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EXAMINING THE REGULATORY REGIME FOR REGIONAL BANKS

HEARING

BEFORE THE

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

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE IMPACT OF THE EXISTING REGULATORY FRAMEWORK ON REGIONAL BANKS

MARCH 19, 2015

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EXAMINING THE REGULATORY REGIME FOR REGIONAL BANKS

THURSDAY, MARCH 19, 2015

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

The Committee met at 10:01 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Richard C. Shelby, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

This week and next, the Committee will examine the impact of the existing regulatory framework on regional banks. Today, we will hear from regulators on the current regulatory construct and whether it should be imposed on these institutions.

Regional banks fulfill a critical role in their communities. They represent what we all recognize as traditional banking. They, for the most part, take deposits so that they can provide residential, small business, and commercial loans. This is the fuel that drives local and regional economic growth.

Unfortunately, these banks have been placed in a regulatory framework designed for large institutions because of an arbitrary asset threshold established by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The title of the Act says "Wall Street," but today, we are talking about banks that call Birmingham, Alabama, and Cincinnati, Ohio, home. The Dodd-Frank framework subjects all banks with assets of $50 billion or more to enhanced prudential standards, which carry heightened capital requirements, leverage, liquidity, concentration limits, short-term debt limits, enhanced disclosures, risk management, and resolution planning. Five years after this new regulatory framework was conceived, I believe it is appropriate today to revisit its suitability for these particular institutions.

Many experts have expressed concern about an arbitrary $50 billion threshold as an automatic cut-off for systemic risk. I share their concerns. It has been said that regulators should not apply macroprudential rules to those institutions that do not pose macroprudential risk. I could not agree more.

I have also been a proponent of prudent regulation and strong capital requirements. I believe we must, however, consider the economic impact of subjecting banks that are not truly systemically risky to enhanced prudential regulation. I think we also must ask

whether the existing regulatory framework is the best use of the regulatory resources.

Today, I would like to hear from the witnesses whether the $50 billion threshold is the appropriate and most accurate way to determine systemic risk in our banking sector. For example, a recent paper by the Office of Financial Research examines broad indicators used by global bank regulators to determine when a bank is systemically important. In fact, global bank regulators do not focus strictly on asset size. Rather, they take a broader view of the bank's total exposures that captures activities beyond assets.

The Office of Financial Research report takes into account the bank's size, interconnectedness, complexity, among other factors, and applies this criteria to regional banks in the U.S. The results of this analysis show that regional banks generally pose a small fraction of the risk to the financial system compared to the largest banks. The report states that the data set, quote, "is a significant step in quantifying specific aspects of systemic importance."

What this analysis reveals is in stark contrast with the in or out approach mandated by the $50 billion threshold. Some supporters of this automatic in or out approach to systemic risk argue that the regulators can tailor requirements based on the institution's size. I believe what this argument fails to take into account is that the law that established this regulatory framework is very prescriptive on how the regulators can tailor their regulations.

For example, under the current system, a $51 billion bank must receive disparate treatment from regulators compared to a $49 billion bank. This statute, I believe, effectively ties regulators' hands from taking into account a holistic view similar to that employed by the Office of Financial Research in its analysis on systemic risk.

A regulatory system that is too constrictive is not a system that will allow our banks to thrive or our consumers and businesses to have access to affordable credit. Moreover, a system that directs regulators' resources away from issues of systemic importance raises questions of whether regulators are adequately focused on protecting the economy and American taxpayers from the next crisis.

When the Ranking Member and I first met to discuss the agenda of the 114th Congress, I thought we shared a common interest that the SIFI threshold was one of a number of topics on which we should focus. Today, we will begin that effort.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Chairman Shelby, and thank you to the witnesses today and thank you all for your public service over the years.

I appreciate the Chairman calling this hearing to examine the regulation of regional banks. It is an important topic. We held a hearing last July on a similar topic. Unfortunately, it seemed to raise more questions than it provided answers. I hope these next two hearings, this week with the regulators and next week with banks, will help us to advance the conversation as we work to ensure that prudential regulations for regional banks, for midsize banks, are crafted appropriately.

This is a topic that is important to me because I have seen the effects on a community when a regional bank takes excessive risks. National City Corporation was a super-regional bank founded in Cleveland in 1845. It weathered all the bank panics of the 19th century and the Great Depression of the 20th, but it no longer exists today. In 2007, National City was the ninth largest U.S. commercial bank, having $140 billion in assets. Less than a year later, it had been sold to PNC in Pittsburgh with the assistance of $7 billion in taxpayer dollars.

National City's downfall is a case study in management mistakes and regulatory failures. The OCC, for example, allowed the bank to buy back $3 billion of its own stock in early 2007, months before its failure. A Federal Reserve witness before my subcommittee in 2011 called the events at National City, quote, "a collective failure of imagination by the banks and by the regulators."

Even near-failures have costs. Though National City did not technically fail, 4,000 people lost their jobs, many of them in my hometown in Cleveland. National City's management and our regulators failed those workers and communities across my State and across a number of States.

Congress responded to this and the failures of other institutions by passing Dodd-Frank and directing agencies to institute standards like capital and liquidity and risk management and stress testing to lower the likelihood and the costs of large bank holding company failures.

