk management guidance to banks involved in leveraged loan activities and to minimize excessive risk buildup in the leveraged loan market. Maintaining appropriate risk safeguards in the leveraged loan market helps to reduce volatility and the impact of adverse economic events during periods of stress, and thus help maintain banks' ability to provide needed capital to the economy during weaker times.

The guidance has had a positive effect on bank practices without adversely affecting leveraged lending volumes or access to capital. Agent banks have improved their underwriting and risk management processes to reduce and manage risk of leveraged lending exposure. In particular, most agent banks are now better equipped to project future cash-flows to assess borrower repayment capacity and enterprise valuations, which better align with basic safety and soundness principles. In addition, leveraged lending volumes remain robust. Following the 2007–2009 recession, syndicated leveraged lending issuance increased significantly each subsequent year to a record issuance of $1.1 trillion in 2013. This volume was substantially higher than the prior record level of $700 billion in 2007. Although annual issuance levels in 2014–2016 were lower than 2013, these volumes were well above 2007 and represented the second, fourth, and third highest volumes on record, respectively.

The agencies have conducted extensive industry outreach since issuing the guidance, and they have published leveraged lending Frequently Asked Questions (FAQ) to clarify the guidance and supervisory expectations. The purpose of the outreach and FAQ is to promote transparency and consistency for banks' understanding and examiners' application of the guidance. These outreach

activities have helped reduce the number of inconsistencies that bankers noted following the initial issuance of the guidance. The outreach has also indicated that certain parts of the guidance present continued challenges to banks.

The Office of the Comptroller of the Currency (OCC) believes that the guidance is an appropriate and effective supervisory tool that has served the agencies and the banking industry well. Nonetheless, we recognize the challenges expressed during outreach regarding agency expectations and unintended consequences of the guidance. We are open to pursuing additional opportunities for the public to provide such input on the guidance and to considering whether such input necessitates clarifications to the guidance. As noted above, because the guidance is interagency, we will need to engage with the other agencies to ensure consistency.

The OCC is committed to maintaining consistent, reasonable, and transparent application of the guidance. Supervisory guidance should complement the safe and sound activities of federally regulated financial institutions, and the guidance should remain relevant, appropriate, and meaningful to support banks' activities. The OCC will continue to listen to institutions' comments about what has worked well with the guidance and FAQ, and what opportunities exist to clarify the guidance and encourage economic growth in a safe and sound manner.

Q.2. At the time of your appointment as Acting Comptroller of the Currency, you were representing Ant Financial, a Chinese company that is currently under review by CFIUS.

Q.2.a. What, if any, conversations did you have with Treasury Secretary Mnuchin or Treasury staff about Ant Financial or the CFIUS process as you were being vetted to serve as Acting Comptroller?

A.2.a. In line with its statutory confidentiality restrictions, Treasury does not discuss cases before the Committee on Foreign Investment in the United States (CFIUS), including whether or not any case has been filed with CFIUS. That said, I never had any conversations with the Secretary regarding any Ant Financial matter. My only communications with Treasury staff regarding Ant Financial during this time period were limited to my disclosures to ethics officials of my client lists as part of the ethics vetting process.

Q.2.b. Do you believe that there are any conflict of interests by having conversations about a job position within Treasury as you were representing a foreign company that is being reviewed by Treasury as part of the CFIUS process?

A.2.b. No. My only communications with Treasury officials about Ant Financial on any matter during this time period were limited to my disclosures of my client lists to Treasury ethics officials as part of the ethics vetting process. In addition, all ethical rules were observed in the course of my legal representation of Ant Financial to avoid any conflict of interest.

Q.2.c. Separately, have you had communications with any U.S. Government officials about the Ant-MoneyGram transaction since you were appointed to your position?

A.2.c. Since I have become Acting Comptroller, my only communications with U.S. Government officials about Ant Financial on any matter were to alert officials, where applicable (*e.g.,* ethics officials), of my prior client relationship to screen me from any possible involvement in any discussion on any Ant Financial matter.

Q.2.d. Have you had any communications with any officials involved in the CFIUS review of that transaction?

A.2.d. Since I have become Acting Comptroller, I have not had any discussions with any U.S. Government officials on any Ant Financial matters, other than as noted earlier, to alert officials (*e.g.,* ethics officials) of my prior client relationship to screen me from any possible involvement in any discussion on any Ant Financial matter.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM KEITH A. NOREIKA

Each of you serve at agencies that are members of the Financial Stability Oversight Council (FSOC). Insurance has been regulated at the State level for over 150 years—it's a system that works. But FSOC designations of nonbank systemically important financial institutions (SIFIs) have made all of you insurance regulators, despite the fact that you are bank regulators at your core.

Strong market incentives exist for insurers to hold sufficient capital to make distress unlikely and to achieve high ratings from financial rating agencies, including incentives provided by risk sensitive demand of contract holders and the potential loss of firms' intangible assets that financial distress would entail. Additionally, insurance companies are required by law to hold high levels of capital in order to meet their obligations to policyholders. Bottom line: Insurance companies aren't banks, and shouldn't be treated as such.

In March, my colleagues and I on the Senate Banking Committee sent a letter to Treasury Secretary Mnuchin indicating our concerns regarding the FSOC's designation process for nonbanks. I support efforts to eliminate the designation process completely.

I was pleased that President Trump issued a "Presidential Memorandum for the Secretary of the Treasury on the Financial Stability Oversight Council" (FSOC Memorandum) on April 21, 2017, which directs the Treasury Department to conduct a thorough review of the designation process and states there will be no new nonbank SIFI designations by the FSOC until the report is issued. Relevant decisionmakers should have the benefit of the findings and recommendations of the Treasury report as they carry out their responsibilities with respect to FSOC matters.

Please answer the following with specificity:

Q.1. What insurance expertise do you and your respective regulator possess when it comes to your role overseeing the business of insurance at FSOC?

A.1. As one of 10 voting members, the OCC brings considerable expertise to the Financial Stability Oversight Council (FSOC). Many of the areas of financial risk on which the OCC focuses as part of its supervision of financial institutions—for example, credit,

liquidity, interest rate, earnings and operational risk—are risks that the FSOC evaluates with respect to the criteria for designation of nonbank financial companies.

In addition, since passage of the Gramm-Leach-Bliley Act of 1999, national banks have express authority to own so-called "financial subsidiaries." These subsidiaries are specifically authorized to engage in the same set of financial activities, including insurance activities that are permissible for financial holding companies supervised by the Federal Reserve. Thus, through our supervision and regulation of national banks and their financial subsidiaries, the OCC has acquired, and brings to FSOC, important experience and perspective concerning insurance.

Q.2. Do you support the Senate Banking Committee's recent legislative effort, the Financial Stability Oversight Council Insurance Member Continuity Act, to ensure that there is insurance expertise on the Council in the event that the term of the current FSOC independent insurance member expires without a replacement having been confirmed?

A.2. We are supportive of efforts to ensure that there is continuity of service for the independent member.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSE FROM KEITH A. NOREIKA

Q.1. Has the CFPB effectively coordinated with the OCC on rulemaking and enforcement actions? If not, how could coordination be improved?

A.1. Rulemaking: The CFPB consults with the OCC regarding its significant rulemakings. However, as a general matter, the basic framework and policy direction of the CFPB's rulemakings are already in place at the time the OCC is consulted. Early in the CFPB's history, that agency was implementing statutorily required regulations in a compressed timeframe. Now that many of the required regulations are in place, coordination could potentially be improved by earlier consultations regarding the regulatory framework and direction being contemplated. The OCC stands ready to work with the CFPB to continue to improve coordination.

Enforcement Actions: The OCC endeavors to coordinate with the CFPB on enforcement actions, at the examiner and supervisory levels and by way of conference calls and meetings between the enforcement staff of both agencies. Staff have also shared documents and other information related to possible enforcement actions. Further, OCC staff communicate with supervisory and enforcement staff in the CFPB's Office of Fair Lending and Equal Opportunity to coordinate on supervisory and enforcement matters relating to banks for which the two agencies have overlapping jurisdiction.

Q.2. As you know, in December of 2016 the OCC released a whitepaper discussing the possibility of a fintech charter, entitled, "Exploring Special Purpose National Bank Charters for Fintech Companies."

Q.2.a. Do you intend to move the OCC forward on finalizing a fintech charter? Why or why not? If so, please provide a timeline on these efforts.

A.2.a. The OCC is continuing to consider in a deliberative way the special purpose national bank charter described in the December paper. We have no imminent or concrete plans to use the authority set out in our regulations[1] to charter, or to accept applications to charter, an uninsured special purpose fintech national bank. Companies may, however, continue to apply for a charter as a full-service national bank or Federal savings association, and they also may seek a charter under the OCC's long-established authority to charter other types of special purpose national banks, such as credit card banks and trust companies.

The OCC is continuing to hold discussions with fintech companies that may be interested in a bank charter to better understand diverse business models and identify potential risk. These meetings have been very informative and provide important insights into the changing landscape of the financial services industry.

Yesterday, I explained these points in greater detail in remarks given before the Exchequer Club.[2]

Q.2.b. Does the OCC have sufficient statutory authorization to implement a fintech charter? Why or why not?

A.2.b. The OCC has broad authority under the National Bank Act to grant charters for national banks to carry on the "business of banking." That authority includes granting charters for special purpose national banks. The OCC clarified eligibility for receiving a special purpose national bank charter in 2003 in a regulation, 12 CFR 5.20(e)(1). Specifically, a special purpose national bank that conducts activities other than fiduciary activities must conduct at least one of the following three core banking functions: receiving deposits, paying checks, or lending money.

Two lawsuits have been filed, by the New York Department of Financial Services and the Conference of State Bank Supervisors, respectively, that challenge the OCC's authority to grant special purpose national bank charters to fintech companies. We are currently preparing our responses in both cases, and will vigorously defend our authority to charter these special purpose national banks.

Q.2.c. Under what legal circumstances is the OCC allowed to regulate fintech companies?

A.2.c. As the chartering authority and the prudential regulator for national banks, the OCC has clear authority to regulate and supervise a fintech company that is engaged in the business of banking. Indeed, the OCC has made clear that a fintech company with a special purpose national bank charter would be regulated and supervised like similarly situated national banks. That regulation and supervision would include, for example, capital and liquidity standards, risk management and governance expectations, and regular examination by OCC examiners.

The OCC also has authority under the Bank Service Company Act to regulate fintech companies if they are acting as third-party service providers to national banks or Federal savings associations.

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[1] 12 C.F.R. § S. 20(e)(1).

[2] Exchequer Club Remarks at *https://www.occ.gov/news-issuances/speeches/2017/pub-speech-2017-82.pdf.*

Q.2.d. What concerns, if any, do you have with the OCC's fintech charter, as outlined in the previously mentioned December 2016 whitepaper?

A.2.d. As I explained in my Exchequer Club remarks, in my view companies that offer banking products and services should be allowed to apply for national bank charters so that they can pursue their businesses on a national scale if they choose, and if they meet the criteria and standards for doing so. Providing a path to become national banks is pro-growth and in some ways can reduce regulatory burden for those companies. National charters should be one choice that companies interested in banking should have. That option should exist alongside other choices that include becoming a State bank or operating as a State-licensed financial service provider, or pursuing some partnership or business combination with existing banks.

I also believe that a firm that provides banking products and services should be regulated and supervised like a bank. That is not the case today. Hundreds of fintechs presently compete against banks without the rigorous oversight and requirements facing national banks and Federal savings associations. That status quo disadvantages banks in many ways. While charters would provide great value to the companies that receive them, the supervision that accompanies becoming a national bank would help level the playing field in meaningful ways.

Q.3. As you know, the OCC recently released a bulletin entitled, "Frequently Asked Questions to Supplement OCC Bulletin 2013–29," which provided some regulatory guidance for banks that partner with fintech companies. However, I am told there is still confusion about such partnerships, including when fintech companies will be treated as third-party service providers, as well as the regulatory implications of this arrangement.

Q.3.a. Should the OCC provide further guidance to banks about their partnership with fintech companies, including when fintech companies will be treated as third-party service providers, and the corresponding regulatory implications for banks? If so, please provide a timeline for such efforts.

Q.3.b. Under what conditions have onsite bank examiners treated fintech companies as third-party service providers?

A.3.a.–A.3.b. The OCC has issued guidance on the expectations for risk management of third-party relationships. The primary guidance document is OCC Bulletin 2013–29, "Third-Party Relationships: Risk Management Guidance" (October 30, 2013). OCC Bulletin 2017–7, "Supplemental Examination Procedures for Third-Party Relationships" (January 24, 2017), provides examiners and banks steps on how to review third-party risk management systems. We published OCC Bulletin 2017–21, "Frequently Asked Questions to Supplement OCC Bulletin 2013–29," (June 7, 2017), to address questions on third-party risk management, including several that relate to fintech companies. As is the OCC's practice, we will continue to compile and review questions about third-party risk management and issue further guidance, when we deem necessary. We have no immediate plans to do so at this time.

As part of our supervisory process, we encourage banks to contact their local supervisory office or the appropriate headquarters divisions to seek clarification on our guidance on the management of third-party relationships. The OCC has also established the Office of Innovation, which serves as a central point of coordination for the OCC on banks' interest in fintech, including partnerships. The OCC expects that if a financial institution engages, partners, or otherwise leverages the services of a third-party service provider, including a fintech firm, bank management should understand, assess, and appropriately manage the risk associated with services being provided through the third-party firm. The level of due diligence, control structures, monitoring, and oversight should be commensurate with the inherent risk of the activity or service provided. If the provider service or relationship is critical to the financial institution, we expect strong controls and regular oversight and monitoring.

As part of the supervisory process, examiners may review a financial institution's third-party risk management program, including a listing or inventory of such relationships. If a fintech is included in such a listing or inventory, the examiner would expect that relationship to be managed appropriately and in line with OCC guidance. If an examiner becomes aware of fintech or other companies with which the bank has a business arrangement are not being treated as third-party relationships, the examiner may follow-up to determine if the relationships are being appropriately managed.

Q.4. As you know, the CFPB may be moving forward on a rulemaking for Section 1071 of Dodd-Frank, which granted the CFPB the authority to collect small business loan data. I've heard some concerns that implementing Section 1071 could impose substantial costs on small financial institutions and even constrict small business lending.

Q.4.a. Are you concerned how a Section 1071 rulemaking could hurt small business access to credit?

Q.4.b. Has the OCC coordinated with the CFPB to ensure that implementing these requirements does not constrict small business access to credit?

A.4.a.–b. As I noted in my testimony, Congress could streamline the reporting requirements to which banks—particularly community banks—are subject, freeing the banks' employees to return to the business of banking. In this regard, I specifically suggested that Congress could repeal unnecessary information collection provisions such as the requirement stemming from section 1071 of the Dodd-Frank Act that banks gather extensive information on business loans. The benefits of such information collection are unclear.

Concerning CFPB coordination, I note that the CFPB conducts its coordination with respect to rulemaking on an interagency basis. Rather than consult with each Federal banking agency (FBA), it shares draft rulemakings with all the FBAs at the same time and collects and responds to comments in a similar fashion. The OCC has regularly participated, along with the other FBAs in these joint consultations on other rules. To date, the CFPB has made a presentation to an interagency task force on its small

business loan data rulemaking efforts, but has not yet begun consultations.

Q.5. Constituents in my State tell me that the EGRPRA report came short in highlighting concrete ways to reduce the regulatory paperwork burden.

Q.5.a. What more can the OCC do to reduce the regulatory paperwork burden on community banks?

Q.5.b. Do any of these changes require statutory authorization?

A.5.a.–A.5.b. There is broad consensus that community banks need regulatory burden relief, including paperwork burden reduction. While the Economic Growth and Regulatory Paperwork Reduction Act Report outlines ideas the agencies received from the public to address this need, shortly after arriving at the OCC, I solicited feedback from OCC staff, including the agency's examiners, for additional ways to reduce burden and improve the efficiency of our supervision and regulation of the Federal banking system. I also have met with trade and community groups, scholars, and my Federal and State colleges to begin a constructive, bipartisan dialogue on how our regulatory system might be recalibrated.

As the Treasury Report notes, however, congressional action is required to implement many of the changes needed to streamline regulation and free up resources, particularly for smaller institutions. My written testimony outlines a variety of legislative changes that would provide specific relief to community banks, thereby strengthening these financial institutions and fostering economic growth. I would be happy to work with Congress on any of the ideas I submitted.

Q.6. Our financial system has become increasingly consolidated, as community banks either close their doors or merge with larger institutions.

Q.6.a. Are you concerned about this pattern?

Q.6.b. What services can these smaller institutions provide that larger institutions cannot provide?

Q.6.c. Are there any benefits that come from consolidation?

A.6.a.–c. I am concerned that a consolidation trend may result in fewer community banks. As I noted in my testimony, the formation of new financial institutions is crucial to maintain a vibrant and growing economy. To facilitate new entrants into the market, I have suggested options for how Congress could streamline the process of forming *de novo* banks by allowing banks that receive deposits (other than trust funds) to obtain Federal Deposit Insurance Corporation (FDIC) deposit insurance more quickly after the OCC charters and authorizes new banks to commence business. This approach would reduce the significant delays that plague the current process and dis-incent *de novo* formations.

The OCC supervises over 1,000 national banks and Federal savings associations in its community bank supervision line of business. These community banks, which range from several million dollars to over $1 billion in total assets, play a crucial role in providing consumers and small businesses in communities across the Nation with essential financial services and a source of credit that

are critical to economic growth and job expansion. Throughout the country, community bankers help small businesses grow and thrive by offering "hands-on" counseling and credit products that are tailored to their specific needs. They fund home purchases; they lend to small businesses and farms; and they play key roles in civic, religious and public organizations. In addition, they often invest or assist in underwriting municipal bonds funding infrastructure improvements for local communities. Community banks and their employees strengthen our communities through their active participation providing staff and monetary resources to support civic life in their towns.

Community banks are important to the OCC, and the OCC is committed to fostering a regulatory climate that allows well-managed community banks to grow and thrive. We have built our supervision of community banks around local field offices where the Assistant Deputy Comptroller (ADC) has responsibility for the supervision of a portfolio of community banks. We have based our community bank examiners in over 60 locations throughout the United States, living in the same communities served by the local banks they supervise. Approximately two-thirds of our examination staff is dedicated to the supervision of community banks.

Through this supervisory structure, community banks receive the benefits of highly trained bank examiners with local knowledge and experience, supplemented by the resources and specialized expertise that a nationwide organization can provide. Our bank supervision policies and procedures establish a common framework, but tailor our expectations for banks based on each bank's risk profile. We clearly communicate which, or to what extent, each piece of guidance applies to community banks. Each bank's portfolio manager then tailors the supervision of each community bank to its individual risk profile, business model, and management strategies. We give our ADCs considerable decisionmaking authority, reflecting their experience, expertise, and first-hand knowledge of the institutions they supervise.

OCC-supervised community banks, which demonstrated their resilience in the aftermath of the recent financial crisis and recession, face challenges in today's operating environment. Strategic planning and governance risk pose a challenge as banks implement plans for adapting business models to respond to changing loan demand, a sustained period of low interest rates, and intense competitive pressures, including competition from nonbanks. Community banks also face challenges from demographic changes to the communities where they operate, technology advances impacting product and services, and attracting and retaining qualified staff. Consolidation is one strategic approach to these challenges—banks pursue merger and acquisition (M&A) activity to maximize shareholder or franchise value, gain economies of scale, increase market penetration, and improve efficiencies. Whether through such M&A activity or by growth and adaptation, community banks will continue to play a critically important role in the U.S. financial system and economy.

Q.7. Multiple anecdotes from constituents make it clear that there are several Nebraska counties where consumers cannot get a mortgage, due to CFPB regulations such as TRIO and the QM rule.

What is the best way to address this problem from a regulatory standpoint?

A.7. It is important for regulators, particularly those responsible for standard setting, to consider issues and concerns raised by stakeholders regarding the impact current regulations have on the availability of credit and to adopt appropriate responsive regulatory amendments.

The CFPB has rulemaking authority for the Truth in Lending Act (TILA), which includes the TILA–RESPA Integrated Disclosures (TRIO) and Qualified Mortgage (QM) provisions. The OCC participates in rulemakings through the statutorily mandated consultation process and provides appropriate feedback to the CFPB regarding individual rules. The OCC supervises banks that range from small community banks and Federal savings associations to multi-trillion dollar institutions that are among the world's largest financial companies. Our ongoing supervisory work offers an efficient channel for soliciting input from a range of supervised institutions regarding the impact of current regulations and any frustrations and concerns about current regulatory requirements. The input we receive from our institutions is a key component of the feedback that we have provided to the CFPB as part of the consultation process.

Q.8. Are there concrete ways in which you believe the CFPB has improperly tailored regulations to match the unique profile of smaller financial institutions?

A.8. As I stated in my testimony, the OCC is supportive of the need to tailor rules to fit the community bank business model. To the extent we receive input from community banks regarding concerns or frustrations with regulatory requirements, we share those views through the consultation process.

Q.9. My understanding is that very few banks have opened since the passage of Dodd-Frank.

Q.9.a. Why do you believe this is the case?

Q.9.b. What potential impacts does this have for our financial system?

Q.9.c. Is there anything more the OCC can do to encourage the opening of new banks?

Q.9.d. Is there anything more Congress should do to encourage the opening of new banks?

A.9.a.–d. Community banks are essential to our Nation's economic growth and prosperity. They play a vital role in meeting the credit needs of consumers and small businesses across the country and help these businesses thrive by offering products and services tailored to their needs.

While the OCC recently approved a charter application for a new national bank, you are correct that there has been a paucity of new bank charters issued since passage of the Dodd-Frank Act. The reasons for this are wide-ranging and include the cost of capital; competition from nonbank financial service providers; and the cost of complying with applicable statutory and regulatory requirements. In addition, as I noted in my testimony, under existing law, a new insured depository institution must obtain the approval of two

regulators—the chartering authority (*i.e.,* the OCC for national banks and Federal savings associations) and the FDIC. This process results in significant delays and has slowed the formation of *de novo* institutions in recent years. I have suggested options for Congress to consider to address this particular issue.

While the OCC cannot address all the factors that have caused the decrease in new bank charter applications, we are committed to minimizing unnecessary regulatory burden for these institutions and will continue to consider carefully the effect that current and future regulations and policies may have.

At the same time, there are steps that Congress can take by providing new and existing community banks with more flexibility to reduce burdens. For example, as I discussed in my June 22, 2017, testimony, Congress could:

- Modernize the corporate governance requirements for national banks by allowing them to adopt fully the corporate governance procedures of, for example, the State in which their main office is located, the State, the Delaware General Corporation Law, or the Model Business Corporation Act;
- Provide regulatory relief to community banks, for example, by exempting community banks altogether from the obligation to comply with the Volcker Rule; and
- Address areas of uncertainty that national banks face, for example, by codifying the "valid when made" principle (*i.e.,* preserving the original interest terms following a transfer of a loan from a national bank) called into question by the Second Circuit in Madden v. Midland Funding, LLC.

Each of these would help create an environment more conducive to community bank success and, thereby, encourage applicants for new bank charters. I look forward to working with Congress to encourage the formation of *de novo* banks.

Q.10. I'm concerned that our Federal banking regulatory regime relies upon too many arbitrary asset thresholds to impose prudential regulations, instead of relying on an analysis of a financial institution's unique risk profile.

Q.10.a. Should a bank's asset size be dispositive in evaluating its risk profile in order to impose appropriate prudential regulations?

Q.10.b. If not, what replacement test should regulators follow instead of, or in addition to, an asset-based test?

A.10.a.–10.b. I share your concern about the use of arbitrary asset thresholds for prudential regulation, particularly for midsize and regional banks. For midsize institutions, the commonly used $50 billion threshold can create a barrier to growth as well as a competitive barrier to entry because compliance costs rise dramatically for banks with assets of $50 billion or more. Although asset size may be appropriate to use as one measure of when and how to tailor regulations, in many cases it may make sense to supplement the use of asset size with other measures that better capture a bank's level of risk. For example, other factors to consider could include the nature and complexity of the bank's activities and the prudential regulator's judgment about the bank's effectiveness in managing risk, which is based on the qualitative and quantitative

results of examinations. The precise mix of tailoring measures can and should vary depending on context. My written testimony provides several context-specific suggestions for how this type of tailoring could be achieved. For example, Congress could give the FBAs the authority to issue rules creating an "off-ramp" for the Volcker Rule that takes into consideration asset size and the nature and complexity of an institution's activities. The use of both asset size and the nature of the institution's activities would, in the Volcker Rule, allow the FBAs to recognize that smaller institutions generally do not engage in the types of risky activities the Volcker Rule was intended to address. In contrast, in the stress testing context, an asset threshold may not be necessary. Instead, Congress could give the FBAs the flexibility to issue rules that tailor the stress testing requirements to be commensurate with risks posed by individual institutions or groups of institutions.

RESPONSE TO WRITTEN QUESTION OF SENATOR COTTON FROM KEITH A. NOREIKA

In your testimony, you stated that the CFPB has a different supervisory approach to bank examinations than the OCC.

Q.1. Can you explain the differences in approach between the agencies in examining national banks and Federal savings associations for compliance with consumer protection requirements?

A.1. There are a number of differences in the OCC and CFPB approaches to examining for compliance with consumer protection laws. Based on the statutory and regulatory requirements, the OCC examines each of its institutions on a regular cycle, currently every 12 or 18 months depending on the bank's asset size and rating. At each examination, the OCC reviews areas that are mandated by statute, regulation, or agency policy and also applies a risk-based approach to assess the bank's operations and focus exam work on areas of highest risk. As an example, OCC supervisory offices are responsible for identifying and assessing fair-lending risks during each supervisory cycle. For institutions with assets of $10 billion or less, the OCC has the authority to assess compliance with the 18 Federal consumer financial laws defined in Title X of Dodd-Frank, 12 U.S.C. 5481(14). These laws include the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the Home Mortgage Disclosure Act of 1975, the Home Owners Protection Act of 1998, the Home Ownership and Equity Protection Act of 1994, the Truth in Lending Act, the Truth in Savings Act, and the Real Estate Settlement Procedures Act of 1974. In performing this responsibility, the agency focuses its examination resources on areas of greatest risk based on that bank's particular retail business model and operations, in the context of the then-current state of the legal, regulatory and market environment. For banks with total assets of more than $10 billion, the OCC evaluates the quantity of risk and the quality of compliance risk management through the OCC's Risk Assessment System and assigns consumer compliance ratings.

The CFPB, however, does not have a similar statutory mandate to conduct consumer compliance examinations on a fixed schedule. Instead, as we understand it, the CFPB has developed a process

that focuses on identifying and addressing across all of its supervised institutions (institutions with over $10 billion in assets), the areas of highest risk to consumers throughout the financial services industry. We understand that the CFPB implements this approach each year by identifying focus areas of high risk to consumers, then identifying and scheduling for examination the financial services providers (both banks and nonbanks) that it believes pose the greatest risks to consumers in these areas.

As a result of this targeted approach, the number of CFPB examinations of OCC-supervised banks with more than $10 billion in assets each year may be limited. In addition, the scope of these exams may also be limited to specific rules, lines of business, products or services or other similar areas that have been identified as having the highest associated risk to customers.

RESPONSE TO WRITTEN QUESTION OF SENATOR WARNER FROM KEITH A. NOREIKA

Q.1. Cybersecurity regulation is receiving increased emphasis by all financial institution regulators. How do your agencies coordinate with each other to harmonize the promulgation of new cybersecurity regulations? With the increased use of the NIST Cybersecurity Framework by both Federal agencies and the private sector, how do your agencies intend to achieve greater alignment between the framework and your own regulatory initiatives?

A.1. The FBAs (OCC, FRB, and FDIC) meet monthly to discuss topics of mutual interest. The FBAs also work very closely to assess any potential new regulation. The Federal Financial Institutions Examination Council (FFIEC) is more expansive in membership and includes the FBAs as well as the National Credit Union Administration, the CFPB, and the State Liaison Committee, which includes representatives designated by the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. The FFIEC's Task Force on Supervision includes two specific working groups that assess technology and cybersecurity: Cybersecurity Critical Infrastructure Working Group (CCIWG) and Information Technology Systems (ITS). These committees meet monthly with a primary objective of discussing shared interest and assessing and developing any new examiner guidance.

The FFIEC has a legal mandate to develop common examination guidance for the banking sector. The FFIEC has historically and currently uses the National Institute of Standards and Technology (NIST) security and technology standards as a reference when assessing potential new regulations or developing examiner guidance. The CCIWG developed the Cybersecurity Assessment Tool (CAT) as a voluntary tool that institutions could use to provide a repeatable and measureable process to inform management of the institution's risks and cybersecurity preparedness. The FFIEC published the CAT in June 2015. The FFIEC worked closely with the NIST during the development phase of the CAT and mapped many of the CAT declarative statements to standards set forth in the NIST Cybersecurity Framework. NIST references the CAT on their website as a tool that incorporates the NIST Framework. The OCC as a

bank regulator with individual rule writing authority and as a member of the FFIEC will continue to consult with the NIST and reference the NIST Framework during any consideration of new examiner guidance or potential regulation.

The CAT does not represent new requirements or guidance. The CAT packages existing, often long standing, FFIEC guidance at the expected Baseline level to focus on cybersecurity. The CAT is publicly available on the FFIEC website for industry awareness in keeping with the regulators' principle of transparency. The CAT may also be used by regulatory agencies during their normal duties. The OCC has implemented the FFIEC CAT in our normal supervisory processes to assess the Federal banking system's cybersecurity preparedness.

The OCC also attends the quarterly Federal Banking Information Infrastructure Committee (FBIIC) meetings. The FBIIC includes a broad group (18) of regulators and industry consortiums related to the financial services industry. The FBIIC serves as mechanism to discuss common approaches and items of mutual interest related to technology and cybersecurity.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM KEITH A. NOREIKA

Q.1. I'm a proponent of tailoring regulations based off of the risk profiles of financial institutions, as opposed to having strict asset thresholds that do not represent what I believe is the smart way to regulate. But, my question here is really about the importance of ensuring that we have a system that is rooted in fundamental, analytical, thoughtful regulation so that we can achieve and execute on goals, whether balancing safety and soundness with lending and growth, or encouraging more private capital in the mortgage market to protect taxpayers and reform the GSEs.

Q.1.a. Do you think that we should use asset thresholds as a way to regulate—yes or no? If no, can you provide me with the metrics or factors by which a depository institution should be evaluated? If yes, please explain.

A.1.a. Although in some cases asset size may be appropriate to use as one measure of when and how to tailor regulations, in many cases it may make more sense to supplement asset size with other measures that better capture the level of risk a bank presents. One such measure is the nature and complexity of the bank's activities. Another is the prudential regulator's judgment about the bank's effectiveness in managing risk, which is based on the qualitative and quantitative results of examinations.

The precise mix of tailoring measures can and should vary depending on context. My written testimony provides several context-specific suggestions for how this type of tailoring could be achieved. For example, Congress could give the FBAs the authority to issue rules creating an "off-ramp" for the Volcker Rule that takes into consideration asset size as well as the nature and level of an institution's activities. The use of both asset size and activities would be appropriate in the Volcker Rule context because it would allow the FBAs to recognize that smaller institutions generally do not engage in the types of risky activities the Volcker Rule was intended

to address. In contrast, in the stress testing context, an asset threshold may not be necessary. Instead, Congress could give the FBAs the flexibility to issue rules that tailor the stress testing requirements to be commensurate with risks posed by individual institutions or groups of institutions.

Q.1.b. Section 165 of Dodd-Frank requires enhanced supervision and prudential standards for banks with assets over $50 billion. This applies to any bank that crosses the asset threshold, without regard to the risks those banks pose based upon the complexity of the business model. This includes heightened standards on liquidity and capital under the Liquidity Coverage Ratio (LCR) and the Comprehensive Capital Analysis and Review (CCAR) which have a various assumptions built in that may drive business model.

Q.1.b.i. I understand under these two regulatory regimes, banks have changed certain lending behaviors because of the assumptions Federal regulators have made regarding certain classes of assets and deposits. Can you provide some examples of how the LCR and CCAR have changed the types of loans, lending, and deposits your institution holds?

Q.1.b.ii. Construction lending by banks over the $50 billion threshold has been a source of concern, namely because these enhanced prudential standards have treated construction loans punitively. This includes construction lending for builders of apartments, warehouses, strip malls, and other projects that may have varying risk profiles associated with them. However, under the CCAR and DFAST assumptions, the regulators have assigned all these categories of lending the same capital requirements. The result is an overly broad capital requirement for varying loans that have different risks, a capital requirement that may be greater for some loans and lower for others, influencing the decision of many banks over the $50 billion threshold to hold less of these assets due to the punitive capital requirements associated with them. Have you seen a similar corresponding issue with construction loans because of the heightened prudential standards?

Q.1.b.iii. Under the CCAR regulations, Federal regulators routinely assign risk weights to certain assets that Bank Holding Companies have on their balance sheets. These risk weights oftentime changes the costs associated with holding certain investments, such as Commercial Real Estate. Has this changed the type of assets that institutions hold, or caused institutions to alter their business plans because of the regulatory capital costs? If so, can you provide examples of this?

A.1.b.i.–b.iii. Banks' balance sheets have changed since the financial crisis. These changes, which include reducing reliance on short-term funding, strengthening the quality and quantity of capital, streamlining business units, and improving and investing in data and associated infrastructure, are likely to improve banks' resilience. Many factors are driving these changes including banks' strategic reactions to the financial crisis, newly developed or enhanced capital and liquidity planning efforts, and statutory and regulatory changes such as the Comprehensive Capital Analysis and Review (CCAR) and liquidity coverage ratio (LCR). Banks

consider all of these factors as they manage their businesses and make portfolio decisions.

It has been our experience that CCAR is consistently the most binding capital constraint. Banks often maintain a capital buffer above the CCAR requirements due to uncertainty surrounding the CCAR assessments and potential future changes in the Federal Reserve's assumptions and model. The capital calculations within CCAR and Dodd-Frank Act Stress Test (DFAST) are based on the regulatory capital rule, which assigns risk weights based on the relative riskiness of broad categories of assets. With respect to commercial real estate (CRE) loans, the capital rule assigns a higher risk weight to certain CRE acquisition, development, and construction loans as historically most banks have experienced higher loss rates on such loans compared to loans that fund stabilized, completed CRE properties. Similarly, the OCC expects banks to model losses for the two categories of CRE loans separately for purposes of stress testing.

Since the LCR rule was implemented, national banks have materially increased their portfolio of high quality liquid assets (or HQLA). Since 2009, as the LCR was being developed internationally, the 19 largest national banks added $1.7 trillion of highly liquid assets, a proxy for HQLA, which now represent 29 percent of those banks' assets. The LCR also has transformed liabilities, as firms were encouraged to reduce reliance on funding from financial entities and short-term repo and increase core deposits and longer-term funding. Core deposits at national banks increased by nearly $2.9 trillion from 2009–2016.

Q.1.b.iv. Do you think that regulators, on a general basis, get the risks weights right?

A.1.b.iv. I think the relevant risk weights are generally appropriate. The regulatory capital rules assign risk weights to assets based on the relative riskiness of broad asset categories. The regulatory capital rules went through the public notice and comment process and the OCC, FDIC and Federal Reserve considered the public comments received when finalizing the rules.

As part of the rulemaking process, the agencies considered the potential cost of the revised capital rules using regulatory reporting data, supplemented by certain assumptions and estimates if data needed for certain calculations were not available. The FBAs reviewed the results of their respective reviews, as well as the input received from commenters during the notice and comment process, and concluded that the vast majority of banks had regulatory capital sufficient to meet the revised minimum requirements on a fully phased-in basis. In fact, the vast majority had capital sufficient to exceed the fully phased-in capital conservation buffer, such that they would not face restrictions on capital distributions.

Q.1.b.v. Fed Governor Tarullo has argued that the $50 BB threshold is too low in terms of an asset threshold for enhanced prudential standards; does this number make sense? Why do we need such arbitrary thresholds? Shouldn't we get away from these thresholds and move toward a regulatory system that evaluates substance and activities of an institution as opposed to an arbitrary number? Why can't we do that?

Q.1.b.vi. Does Title I allow the Fed to treat a $51 BB bank in a similar manner to a $49 BB bank for the purposes of enhanced prudential standards?

A.1.b.v.–A.1.b.vi. I am concerned that the $50 billion threshold for the application of enhanced prudential standards (EPS) under section 165 of the Dodd-Frank Act creates an effective barrier to competition that protects the market position and competitive advantage of the largest, most complex institutions while imposing proportionally higher costs and larger burdens on institutions with assets closer to the $50 billion threshold. Consequently, I would support efforts to raise the threshold for application of EPS under section 165 of the Dodd-Frank Act. I would also support efforts to use a qualitative assessment process. Either approach would more specifically capture the companies that present the types of risk that would require EPS.

There are several ways to implement these approaches. Congress could take action to amend the $50 billion threshold established by section 165 of the Dodd-Frank Act. In the alternative, section 115 of the Dodd-Frank Act gives the FSOC the ability to make recommendations to the Federal Reserve about the establishment and refinement of EPS, including recommendations to differentiate among companies subject to EPS on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factor, and recommendations for an asset threshold that is higher than $50 billion for contingent capital requirements, resolution plans, credit exposure reports, concentration limits, public disclosures, and short-term debt limits. In addition, under section 165(a) of the Dodd-Frank Act, the Federal Reserve could differentiate among companies with respect to application of EPS, either on its own or pursuant to a recommendation from the FSOC and, pursuant to a recommendation from the FSOC, could raise the asset thresholds for EPS addressing contingent capital requirements, resolution plans, credit exposure reports, concentration limits, public disclosures, and short-term debt limits.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KENNEDY FROM KEITH A. NOREIKA

Q.1. In response to a question from Chairman Crapo, you responded by saying that not only was changing the $50 billion threshold appropriate, but that arbitrary thresholds in general act as barriers to entry to higher asset levels. Furthermore, in response to a question from Sen. Shelby, you responded that size is not the only factor to consider and that risk profiles are imperative when judging appropriateness.

In light of these responses, do you think that a risk-based formula such as the one already developed and in use by the Federal Reserve to determine G–SIB surcharges, could be effectively and appropriately used to determine which firms are systemically important and should be subject to increased regulation?

A.1. Regulators use a variety of measures to tailor their regulations to identify and take into account the level of risk an institution presents. The Federal Reserve's risk-based formulas for identifying,

and assessing capital against, global systemically important bank holding companies (GSIBs) is one example of how a regulator can use a variety of measures to assess risk. The Federal Reserve's formulas use a methodology based on metrics that are correlated with systemic significance: size, interconnectedness, cross-jurisdiction activity, substitutability, complexity, and short-term wholesale funding. To identify GSIBs, each institution is scored by category relative to aggregate global indicator amounts across other large, global banking organizations and an aggregate systemic indicator score is calculated. A bank holding company that exceeds a defined threshold is identified as a GSIB.

This approach has some drawbacks. While metrics such as those used by the Federal Reserve to identify GSIBs should be taken into account when determining an institution's level of systemic risk, these metrics do not always leave room for a prudential regulator's judgment. Regulators should be able to leverage the insight into an institution's effectiveness in managing risk that they have gained through the examination process. This insight is especially important when regulating sophisticated financial institutions. Furthermore, relying on relative measurements of systemic risk profiles can make it more difficult for an institution to alter its systemic importance through its own actions (such as a reduction in its risk profile), since its systemic indicator score is influenced not only by its own actions, but also by the actions of other institutions included in the aggregate global indicator. To the extent practicable we should strive for methodologies that minimize such relational distortions.

Q.2. You both have spoken about the need to "right-size" or eliminate regulations that are duplicative, costly and that inhibit growth. Dodd-Frank added to an already complex set of overlapping capital regimes that could be considerably streamlined by your agency without the need for legislative action. Larger regional banks that do not pose the kinds of systemic risks as the larger global players remain subject to the Advanced Approaches regime under Basel. That regime compels regional banks to run complex internal capital models, deploying valuable resources and costing tens of millions of dollars in compliance costs, all for no risk management benefits. In fact, the Collins Amendment to the Dodd-Frank Act nullified the relevance of Advanced Approaches by requiring large regionals to adhere to the simpler Standardized Approach, which requires higher capital levels.

Would you support either raising the threshold for application of the Advanced Approaches regime from $250B to capture only truly global banks, or giving large regionals the opportunity to opt-out of this regime?

A.2. I fully agree that when setting an asset threshold in a regulation, financial institutions on different sides of the asset threshold are affected differently. As I said in my testimony, it is a bank supervisor's job to strike the right balance between supervision that effectively ensures safety, soundness, and compliance, while at the same time enabling economic growth. Establishing a higher asset threshold is one way to provide regulatory relief to institutions that do not pose systemic risks. However, I believe that regulators are

likely to have more success in striking the right balance in the context of capital requirements if they have the flexibility to establish standards that are tailored to take risk into consideration.

Allowing regulators to consider a broader array of factors—such as size, complexity, risk profile, and interconnectedness—when developing and implementing capital regulations would allow them to better capture the level of risk an institution presents. Using measures that consider the nature and scope of an institution's activities complemented by the prudential regulator's judgment are critical components of an efficient and effective regulatory framework. The OCC will work within our current authorities to achieve this aim and foster economic growth and opportunity.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM KEITH A. NOREIKA

Q.1. In your written testimony to the Committee, you suggested that Congress revoke the CFPB's authority to examine and supervise the activities of insured depository institutions with over $10 billion in assets with respect to compliance with the laws designated as Federal consumer financial laws. You further suggest that Congress return examination and supervision authority with respect to Federal consumer financial laws to Federal banking agencies.

When I asked you about this recommendation at the hearing, you noted that:

> what we're seeing in practice is that the CFPB is not enforcing those rules against the mid-size banks—the large-small banks to the small-big banks. And so we do have a problem of both over- and under-inclusion. And so when we get up to the bigger banks, we have a little bit of overlap and overkill there. So we need some better system of coordination.

Q.1.a. Can you elaborate on your comments from the hearing and describe which rules the CFPB is not enforcing against "large-small banks" to "small-big banks?" Please list specific examples, to the best of your ability, of instances where the CFPB failed to catch or remediate misconduct at these institutions through the supervisory process.

A.1.a. Based on the statutory and regulatory requirements, the OCC examines each of its institutions on a regular cycle, currently every 12 or 18 months depending on the bank's asset size and rating. At each examination, the OCC reviews areas that are mandated by statute, regulation, or agency policy and also applies a risk-based approach to assess the bank's operations and focus exam work on areas of highest risk. As an example, OCC supervisory offices are responsible for identifying and assessing fair-lending risks during each supervisory cycle. For institutions with assets of $10 billion or less, the OCC has the authority to assess compliance with the 18 Federal consumer financial laws defined in Title X of Dodd-Frank, 12 U.S.C. 5481 (14). These laws include the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the Home Mortgage Disclosure Act of 1975, the Home Owners Protection Act of 1998, the Home Ownership and Equity Protection Act of 1994, the Truth in Lending Act, the Truth in Savings Act, and the Real Estate Settlement Procedures Act of 1974. In performing this

responsibility, the agency focuses its examination resources on areas of greatest risk based on that bank's particular retail business model and operations, in the context of the then-current state of the legal, regulatory and market environment. For banks with total assets of more than $10 billion, the OCC evaluates the quantity of risk and the quality of compliance risk management through the OCC's Risk Assessment System and assigns consumer compliance ratings.

The Consumer Financial Protection Bureau (CFPB), however, does not have a similar statutory mandate to conduct consumer compliance examinations on a fixed schedule.

Instead, as we understand it, the CFPB has developed a process that focuses on identifying and addressing across all of its supervised institutions (institutions with over $10 billion in assets), the areas of highest risk to consumers throughout the financial services industry. We understand that the CFPB implements this approach each year by identifying focus areas of high risk to consumers, then identifying and scheduling for examination the financial services providers (both banks and nonbanks) that it believes pose the greatest risks to consumers in these areas.

As a result of this targeted approach, the number of CFPB examinations of OCC-supervised banks with more than $10 billion in assets each year may be limited. In addition, the scope of these exams may also be limited to specific rules, lines of business, products or services or other similar areas that have been identified as having the highest associated risk to customers. This approach has resulted in a substantial number of OCC-supervised banks with more than $10 billion in assets that have not received an examination from the CFPB for multiple years. For example, based on information provided to us by the CFPB since 2012, we have calculated that only approximately one-third of OCC-supervised banks with more than $10 billion but less than $50 billion in assets are subject to consumer compliance examinations from the CFPB annually. As a result, approximately two-thirds of national banks and Federal savings associations within the CFPB's jurisdiction lack the necessary supervisory examination of compliance with Federal consumer financial laws as the OCC does not have the authority to assess compliance for these institutions.

Q.2. Please also describe specific examples where CFPB supervision of insured depository institutions has led to "a little bit of overlap and overkill" for "bigger banks." What instances informed your views expressed in this comment? In what ways has the CFPB been too punitive toward "bigger banks?"

A.2. We have observed an emerging trend of the CFPB focusing its supervisory and enforcement activities on banks with asset sizes over $50 billion. In 2015 and 2016, the records currently available to the OCC indicate that the CFPB examined 41 percent and 34 percent, respectively, of the largest OCC-supervised banks. During the same period, our records indicate that the CFPB examined 12 percent and 16 percent of OCC-supervised midsize banks (generally between $10 and $50 billion in assets). The cumulative result therefore, is that the "bigger banks" are the focus of more of the CFPB's supervisory activity. Several of these banks also have,

during the 5 years of the CFPB's existence, been subject to simultaneous consumer protection-related enforcement actions by multiple regulators.

In my written testimony, I proposed an approach to address the overlap in supervisory authority over consumer compliance matters. In describing the OCC's proposed approach, the testimony uses the analogy of traffic lights—one regulator has the lead responsibility or primary authority to act (*i.e.,* "green light"). The other regulators have concurrent or back-up authority (*i.e.,* "red light"). They wait to act until a contingency provided in the law has occurred. Such an approach avoids the current situation where, not only is there a trending CFPB focus on bigger banks, but there is also an emerging practice of multiple regulators taking actions at the same time for the same underlying reason.

Q.3. Since joining the OCC several weeks ago, have you discussed with CFPB Director Cordray your concern that "large-small banks" and "small-big banks" are receiving inadequate oversight through the supervisory process?

A.3. Yes.

Q.4. Please describe the asset sizes or other characteristics that define, to your mind, "large-small banks," "small-big banks," and "bigger banks."

A.4. In my written testimony, I discussed the importance of "right-sizing regulation," noting the unintended consequences of applying statutes intended to address systemic risks that are typically associated with larger, more complex institutions to smaller institutions that do not pose those broad, systemic risks. Right-sizing regulation emphasizes tailoring the rules to the business models and risk profiles of banks, rather than relying on arbitrary asset thresholds.

While asset size can be an important consideration, it should be combined with considerations of the risks that are present in the institution. The latter are generally associated with factors such as an institution's product and service offerings, customer base, target markets and geographic locations in which the institution or its customers conduct business. Adding these risk considerations may change the overall profile of the institution. Therefore, when viewed holistically, a bank that falls into the category of a large bank in terms of asset size, may have a risk profile that has traditionally been viewed as one associated with a bank that is small in asset size.

In referring to the terms "large-small banks," "small-big banks," and "bigger banks," the OCC is combining consideration of asset size and risk profile. Large-small banks could be viewed as banks that are small in terms of asset size, but have "large bank" risk profiles. Similarly, a small-big bank would be one that would be considered large in terms of asset size, but have a "small bank" risk profile. In these cases, applying the same regulation to all large or small banks in terms of asset size would be inappropriate as the risk profiles of the banks in each of these asset groups may vary.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSE FROM CHARLES G. COOPER

Q.1. Our financial system has become increasingly consolidated, as community banks and credit unions either close their doors or merge with larger institutions.

Q.1.a. Are you concerned about this pattern? Why?

A.1.a. State regulators are very concerned about this pattern. Small, local banks continue to consolidate across the country, leaving many communities without access to financial services and reducing the diversity of the banking system.

An astonishing 1,715 community banks have disappeared since 2010, and this trend continues with 54 banks exiting the market in the first quarter of 2017. By contrast, only three community banks have closed due to failure in 2017. Consolidation leaves consumers with less choice, and diminishes healthy competition within the market.

Prior to the financial crisis, this consolidation was countered by new bank formation. However, the current trend of consolidation lack a corresponding appearance of new entrants. State regulators are concerned that further consolidation and a lack of *de novo* applications could have drastic effects on credit availability.

Q.1.b. What services can these smaller institutions provide that larger institutions cannot provide?

A.1.b. According to the Federal Reserve's 2016 Small Business Credit Survey, small banks are a primary source of credit for small businesses, and successful small business loan applicants are most satisfied with small banks. Community banks have an outsized role in small business lending—despite smaller asset size, community banks make 45 percent of all small loans to businesses in the United States. In fact, small business startups with assets under $1 million are most likely to be approved for financing at community banks. Small banks' small business lending activity levels the playing field, allowing for small firms to gain a foothold in the local market. Furthermore, community banks hold majority market share in the agricultural lending space, originating upwards of 75 percent of agricultural loans.

State regulators have seen that these lending activities require an understanding of not only the borrower, but also the local community. The effectiveness of this relationship-lending model is reflected in the market share held by community banks in small business and agricultural lending, despite smaller asset size.

Q.2. Multiple anecdotes from constituents make it clear that there are several Nebraska counties where consumers cannot get a mortgage, due to CFPB regulations such as TRID and the QM rule. What is the best way to address this problem from a regulatory standpoint?

A.2. Regarding the Ability to Repay/Qualified Mortgage (ATR/QM) Rule, smaller and less complex institutions have reported that stringent documentation requirements to obtain safe-harbor status from qualified-mortgage (QM) rules have made mortgage lending increasingly unprofitable and more difficult to provide these loans to their customers. Recent research indicates that discontinuation

of residential mortgage origination by community banks is on the rise. The CFPB's QM rule and the ability to repay (ATR) requirements, both made effective in 2014, have had a demonstrable effect on community bank residential lending activity. State supervisors find this to be a disconcerting trend, as community banks are the primary source of mortgage credit in many of our communities.

State regulators recommend that banks that retain mortgages in portfolio should be subject to more flexible underwriting practices, as they are fully incentivized to ensure the borrower can meet the monthly obligations of a mortgage. Specifically, State regulators recommend granting QM status to all loans held in portfolio by community banks. This approach reflects the alignment of interest between the bank and the borrower, tailoring regulatory requirements to the relationship-based nature of community bank mortgage lending.

Regarding the RESPA–TILA Integrated Disclosure Rule (TRID), State regulators were generally supportive of the Bureau's efforts to streamline the incongruent disclosure requirements, language, and definitions in RESPA and TILA. State regulators are supportive of the enhanced consumer protections in the rule, but are cognizant of the fact that compliance has been costly and time consuming for smaller banks, leading to delays in the mortgage lending and closing process while providing little benefit to the customer.

Among the more than 500 community banks that responded to the Federal Reserve/CSBS 2016 National Survey of Community Banks, 23 percent of total compliance costs were expended on compliance with TRID. In addition to being the most costly, the RESPA and TILA regulations were also identified by surveyed bankers as the most confusing to administer. Nearly 45 percent of surveyed bankers said that the rule either "slowed the pace of business" or "delayed closings." Frustration is reflected in the comment of one banker who said, "Only one person in the bank knows how to close a loan." It seems that a rule intended to protect the consumer and increase understanding of the mortgage process has instead increased confusion for lenders and borrowers alike. State regulators believe that the CFPB should assess the quantitative impact of the TRID rule to ensure that the onerous compliance requirements are not preventing consumers from accessing mortgage credit.

Q.3. Are there concrete ways in which you believe the CFPB has improperly tailored regulations to match the unique profile of smaller financial institutions?

A.3. Examples of CFPB rules that are improperly tailored to the unique profile of smaller financial institutions include the Small Dollar Lending Rule proposed in 2016 and the 2015 Final HMDA Rule.

The CFPB's Small Dollar Lending Rule will require any lender that makes a single covered small-dollar loan to comply with a 1,300-page rule. The rule fails to acknowledge the fundamental differences in business model between community banks and payday lenders.

Community banks do not generate a considerable profit from their small-dollar lending, and they generally offer these loans as an accommodation to existing customers.

The Bureau has acknowledged that there will be significant consolidation in the payday lending industry as a result of the rulemaking. Following the rule's finalization, consumer demand for small-dollar credit is unlikely to decrease. Therefore, borrowers could turn to depository institutions as sources of small-dollar credit. However, the complexity of the proposed rule is likely to discourage banks that currently offer small-dollar credit from continuing to do so. It will also make it unlikely that banks will innovate in this area by developing new products.

In addition, the costs associated with the creation of a compliance program specific to small-dollar lending will be prohibitive for community banks, especially smaller banks in rural areas. To the contrary, large nondepository lenders who are able to automate installment lending that is compliant with the Bureau's rule will have an advantage over relationship lenders. In multiple areas within the proposed rule's commentary, the Bureau asked for comment on whether they should create a *de minimis* exemption for certain segments of the industry. State regulators believe that the Bureau should use their authority under Section 1022(3) of the Dodd-Frank Act to provide a *de minimis* exemption from all of the rule's requirements for depository institutions. The exemption should apply to institutions that meet certain criteria regarding loan volume and the percentage of institutions' gross revenue resulting from small-dollar lending. An exemption structured in this way would allow community banks, credit unions, and community development financial institutions (CDFIs) to continue to serve as a source of small-dollar credit.

The 2015 HMDA Final Rule added 25 new data fields that, for 2018 transactions, institutions must collect, record and (in 2019) report. The rule also modified 14 existing data points. In total, covered institutions will be required to collect and report on 48 data fields. With respect to the 13 new data points that were required to be collected by Dodd-Frank, State regulators generally believe that the Bureau has taken appropriate measures to implement the Dodd-Frank requirements.

However, State regulators are very concerned that the new reporting requirements, when viewed as a whole, will impose a disproportionate cost burden on small reporters, especially community banks. With the new rule, the Bureau sought to decrease burden for small reporters by raising the loan volume threshold from one covered loan to 25 covered loans. State regulators are appreciative of the attempt to reduce burden on financial institutions that report less than 25 loans, however, it seems that the number was chosen primarily to shed more light on the lending practices of nondepository institutions, who previously had to report HMDA data only if they originated more than 99 loans. The one-size-fits-all loan volume threshold fails to take into account the relationship (portfolio) lending business model of small depository lenders. State regulators believe that the Bureau, under its delegated authority, should consider the necessity and benefit of the chosen threshold against the backdrop of every increasing regulatory burden for the

smallest financial service providers. State regulators believe that the Bureau should take a tiered approach to HMDA reporting. For example, the tiered approach could consist of a first tier where institutions that make less than 100 loans would be exempt from HMDA reporting. A second tier could apply the original HMDA reporting requirements to institutions that originate 100 to 300 loans. A final tier would apply the expanded HMDA reporting requirements in the final rule to institutions that make in excess of 300 loans.

Q.4. My understanding is that very few banks have opened since the passage of Dodd-Frank.

Q.4.a. Why do you believe this is the case?

A.4.a. State regulators are concerned that the recent decline in the number of banks is due to a collapse of entry into commercial banking. There are a variety of factors at work that influence the lack of new banks—increased regulatory burden, macroeconomic factors, and effects of the crisis. Whatever the cause, it is a point of concern—a diverse field of banks is essential to meet the credit needs of local communities. State regulators have recognized a research gap when it comes to community banks, and consequently developed the CSBS–Federal Reserve Community Banking Research Conference, which is going into its fifth year. State regulators hope to identify, through data-driven analyses, which primary factors are influencing the lack of new banks.

Q.4.b. What potential impacts does this have on our financial system?

A.4.b. New banks encourage competition, innovation, and provide credit in communities that may otherwise not have it. Smaller and less-complex banks, by the nature of their business model, fulfill an important role in local communities. Per recent FDIC research, there are 1,200 U.S. counties, encompassing 16.3 million people, who would have limited access to mainstream banking services if not for community banking organizations. Community banks are much more likely to be in nonmetro areas and rural areas, and without access to fundamental banking services, those regional economies could be negatively impacted.

Q.4.c. Is there anything more Congress should do to encourage the opening of new banks?

A.4.c. In a general sense, Congress should consider a more tailored approach to regulation for the banking industry, one that takes into consideration smaller institutions and the way they operate. Further, it is essential that individuals with community bank supervisory experience be included at every stage of Federal rulemaking and supervisory process development. Without representation of individuals who understand how the banking business model that makes up the majority of the industry operates, *de novo* applications could remain stagnant. We encourage Congress to seek out the perspective of State regulators, as a local, on the ground perspective is critical to effective policy development.

Q.5. I'm concerned that our Federal banking regulatory regime relies upon too many arbitrary asset thresholds to impose prudential

regulations, instead of relying on an analysis of a financial institution's unique risk profile.

Q.5.a. Should a bank's asset size be dispositive in evaluating its risk profile in order to impose appropriate prudential regulations?

A.5.a. No, a bank's asset size should not be dispositive in evaluating its risk profile. Policymakers have often approached bank regulatory requirements based on an institution's asset size. However, this has led to a fragmented and arbitrary regulatory framework that negatively impacts community banks. State regulators are concerned that the current approach to applicable regulation falls short in providing a tailored and reasonable approach to community bank regulation, which in turn harms these institutions and the communities they serve. For example, Commissioners have seen community banks approaching the $10 billion asset mark choose to acquire another institution to quickly achieve a size well beyond $10 billion (rather than organically grow) to absorb the increased costs of direct supervision by the Consumer Financial Protection Bureau (CFPB or Bureau).

Q.5.b. If not, what replacement test should regulators follow instead of, or in addition to, an asset-based test?

A.5.b. CSBS has developed an activities-based approach to defining community banks that is based on the Federal Deposit Insurance Corporation's (FDIC) research definition, introduced in 2012. CSBS believes the FDIC research definition of a community bank—which considers an institution's business activities, funding characteristics, and geographic footprint—provides a good foundation on which to build a more rational regulatory and supervisory framework for community banks.

The FDIC's research definition is activities-based, while also providing certainty, as the FDIC publishes on a quarterly basis the list of institutions meeting this definition. State regulators also propose that the FDIC's research definition can be coupled with a petition process for institutions who fall outside the definition to petition their chartering authority for designation as a community bank.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM CHARLES G. COOPER

Q.1. I'm a proponent of tailoring regulations based off of the risk profiles of financial institutions, as opposed to having strict asset thresholds that do not represent what I believe is the smart way to regulate. But, my question here is really about the importance of ensuring that we have a system that is rooted in fundamental, analytical, thoughtful regulation so that we can achieve and execute on goals, whether balancing safety and soundness with lending and growth, or encouraging more private capital in the mortgage market to protect taxpayers and reform the GSEs.

Q.1.a. Do you think that we should use asset thresholds as a way to regulate—yes or no? If no, can you provide me with the metrics or factors by which a depository institution should be evaluated? If yes, please explain.

A.1.a. No. Regulation and supervision should be tailored to the complexity and risk profile of the institution. As an example, CSBS has developed an activities-based approach to defining community banks that is based on the Federal Deposit Insurance Corporation's (FDIC) research definition, introduced in 2012. CSBS believes the FDIC research definition of a community bank—which considers an institution's business activities, funding characteristics, and geographic footprint—provides a good foundation on which to build a more rational regulatory and supervisory framework for community banks.

The FDIC's research definition is activities-based, while also providing certainty, as the FDIC publishes on a quarterly basis the list of institutions meeting this definition. State regulators also propose that the FDIC's research definition can be coupled with a petition process for institutions who fall outside the definition to petition their chartering authority for designation as a community bank. As the complexity and risk profile increases, so should the regulatory scheme, with the highest level being the systemically important institutions.

Q.1.b. Section 165 of Dodd-Frank requires enhanced supervision and prudential standards for banks with assets over $50 billion. This applies to any bank that crosses the asset threshold, without regard to the risks those banks pose based upon the complexity of the business model. This includes heightened standards on liquidity and capital under the Liquidity Coverage Ratio (LCR) and the Comprehensive Capital Analysis and Review (CCAR) which have a various assumptions built in that may drive business model.

Q.1.b.i. I understand under these two regulatory regimes, banks have changed certain lending behaviors because of the assumptions Federal regulators have made regarding certain classes of assets and deposits. Can you provide some examples of how the LCR and CCAR have changed the types of loans, lending, and deposits your institution holds?

A.1.b.i. State regulators experience to date has been that the impact of the LCR and CCAR alone on lending activity is difficult to isolate, particularly given market conditions. More broadly, there is no doubt that the LCR and CCAR have an impact on the firms by consuming resources and adding operating expenses as the banks endeavor to meet higher regulatory expectations. It is difficult to determine a dollar cost because LCR/CCAR support is woven throughout the organizations.

Q.1.b.ii. Construction lending by banks over the $50 billion threshold has been a source of concern, namely because these enhanced prudential standards have treated construction loans punitively. This includes construction lending for builders of apartments, warehouses, strip malls, and other projects that may have varying risk profiles associated with them. However, under the CCAR and DFAST assumptions, the regulators have assigned all these categories of lending the same capital requirements. The result is an overly broad capital requirement for varying loans that have different risks, a capital requirement that may be greater for some loans and lower for others, influencing the decision of many banks over the $50 billion threshold to hold less of these assets due to the

punitive capital requirements associated with them. Have you seen a similar corresponding issue with construction loans because of the heightened prudential standards?

A.1.b.ii. I am aware of industry concerns about this. From my position as a regulator, it is difficult to know what loans are not made; however, maintenance and the personnel cost of CCAR systems are inordinately expensive. It is easy to assume that some of this cost has been diverted away from the lending area. This emphasizes the need to require this type of testing only on the more complex institutions.

Q.1.b.iii. Under the CCAR regulations, Federal regulators routinely assign risk weights to certain assets that Bank Holding Companies have on their balance sheets. These risk weights often time changes the costs associated with holding certain investments, such as Commercial Real Estate. Has this changed the type of assets that institutions hold, or caused institutions to alter their business plans because of the regulatory capital costs? If so, can you provide examples of this?

A.1.b.iii. The goal of these risk weightings is to affect the mix of assets and investments banks hold, and State regulators have seen this occurring.

Q.1.b.iv. Do you think that regulators, on a general basis, get the risks weights right?

A.1.b.iv. Appropriately calibrating risk weights has proven to be a challenge as risk weightings tend to reflect the most recent crisis or backwards looking. The elevated risk weights for High Volatility Commercial Real Estate (HVCRE) and Mortgage Servicing Assets (MSAs) are two instances where risk weights may not accurately reflect the risks associated with the underlying asset class. In the 2017 EGRPRA Report, the Federal banking agencies committed to revisiting these particular risk weights; an effort which we have and continue to encourage the Federal banking agencies to pursue.

However, equally important to ensuring that the individual risk weights themselves are appropriately calibrated is ensuring that the risk weighting system as a whole is appropriately calibrated. Specifically, the new exposure categories and risk weights introduced under Basel III should be revisited and potentially eliminated for institutions, such as community banks, where greater granularity does not result in greater risk sensitivity but simply unnecessary compliance burden.

Q.1.b.v. Fed Governor Tarullo, has argued that the $50 BB threshold is too low in terms of an asset threshold for enhanced prudential standards; does this number make sense? Why do we need such arbitrary thresholds? Shouldn't we get away from these thresholds and move toward a regulatory system that evaluates substance and activities of an institution as opposed to an arbitrary number? Why can't we do that?

A.1.b.v. State regulators believe that a bank's asset size should not be dispositive in evaluating its risk profile. Policymakers have often approached bank regulatory requirements based on an institution's asset size. However, this has led to a fragmented and

arbitrary regulatory framework that negatively impacts community banks.

Q.1.b.vi. Does Title I allow the Fed to treat a $51 BB bank in a similar manner to a $49 BB bank for the purposes of enhanced prudential standards?

A.1.b.vi. No; however, if a bank is getting close to going over the threshold, regulatory expectations are that the institution should ramp up its processes to be prepared for the new standards. Some cite this is as the "trickle-down effect."

Additional Material Supplied for the Record

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

NEIL L. BRADLEY
SENIOR VICE PRESIDENT &
CHIEF POLICY OFFICER

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June 21, 2017

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

The U.S. Chamber of Commerce ("Chamber") welcomes this week's hearing, *Fostering Economic Growth: Regulator Perspective*. Promoting economic growth should be a top national priority. To put our economic potential into perspective, if our economy moved from 2% growth to 3% growth, our gross domestic product (GDP) would double 12 years faster (23 years vs. 35 years), while the rise in our national debt over the next decade would be slowed by over $3 trillion. If the economy went from 2.5% growth to 3% growth, average annual incomes would rise by $4,200 and 1.2 million jobs would be created over the next decade. The Chamber has long argued that existing financial regulations have limited economic growth by constricting and in many cases raising the cost of credit for small and medium sized businesses–major engines of economic growth and job creation.

There is a wealth of new research that may inform the Committee's consideration of this matter. In the Chamber's 2016 survey of more than 300 corporate financial professionals, nearly four in five reported that financial services regulation has directly affected their financing activities. One half reported that bank capital charges have increased their costs, and one third expected the regulatory effect to worsen in the next three years.

In April, the twelve Federal Reserve Banks reported the results of their annual survey of small business credit. While finding "widespread demand" for small loans–45 percent of firms applied for funding–there were substantial financing shortfalls. 60 percent of firms obtained less than the amount for which they had applied, and almost a quarter of small businesses were unable to obtain any financing at all.

Recent research has connected small business credit gaps to bank capital and liquidity rules. In May, a team of economists concluded that "small business lending in all size categories is statistically significantly less at stress-tested banks"–consistent with the hypothesis that stress-tested banks reduce the supply of credit in order to reduce bank risk–after analyzing Community

Reinvestment Act loan origination data. Researchers at The Clearing House came to the same conclusion after analyzing loan data in Federal Reserve and FDIC call reports. In March, a study from Harvard Business School linked the decline in small bank lending at the four largest U.S. banks to stress tests' relatively severe assumptions about the losses on small business loans, as well as the sheer amount time and effort required of senior managers to comply with the full array of regulations implemented after the financial crisis. Professor Hal Scott, also of Harvard and an authority on prudential regulation, recently implicated liquidity requirements as a key constraint on small business lending.

The Committee–and regulators–should rigorously examine the impact of bank capital and liquidity rules on small and medium enterprises' access to credit. Such examination is necessary to balance the equally important goals of financial stability and growth–the twin pillars of true prosperity. Again, the Chamber commends the Committee for holding this hearing, and looks forward to hearing regulators' perspectives on this important matter.

Sincerely,

Neil L. Bradley

cc: Members of the Committee on Banking, Housing, and Urban Affairs

June 22, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

The Consumer Bankers Association (CBA) appreciates the Banking Committee's interest in tailoring the regulatory framework to foster economic growth. From underwriting loans to main street businesses to providing banking services to previously unbanked or underbanked consumers, CBA member banks are integral to fueling the economic engine that drives prosperity. As such, we would like to take this opportunity to submit the following comments on the hearing entitled, "Fostering Economic Growth: Regulator Perspective." CBA is the voice of the retail banking industry whose products and services provide access to credit to millions of consumers and small businesses. Our members operate in all 50 states, serve more than 150 million Americans and collectively hold two-thirds of the country's total depository assets.

Regulatory Coordination

The financial regulatory framework that oversees safety, soundness and consumer protection is a complex system that lends itself to silos within each agency and an overall lack of coordination among regulators. Greater regulatory coordination to limit redundancy is needed, particularly when major industry issues arise that require regulators to move swiftly.

Oftentimes, multiple banking regulators conduct independent reviews based on their supervisory jurisdiction while targeting the same issue. In addition to the challenge of managing multiple information requests, different agencies have differing interpretations and can hold banks to inconsistent standards of regulation and guidance.

The onslaught of demands placed on banks from numerous regulators can prove duplicative and force a reallocation of valuable staff resources away from the development of innovative products that better serve America's consumers and small businesses. Ultimately, the reallocation of resources to satisfy the multitude of requests from regulators diverts focus from the real business of banking and harms our members' ability to serve their customers.

To help illuminate the lack of regulatory coordination faced by industry, CBA would like to provide the following examples:

Example 1

The CFPB was granted a significant new authority, when compared to other banking regulators, to issue enforcement actions based on unfair, deceptive, or abusive acts or practices (UDAAP). The inclusion of "abusive" within the power and scope of the CFPB's authority has proven to be a powerful tool that the Bureau can use to bring enforcement actions and levy penalties over the institutions they supervise. As the CFPB wields this new and undefined authority, the prudential regulatory agencies also have authority to enforce traditional unfair or deceptive acts or practices (UDAP) powers under the Federal Trade Commission Act, even against large banks subject to CFPB supervision. In addition to UDAAP and UDAP at the federal level, financial institutions are also potentially subject to a patchwork of 50 state consumer protection laws—often referred to as "mini-UDAP" statutes—even further complicating the regulatory arena.

The prudential agencies continue to assert UDAP as the basis for supervisory findings during examinations, apparently without consultation with the CFPB, which not only creates duplication and overlap but could result in divergent interpretation and application of the legal standards. This tension can also occur in the fair lending space, where the prudential agencies retained authority under the Federal Housing Act, notwithstanding the CFPB's general responsibilities in the fair lending area.

To ensure proper regulatory alignment, Congress should repeal the CFPB's overly broad "abusive" standard and establish a single regulator to examine and enforce UDAP. Additionally, Congress should make the federal UDAP standard preemptive of similar state laws. These steps would eliminate duplication and ensure that there is a uniform standard for UDAP.

Example 2

In the supervision of student lenders, regulatory overlap has led to conflicting advice. For example, CFPB guidance encourages loan modification programs, but the Office of the Comptroller of the Currency (OCC) restricts them to limited circumstances. There have also been inconsistent regulatory expectations with respect to servicer influence and oversight by banks. There are some industry standard practices that are now being criticized by bank regulators, but banks have very little influence to change them (e.g., student loan servicers who consolidate multiple student loan accounts into a single statement and determine payment allocation order). The CFPB has supervisory authority over servicers, yet prudential agencies may require banks to directly influence change.

The above constitutes only but a few examples of why Congress and the Administration should consider a much needed review of the financial services regulatory framework and address the duplication of regulatory efforts.

To find solutions to the problem we outlined above, we encourage Congress to commission a study of duplicative regulation in the industry. By taking a close look at all of the guidance, FAQs, public announcements, and policy statements that have been issued, Congress should determine where duplication and scope creep exist, and work to ultimately refine mandates and eliminate overlap. We also support the creation of an Office of Financial Regulatory Coordination with an official ombudsman. The purpose would be to address duplicative exams, enforcement matters, and frequent overlap, giving banks an outlet and providing protection against regulatory overreach that stifles consumer and small business lending.

Small-Dollar Lending

Prior to 2013, several banks offered small-dollar bank loans, often known as deposit advance products (DAP), to meet overwhelming consumer demand for access to emergency credit. Unfortunately, the Federal Deposit Insurance Corporation (FDIC) and OCC issued guidance (2013-10101; 2013-0005) in 2013, which effectively eliminated the ability of the financial institutions they regulate to offer a viable alternative to compete with payday lending. The FDIC and OCC guidance recommended the use of underwriting that is more appropriately applied to a much larger credit product, such as a mortgage loan, and placed other restrictions on the products. This, combined with a low interest rate environment, has made small-dollar credit unviable and has forced banks to exit the market.

Furthermore, the CFPB is prepared to finalize a proposed rule covering payday loans, vehicle title loans, "high-cost" installment loans, and lines of credit that would make it difficult for any lender to offer affordable, easy-to-use products.[1] This small-dollar loan proposal is incredibly prescriptive as it would effectively create a narrowly tailored product designed to operate within a very constrictive regulatory scheme. In general, we find this approach to be an inappropriate exercise of the CFPB's UDAAP rulemaking authority, as remedies for alleged unfair or abusive acts or practices should be tailored to those practices observed and not used to dictate product offerings filled with ancillary provisions that have little if anything to do with the alleged harmful practices.

To ensure consumers have access to small dollar credit, CBA recommends Congress encourage the FDIC and OCC to repeal the DAP guidance that was issued in 2013. In addition, we recommend the CFPB work in coordination with the prudential regulators in issuing any rule or guidance related to small-dollar lending to ensure a consistent regulatory environment that is conducive to small-dollar lending, as opposed to one that pushes already heavily regulated banks out of the short-term liquidity market.

[1] https://www.federalregister.gov/documents/2016/07/22/2016-13490/payday-vehicle-title-and-certain-high-cost-installment-loans.

Systemically Important Designation for Financial Institutions

Currently, the Dodd-Frank Act designates a financial institution as systemically important by an arbitrarily low $50 billion asset threshold. This approach is a flawed measurement tool used by the Financial Stability Oversight Council (FSOC) to assess the risk an institution poses to the American financial infrastructure. FSOC should strongly consider changes to the methodology used to determine if banks are "systemically important" by evaluating the complexity, scale, and activities of the individual institution, not a simple asset calculation.

Requiring FSOC to evaluate a number of factors, beyond asset size, will provide a more accurate risk profile of the bank and depiction as to whether an institution could be declared systemically important.

Financial Innovation

The banking industry has a long history of success in bringing the benefits of technology and innovation to our customers. From ATMs to online banking to mobile banking, CBA believes innovation is the foundation for banking the unbanked, better serving our customers, and providing consumers with the tools to take firm control over their financial lives. That is why we are strong supporters of the OCC's Responsible Innovation initiative and its new Office of Innovation, as we hope these changes signal a new mindset at the agency that is more welcoming of the industry's innovation efforts. CBA would recommend the other banking agencies adopt similar offices in order to promote industry innovation.

While we are supporters of responsible innovation, we were surprised and concerned by the OCC's proposal to charter fintech companies. CBA and our membership are well aware of these new entrants in the financial services marketplace and we welcome the new technologies and innovations they bring to all consumers. However, it remains unclear why the OCC believes it necessary and in the public interest to expand the scope of the national bank charter to incorporate non-depository companies with untested business models. The agency has issued both a Whitepaper and a Draft Licensing Manual without, among other things, providing a concrete definition for "fintech," a sufficient rationale for preempting state authorities in this area, or comprehensively addressing the regulatory and supervisory framework that would apply to these companies.

CBA would urge the OCC to adopt a more deliberative approach to determine whether the national bank charter should be offered to fintech companies. Extending the bank charter to untested companies without fully addressing the risks posed by new business models could have unintended consequences for consumers and the U.S. financial system. We recommend the OCC conduct a thorough study of the fintech sector and hold industry roundtables to gather input from all interested stakeholders. And if the OCC ultimately concludes the public would benefit from a fintech charter, then the agency should issue a formal charter proposal consistent with the Administrative Procedures Act.

Conclusion

CBA stands ready to work with Congress and regulators to ensure a sound and coordinated regulatory framework that safeguards the American consumer, ensures access to credit for consumers and small businesses, and promotes competition in the financial marketplace. On behalf of the members of CBA, we appreciate the opportunity to submit this letter for the record.

Sincerely,

Richard Hunt
President and CEO
Consumer Bankers Association

Jim Nussle
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June 21, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of Credit Union National Association (CUNA), thank you for holding the hearing, "Fostering Economic Growth: Regulator Perspective." CUNA represents America's state and federally chartered credit unions and their 110 million members. We applaud the approach the Committee is taking when examining this critical issue and believe it is important to consider the viewpoints of credit unions, as well as certain recommendations from their prudential regulator, the National Credit Union Administration (NCUA).

Credit unions play an integral role in our economy, but they could do even more under a regulatory structure calibrated toward the size, complexity and structure of financial institutions and a modernized credit union charter that ensures not-for-profit, financial cooperatives can meet the savings and credit needs of their members in the 21st century financial services marketplace. The NCUA as credit unions' prudential regulator ensures the safety and soundness of the National Credit Union Share Insurance Fund and examines and supervises credit unions. Through this role, the NCUA has recognized the need for relief for credit unions from regulatory burdens. It recently memorialized several suggestions for alleviating unnecessary burdens and improving the ability of credit unions to serve consumers in a letter to the Consumer Financial Protection Bureau (CFPB).[1]

The NCUA Recently Outlined to the CFPB How It Can Improve Credit Opportunities for Credit Union Members

In a letter from Chairman Mark McWatters to CFPB Director Richard Cordray, the NCUA recently outlined some specific areas where regulatory relief is needed for credit unions. Notably, the NCUA recognized that the different structure and size of credit unions warrants tailored regulations and in certain instances exemption from rules since they are already highly regulated and have a long history as consumer protectors. In the NCUA's letter, it highlighted that the median size for credit unions is less than $30 million in assets and that the median staff size of a credit union is eight employees. Accordingly, it noted that credit unions "can struggle to stay abreast of complex and evolving compliance requirements without the retention of often cost prohibitive counsel, accountants, financial advisors, and other professionals."

Findings from a regulatory burden study of credit unions conducted in 2014, is in line with these same concerns of the NCUA, where it was found that the impact of regulatory burden on credit unions and their members was

[1] National Credit Union Administration Letter to CFPB Concerning Compliance with CFPB Rules, *available at* https://www.cuna.org/uploadedFiles/CUNA/Legislative_And_Regulatory_Advocacy/Removing_Barriers_Blog/Removing_Barriers_Blog/Cordray%20CU%20Compliance%20with%20CFPB%20Rules%20Letter.pdf (May 24, 2017).

$7.2 billion just for that year.[2] This represented a 40% increase in compliance costs from 2010. Since 2014, significant new rulemakings have taken effect which will have undoubtedly increased the cost credit unions and their members are paying to comply with rules designed for abusers even more. At the time of the study, credit union-wide, the equivalent of about one staff member's time for every four employees was spent on regulatory compliance.

Unfortunately, when credit unions are spending their limited resources disproportionately on compliance, for rules often aimed at bad behavior they did not engage in, this means they are spending fewer resources on innovating and providing products and services that spur economic growth throughout the country. As the NCUA noted in its letter when credit unions provide affordable financial services this benefits credit union members and their communities.

A. *The NCUA says to Exempt Credit Unions from CFPB Rules Whenever Possible*

As a result of harm one-size-fits-all CFPB rulemakings have caused credit unions and their members, the NCUA recently urged it to use its Section 1022 (b)(3)(A) exemption authority "whenever possible" given the credit union community's long history of serving members and protecting consumers. The NCUA stated, "Use of this permitted, yet underutilized, statutory authority is appropriate to address compliance costs and the unintended consequences of limiting access to affordable financial services for many millions of middle class credit union members through the enactment of needless regulatory burden." In addition to the NCUA, 399 Members of Congress urged the CFPB to properly use its authority to exempt credit unions from regulations that were never intended to apply to them, and to ensure that regulations do not have the unintended consequences of limiting services or increasing costs for credit union members.

The CFPB's small dollar loan proposal is a good example of a rulemaking that should exempt credit unions. The NCUA in its May letter reiterated its previous point[3] that consumers could face economic harm if the CFPB's proposed small dollar loan rule includes consumer friendly credit union products and makes them more difficult for credit unions to offer. In addition to the NCUA, the Small Business Administration Office of Advocacy also urged the CFPB to exempt credit unions from this rule.[4] The SBA Office of Advocacy specifically outlined the economic impact of not doing so stating, "The CFPB's proposed rule may force legitimate businesses to cease operation. Imposing such a regulation will not alleviate a consumer's financial situation. The consumer will still need to pay his/her bills and other expenses. Imposing these strict regulations may deprive consumers of a means of addressing their financial situation."

B. *The NCUA Specifically Highlighted HMDA and UDAAP as areas that Could be Reformed by the CFPB to Allow Credit Unions to More Fully Serve Consumers*

In its recent letter, the NCUA notes that there are two particular areas that justify regulatory relief for credit unions. These include the Home Mortgage Disclosure Act (HMDA) and the Unfair, Deceptive and Abusive Acts or Practices (UDAAP) requirements of the Dodd-Frank Act.

For HMDA, the NCUA highlights several specific changes that should be made to the CFPB's final rule. It states that consideration should be given by the CFPB to raising the various thresholds to a more substantive asset and

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[2] Hui, V., Myers, R., Seymour, K, "Regulatory Financial Impact Study." Cornerstone Advisors, Inc., *available at* http://www.cuna.org/regburden/ (Feb. 2016).

[3] National Credit Union Administration Comment Letter to CFPB in response to the CFPB's proposed rule for Payday, Small Dollar, and High Cost Loans, *available at* https://www.ncua.gov/newsroom/Documents/comment-letter-2016-oct-metsger-payday-rule.pdf (Oct. 3, 2016).

[4] Small Business Administration Office of Advocacy Letter to CFPB in response to the CFPB's proposed rule for Payday, Small Dollar, and High Cost Loans, *available at* https://www.sba.gov/advocacy/10-07-2016-payday-vehicle-title-and-certain-high-cost-installment-loans (Oct. 7, 2016).

transaction volume level to further reduce the reporting burden on smaller credit unions. The letter further highlights concern with requiring the reporting of 25 new data points. Chairman McWatters writes that credit unions should be exempt from reporting the additional 14 data points and that, "such an exemption would provide much-needed regulatory relief to the credit union community and assist these institutions in their mission to serve middle class Americans, those striving to join the middle class, and small business owners, employees, customers, and vendors." Specifically, the NCUA asks the CFPB to consider the economic burden its rule would place on credit unions.

When discussing its concerns surrounding the CFPB's UDAAP authority, the NCUA notes that there is no precedent for the abusive prong under the FTC Act. Furthermore, it highlights that the CFPB has yet to issue a regulation or formal guidance to further define the term and implement its UDAAP authority. Chairman McWatters urges the CFPB to provide clarity with respect to UDAAP for credit unions either through a rulemaking or guidance. He states, "I believe the Bureau should promptly issue clear, transparent guidance that is reasonable, objective, and specifically tailored for the credit union community so these not-for-profit financial institutions can comply fully with the law and meet the needs of their members in a cost efficient and effective manner." Credit unions support efforts to ensure that credit union members are treated fairly, and this concept is inherent in the mission of credit unions. Overall, however, we are concerned with any circumstances in which the CFPB faults credit unions, when they are complying with current law, using its UDAAP authority. We concur with the NCUA that far more clarity is needed about the CFPB's intended use for its UDAAP authority, to ensure that safe and affordable products or lending are not unnecessarily curtailed.

CUNA not only urges the CFPB to address these concerns, but notes that it must address these issues in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act.[5] The Dodd-Frank Act states that when issuing rules under UDAAP authority, "the Bureau shall consult with the Federal banking agencies, or other Federal agencies, as appropriate, concerning the consistency of the proposed rule with prudential, market, or systemic objectives administered by such agencies." As the NCUA notes it has a long history of successfully balancing consumer protection with supervision and regulation of credit unions, and these and other views it has for regulating credit unions, should at the very least be carefully analyzed and considered in a meaningful way.

On behalf of America's credit unions and their 110 million members, thank you for holding this important hearing and for your attention to these matters.

Sincerely,

Jim Nussle
President & CEO

[5] Dodd-Frank Act § 1031(e).

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June 27, 2017

The Honorable Michael Crapo, Chairman
The Honorable Sherrod Brown, Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

I followed with interest your Committee's hearing last week on "Fostering Economic Growth: Regulator Perspective". FIA[1] strongly supports the work of the committee to pass bipartisan legislation to improve the bank regulatory framework and promote economic growth.

For some time, FIA has expressed concern that the treatment of centrally-cleared customer margin under the leverage ratio is lessening clearing options for end-user customers who use futures and cleared swaps to manage their business risks. These capital requirements have made it difficult for many clearing member banks to offer clearing services to their clients—a result that seems at odds with recent efforts by the Group of 20 nations (G-20) to increase the use of clearing as a counterparty risk mitigation tool. We believe a vital step to support the use of central clearing is to ensure the leverage ratio properly recognizes the exposure-reducing effect of segregated client margin posted to the bank in the limited context of centrally cleared derivatives transactions.

We are pleased that this issue has started gaining attention among policymakers. The U.S. Treasury review of the regulatory framework for the depository sector recommended granting such an offset. It recognized that such a move would foster economic growth by removing a disincentive to provide client clearing services: "Because of the low-margin and high-volume nature of the business of providing clients access to central clearing, high leverage ratio capital charges discourage firms from providing such services."[2] This is in an environment where the number of firms engaged in this business has declined from 100 in 2002 to 55 at the start of 2017.

I wish to respond to testimony of FDIC Chairman Martin Gruenberg at your hearing on such potential revisions to the leverage ratio. Chairman Gruenberg stated that removing central bank deposits, Treasury securities, and initial margin on derivatives from the denominator of the leverage ratio "would significantly reduce leverage capital requirements for large systemically important banking organizations and

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[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets. FIA's membership includes clearing members, exchanges, clearinghouses, trading firms, and agricultural, commodity and financial customers from more than 48 countries.
[2] https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf

significantly weaken the resiliency of the U.S. banking system to future financial stress."[3] I would like to outline why such a view is not correct in the context of centrally cleared margin, and the wide range of policy makers who have recently expressed support for granting such an offset.

Granting an offset would foster economic growth without increasing systemic risk

We respectfully disagree with the statement by Chairman Gruenberg that granting such an offset would "significantly" reduce capital requirements and weaken the resiliency of the U.S. financial system. As stated in the U.S. Treasury report and by CFTC Acting Chairman Christopher J. Giancarlo, granting such an offset would have an insignificant impact on capital requirements. Research undertaken by FIA last year found that granting such an offset would reduce leverage exposure by an average of $3.5 billion for each Bank.[4] This compares to total leverage exposures in the trillions of dollars for the largest banks.[5]

Margin is collected by Banks on centrally-cleared trades for the purpose of offsetting the Bank's exposure to a clearinghouse. Congress, through the Commodity Exchange Act, requires the clearing member to treat margin received from a customer for cleared derivatives transactions as belonging to the customer and segregated from the clearing member's own funds. These are customer funds provided specifically by the customer to offset the clearing member's exposure arising from its obligation to pay the clearinghouse on behalf of the customer. That is, the very nature of initial margin posted by a derivatives customer is solely exposure-reducing with respect to the clearing member's cleared derivatives exposure.

Left unchanged, the leverage ratio undermines recent financial regulatory reforms by discouraging banks from participating in the clearing business, thereby reducing access to clearing, limiting hedging opportunities for end users, and stifling economic growth. Banks will be less likely to take on new clients for derivatives clearing. Further, the liquidity and portability of cleared derivatives markets could be significantly impaired if the offset is not granted, which would substantially increase systemic risk. The lack of an offset would severely limit the ability of banks to purchase portfolios of cleared derivatives from other distressed clearing members—including distressed banks. This will leave clearinghouses and customers of any failing clearing member with an added strain during an already stressful situation. Moreover, as the levels of margin required by clearinghouses increase in times of stress, Basel leverage ratio capital costs will correspondingly increase, aggravating the constraint on portfolio purchases. Such a constraint on providing liquidity to stressed markets would accelerate downward price pressure at exactly the wrong moment, thereby increasing risk to the system.

A range of policymakers have expressed concern about the impact of the leverage ratio on central clearing

In written testimony to the Committee, member of the Board of Governors of the Federal Reserve System Jerome H. Powell stated that the Federal Reserve is reviewing the leverage ratio, and getting the calibration of the leverage ratio right "is critical to mitigating any perverse incentives and preventing distortions in

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[3] https://www.banking.senate.gov/public/_cache/files/7ea46c04-a030-4bba-bb90-741e36ee1978/0156DC39EAA99E3C4D1E9D26D9805EF1.gruenberg-testimony-6-22-17.pdf
[4] https://fia.org/articles/fia-analysis-leverage-ratio-proposals-will-negatively-impact-client-clearing
[5] https://www.clarusft.com/supplementary-leverage-ratio-comparing-us-banks/

money markets and other safe asset markets."[6] Governor Powell had previously stated his concerns over the impact of the leverage ratio on client clearing: "Take central clearing for clients – this is something we want and we think makes the world a better place – but we apply the leverage ratio to the initial margin posted by clients which makes it more expensive. We see clients getting out of the client clearing business, so we are undermining the clearing mandate and the ability of smaller clients to get their products centrally cleared."[7]

Just last week, Acting CFTC Chairman Giancarlo emphasized his support for such an offset, and emphasized how granting the offset would foster economic growth. He stated that if an offset were granted "[a]ssuming these savings are fully passed on to their customers, these reductions could translate into a three-fold increase in trading activity, especially hedge positions that are carried overnight." He also argued that "such a significant reduction in costs on a service imperative to managing systemic risk in swaps is entirely worth the trade-off of a miniscule reduction in balance sheet protection. The financial system will be safer and more stable for it."[8]

This is also not a partisan issue. Immediate past CFTC Chairman Timothy G. Massad expressed on multiple occasions his concern on the impact of the leverage ratio on client clearing. He stated "we must consider the effects the leverage ratio may have on clearing." He believed that not granting the offset "could increase the risk arising from [a] default, in what could already be a stressed market."[9]

The European Union is expected to grant an offset for client margin from the leverage ratio for European Banks. This followed a decision by the Bank of England to grant such an offset in the UK.[10] Not granting an offset would therefore put U.S. banks at a significant disadvantage in the provision of trading and clearing services to clients compared to European Banks.

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[6] https://www.banking.senate.gov/public/_cache/files/4a5d2609-6d61-4d20-a01e-a3f864633ba2/F34B018FA3CC1721CAA5D6EF79ACFEA8.powell-testimony-6-22-17.pdf
[7] http://www.risk.net/regulation/4974791/feds-powell-joins-chorus-of-volcker-rule-critics
[8] http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement062017
[9] http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-46
[10] http://www.bankofengland.co.uk/publications/Documents/fsr/2016/fsrjul16.pdf

Derivatives markets play a critical role in our national economy. Our markets exist for the purpose of allowing businesses to hedge against uncertainty and volatility and focus their attention on growth and innovation. Granting an offset for centrally cleared margin would make U.S. derivatives markets more competitive and ensure our farmers, ranchers and manufacturers can access the full range of derivatives products they need to manage risk in their businesses.

Most respectfully,

Walt L. Lukken
President and CEO

Statement of the Financial Services Roundtable
On Fostering Economic Growth: The Regulatory Perspective

Submitted to the
U.S. Senate Committee on Banking, Housing and Urban Affairs

June 22, 2017

The Financial Services Roundtable[1] (FSR) is pleased to submit this statement for the record in connection with the Senate Banking Committee's series of hearings on fostering economic growth. In announcing these hearings, Chairman Crapo has expressed interest in developing bipartisan legislation to improve banking regulation and stimulate economic growth. FSR strongly supports this goal. FSR's members are committed to meeting the financial needs of consumers and businesses and promoting economic growth while preserving the stability of the financial system.

Reforms adopted in response to the financial crisis have strengthened the financial system, but economic growth has suffered as a result.

A decade ago a sudden fall in real estate prices caused a recession and revealed gaps in our nation's financial regulation system. In response, Congress enacted the Dodd-Frank Act and financial regulators have adopted dozens of new regulations aimed at stabilizing the financial system. Capital levels at the nation's largest banks have now risen dramatically, more than doubling from 5.5 percent in 2009 to over 12 percent in 2016.[2] This represents a total increase of more than $700 billion in equity capital held by these firms and brings their total equity capital to over $1.2 trillion.

Today, FSR members are well positioned to provide credit, investment and insurance, and asset management products and services to the American consumer. We strongly believe that a stable and efficient financial system, by providing important links between investors and entrepreneurs, and savers and borrowers, is an essential necessary ingredient for sustained economic growth. Our members have found, however, that some

[1] *As advocates for a strong financial future,* FSR represents the largest integrated financial services companies providing banking, insurance, payments and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

[2] Federal Reserve Board, *Comprehensive Capital Analysis and Review 2016: Assessment Framework and Results* (June 2016). https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160629a1.pdf.

financial laws and regulations are holding back a more robust economic recovery. For example, the Urban Institute has calculated that over 5 million borrowers were unable to obtain a mortgage loan between 2009 and 2014 because of new regulatory requirements and increased litigation risks faced by lenders and investors.[3] Similarly, the Goldman Sachs Global Markets Institute has found that since the financial crisis, small businesses have suffered low rates of business formation and tepid employment growth due, in part, to regulations that make it difficult for small businesses to obtain credit.[4]

Economic growth has been further stymied by overzealous supervisory practices aimed at wringing risk out of financial intermediation. Since the crisis, regulators have defaulted to place equal significance on all financial regulations at all times, regardless of actual financial risk. This results in a misallocation of resources for both regulators and regulated firms. Firms are required to maintain compliance personnel whose duties do not meaningfully contribute to the reduction of financial risk, and regulators expend resources reviewing items that are tangential to a firm's actual financial stability. In other words, overly cautious and overly broad supervisory and enforcement practices have reduced loans and investments by financial firms.

Given this record, it is appropriate for the Committee to assess the relationship between financial regulation and economic growth and determine if there are ways to better tailor current regulatory requirements to increase economic growth.

FSR supports targeted reforms to better balance the goals of financial stability and economic growth.

FSR recently submitted a set of recommendations to the Treasury Department aimed at aligning financial regulation with economic growth.[5] Our recommendations were made in connection with the Department's mandate to assess the extent to which existing financial regulations are consistent with a set of Core Principles contained in Executive Order 13,772.[6] The following represent some of the broad areas where we believe reforms

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[3] Bing Bai, Laurie Goodman, and Jun Zhu, *Tight Credit Standards Prevented 5.2 Million Mortgages Between 2009 and 2014*, Urban Institute (Jan. 28, 2016), http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014.

[4] Amanda Hindlian, Sandra Lawson, Katherine Maxwell, Koby Sadan, and Sonya Banerjee, *The Two Speed Economy*, Goldman Sachs Global Markets Institute (Apr. 2015), http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/2-speed-economy-report.pdf.

[5] Letter from Richard Foster, Senior Vice President & Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable, to Craig Phillips, Counselor to the Secretary, U.S. Department of Treasury (May 3, 2017), http://www.fsroundtable.org/wp-content/uploads/2017/05/FSR-Letter-to-Treasury-on-Core-Principles-May-3.pdf. Appendix A to the letter provides a comprehensive list of each of FSR's recommendations.

[6] *Core Principles for Regulating the United States Financial System, Exec. Order No. 13,772*, 82 Fed. Reg. 9965 (Feb. 3, 2017) These Core Principles call for financial regulation in the U.S. that: (a) empowers Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; (b) prevents taxpayer-funded bailouts; (c) fosters economic growth and vibrant

are warranted. Detailed suggestions in each of these areas were included in our submission to the Treasury Department.

- Coordinate Regulatory Policies –The member agencies on the Financial Stability Oversight Counsel should improve coordination of financial regulatory policies;

- Set Prudential Standards Based on Risk Not Arbitrary Asset Thresholds – Prudential standards for financial organizations should be based upon risk and not arbitrary asset thresholds;

- Harmonize Cybersecurity Compliance Standards Across All Regulations – Federal and state policymakers should harmonize cybersecurity compliance requirements;

- Discontinue FSOC Nonbank Designations – The nonbank designation process should be eliminated, and FSOC should instead exercise its existing authority to recommend, when appropriate, new prudential standards to the primary financial regulators;

- Promote Comprehensive Housing Finance Reform –The conservatorship of Fannie Mae and Freddie Mac should be replaced with a secondary market system based on private capital that allows the conventional mortgage market to meet the credit needs of consumers and protects taxpayers from risk;

- Improve Living Wills, Stress Test, Comprehensive Capital Analysis and Review and other Prudential Requirements –Prudential standards should be better aligned to balance the goals of economic growth and controlling financial risk;

- Fix the Consumer Financial Protection Bureau, Protect Consumers, and Enhance the Market for Consumer Financial Services –The governance structure of CFPB should be revised to ensure greater accountability in the management of the agency;

- Protect and Enhance Retirement Savings – Policymakers should support retirement savings and enable financial services providers to better meet the long-term needs of hard-working Americans in their retirement years;

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financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; (d) enables American companies to be competitive with foreign firms in domestic and foreign markets; (e) advances American interests in international financial regulatory negotiations and meetings; (f) makes regulations efficient, effective, and appropriately tailored; and (g) restores public accountability within federal financial regulatory agencies and rationalizes the federal financial regulatory framework.

- Promote Strong Insurance Markets – Policymakers should protect insurance markets by supporting the state-based system of insurance regulation, encouraging the Federal Reserve Board (Board) to ensure that regulations for insurers that own savings and loans are tailored to the business of insurance, and ensuring that FSOC's Independent Member with insurance expertise can remain on the Council until a successor is approved;

- Promote Strong and Liquid Capital Markets – Policymakers should reduce unnecessary regulatory burdens imposed by the Volcker Rule and harmonize rules issued by the Securities and Exchange Commission and the Commodities Futures Trading Commission;

- Modernize the Anti-Money Laundering Requirements – Policymakers should lead a comprehensive review of the current anti-money laundering and counter-terrorism financing framework established in the Bank Secrecy Act.

Treasury has proposed a recalibration in financial policy to achieve a better balance between financial stability and economic growth.

On June 5, 2017, the Treasury issued its first report in response to Executive Order 13,772. That report, which addressed the regulation of banks and credit unions, highlighted the relationship between financial regulation and economic growth. The report noted that the presence of liquid and robust financial markets and the availability of credit are fundamental requirements for economic expansion.[7] It also found that certain regulations adopted since the financial crisis have not been sufficiently tailored to the specific risk profiles of different types of depository institutions and that overlapping regulatory mandates have needlessly raised compliance costs for firms.[8]

The Treasury report supports many of the reforms adopted in response to the financial crisis. However, the Treasury report does call on Congress and financial regulators to refine current prudential standards and supervisory policies to achieve a better balance between financial stability and economic growth. In other words, what is needed is not a complete reversal of the Dodd-Frank Act, but a recalibration of some of the requirements put in place since the crisis.

The Treasury report also indicates that market concentration is an unintended consequence of regulations that are not tailored to risk. Much has been made of the fact that the total assets of the nation's largest banking organizations have increased since the crisis. The Treasury report attributes this result to "excessive" regulation that is not tailored to risk, stating:

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[7] A Financial System That Creates Economic Opportunities: Banks and Credit Unions, U.S. Department of Treasury, June 2017, p. 6.
[8] Id.

> Excessive regulation imposes costs on institutions that can create incentives for institutions to grow larger than market conditions would otherwise require. To the extent regulatory costs can be spread over a large number of customers, regulation can create a barrier to entry for smaller firms and confer competitive advantages on the largest institutions. Tailoring regulation therefore is essential to ensure that regulation does not play a role in fostering too-big-to-fail institutions.[9]

Congressional action is needed to implement refinements to existing requirements.

The Treasury report includes numerous recommendations for aligning financial regulation with the Core Principles in Executive Order 13,772, many of which are consistent with FSR's suggestions. Although financial regulators can implement certain recommendations, many key recommendations require Congressional action. FSR urges the Committee to advance legislation on the following matters, each of which is discussed in the Treasury report:

- Set Prudential Standards Based on Risk, Not Arbitrary Asset Thresholds – The Treasury report highlights the inequities and inefficiencies that result from linking regulatory standards to asset thresholds. Arbitrary thresholds can impose requirements on firms that are not relevant to the firm's profile. This results in a misallocation of resources for both the firm and regulators. Several of these thresholds are set in law, and can only be removed by Congress. FSR supports legislation to replace asset thresholds with risk-based assessments, so that regulatory standards can be tailored to the risk posed by a firm.

- Revise Stress Testing – The Dodd-Frank Act requires bank holding companies with more than $50 billion in assets to conduct a mid-year stress test and to conduct stress tests under several economic scenarios. As stress-testing has evolved, it is apparent that these requirements should be refined and that their scope should be more limited. The mid-year stress test should be eliminated and the tests should be based only upon baseline and severely adverse scenarios. Similarly, Treasury proposes to remove bank holding companies with less than $50 billion in assets from annual stress test exercises. We urge the Committee to pursue these changes.

- Revise Living Wills – The resolution planning process has proven to be a useful tool for regulated firms and regulators. However, the process has suffered from significant delays in feedback to firms. These delays are caused in large part by the fact that the Board and the Federal Deposit Insurance Corporation (FDIC) share authority for the review of resolution plans. Treasury has recommended that the Dodd-Frank Act be amended to remove the FDIC from this process, and that the Board be required to provide firms with feedback within six months of the

[9] Id, pp. 9-10.

submission of a plan. We support these changes and urge the Committee to act upon them. These changes would streamline the process and make it more effective for firms and the Board.

- Revise the Volcker Rule – The Volcker Rule is having an unintended negative impact on market liquidity. FSOC has undertaken an assessment of the Rule to identify refinements that can eliminate this problem and regulators can make some adjustments in the Rule. However, some changes require Congressional action, such as the application of the Rule to all banking entities regardless of the scope of their activities. We urge the Committee to work with FSOC and revise the Volcker Rule to tailor its application and better define the scope of activities it should limit.

- Modify Governance Structure for CFPB – The governance structure of the CFPB should be revised to improve the transparency and accountability of the agency. This could be accomplished through the creation of a governing commission, rather than a single agency head. A commission would provide stability and balance for consumers and the financial services industry by facilitating more internal deliberations and a more fulsome exchange of ideas that delivers the appropriate policy outcome.

Additional statutory reforms are needed.

As noted above, the Treasury report was focused on banks and credit unions. This initial report will be followed by additional reports on other aspects of financial regulation. In anticipation of those reports, FSR has recommended some other changes in financial policy that require action by the Committee. As part of the Committee's review of existing financial laws, we urge the Committee to endorse and pursue additional statutory reforms, including the following:

- Discontinue the FSOC Nonbank Designations – The process for FSOC designation of nonbank financial companies for supervision by the Board has failed to reduce systemic risk, and the standards used to make designations have been subject to critical assessments by Congress, the General Accountability Office, and FSOC itself. Congress should eliminate the designation process and direct FSOC to address systemic risks which may be posed by nonbank firms through its existing statutory authority to recommend new or enhanced prudential standards to primary financial regulators.

- Enact Housing Finance Reform – FSR supports comprehensive housing finance reform legislation to replace the conservatorship of Fannie Mae and Freddie Mac with a secondary market system based on private capital that allows the conventional mortgage market to meet the credit needs of borrowers and that protects taxpayers from risk. Housing finance reform also should include reform of the Federal Housing Administration's (FHA) single family mortgage insurance

program, including a clearer defect taxonomy, standards governing the application of the False Claims Act to FHA claims, and sufficient funding for FHA's technology systems.

- Ensuring Insurance Market Expertise on FSOC – The statutory term of the FSOC Independent Member with insurance expertise is 6 years, and the term of the current Independent Member expires in September. Unlike other FSOC voting members, the Dodd-Frank Act does not provide continuity for the Independent Member if a replacement is not approved prior to the term expiration. The Dodd-Frank Act should be amended to allow the Independent Member to continue serving in this position until a successor is approved by the Senate.

In conclusion, FSR stands ready to work with Chairman Crapo, Ranking Member Brown, members of the Committee, and each of the regulatory agencies testifying today on improving financial regulations to better serve customers and to spur economic growth.