In 2010, American Banker wrote that many of the powers in Title I of Dodd-Frank were not new. They were put there as a directive from Congress to the regulators to use their authorities in ways that have teeth. That is why one bank lobbyist said, "When the President signed the financial reform law, that was halftime. The legislators left the field. Now, it is time for the regulators to take over. We want to see that we do not over-regulate here," unquote.

I agree, we should not over-regulate. So did the authors of Dodd-Frank. We often hear that a $50 billion bank should not be treated the same way as JPMorgan Chase. I agree on that, too. Dodd-Frank did not go as far as I would have liked in some respects, but in other respects, it struck a pretty good balance. It called for heightened rules for large bank holding companies but directed regulators not to take a one-size-fits-all approach. These rules were not meant to cover just the too-big-to-fail banks nor just the systemically important banks. They were meant to cover institutions like National City.

That is why enhanced prudential standards increase in stringency as institutions grow larger. Regulators have proposed or implemented different rules that apply to banks with $50 billion or more in assets, rules that apply to banks with 250 or more in assets, and rules that apply to banks with 700 or more in assets, the way it should be. Further, the law allows regulators—and this is key, I believe—the flexibility to lift the thresholds for some of these standards.

I hope that in the process of these hearings and our discussions we explore the benefits and the burdens of specific regulations and whether issues are being caused by the law or its implementing

regulations. Enhanced prudential standards are important, not just to respond to the last crisis, but also to prevent the next one. The failure of a single large institution can create systemic risk, but so can multiple failures of similar small or medium-size institutions.

The term "too big to fail" originated from the failure of the $40 billion bank Continental Illinois in 1984. In today's dollars, it would have been a $90 billion bank.

I look forward to hearing our witnesses are using their authority to tailor their regulations to the institutions and activities that present the most risk while not becoming complacent and taking their eyes off of all potential sources of risk. Our imaginations have failed us more than once when it comes to anticipating problems. We should make sure we do not let it happen again.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Without objection, I would like to enter into the record now the Office of Financial Research Brief 15-01 and the OFR Table of Systemic Importance Indicators.

Our witnesses today include Governor Daniel Tarullo, a member of the Board of Governors of the Federal Reserve System, who is no stranger to this Committee; Comptroller Thomas Curry of the Office of the Comptroller of the Currency, who is no stranger, either; and also Martin Gruenberg of the Federal Deposit Insurance Corporation, who was a longtime staffer here. Welcome, gentlemen.

Governor, we will start with you.

STATEMENT OF DANIEL K. TARULLO, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. TARULLO. Thank you very much, Mr. Chairman, Senator Brown, and other Members of the Committee.

In response to your request for comments on possible adjustments to statutory thresholds for mandatory application of certain forms of prudential regulation, let me begin with three comments.

First, Dodd-Frank's creation of different tiers of prudential regulation was a very important step forward in dealing with the problem of too-big-to-fail and larger institutions. The approach of requiring enhanced prudential standards for larger, significant institutions is an important method of promoting financial stability, assuring the availability of credit for American businesses and households, and countering moral hazard, while taking into account the relative costs and benefits of different forms of regulation to banks of different sizes and scope of activities.

Second, it is worth considering whether the threshold as applied to smaller institutions within this range might be adjusted in light of experience to date. As I have said before, it may be sensible to exempt community banks completely from certain regulatory requirements where this would reduce compliance costs with little or no cost to safety or soundness. It is also worth thinking about some adjustment to the $50 billion threshold in Section 165, a point to which I will return in a moment.

Third, any possible change in these thresholds should be limited to specifying the universe of banks for which it is mandatory that certain regulations apply. It is critical that the three banking agencies in front of you today retain discretion to require prudential

measures, including things such as more capital or liquidity, for specific firms or groups of firms when necessary to ensure the safety and soundness of those institutions.

Coming back now to the issue of the $50 billion threshold, let me first note that we have implemented the enhanced prudential standards requirements in accordance with the Section 165 criterion of increasing stringency depending on the systemic importance of the banks as determined through application of the relevant statutory factors. In essence, we have created three categories for firms in that group, that universe of banks of $50 billion or more. So, there is already a good bit of tiering as we have taken advantage of the flexibility granted to us.

Now, one might debate whether even the less restrictive forms of those standards as applied to a $50 billion institution should be mandatory or just left to supervisory discretion. But, I would say, in trying to be responsive to the questions the Committee is asking, that the issue is most clearly joined with respect to supervisory stress testing. The incremental supervisory costs for us of doing this entire universe of banks are significant. The resource demands on the institutions are substantial. The marginal benefits for safety and soundness for that group of $50 to $100 billion institutions seem rather limited. And, finally, our ability to tailor to these smaller institutions is more constrained in the context of a supervisory stress test with the three required scenarios than in those other enhanced prudential standards areas I was referring to a moment ago.

That is, even though we do vary some of the qualitative expectations we have for the smaller banks in the stress test, the basic application of supervisory scenarios, comparable loss functions, and other elements of the test create a baseline of a considerable amount of detail and resource expenditure for the affected banks. So, I think this is an example of where things are less susceptible to significant tiering and, thus, the decision at its root tends to be a bit more of a binary one, that is, the bank is either in or it is out.

Thank you for your attention, and I would be pleased to answer any questions you might have.

Chairman SHELBY. Thank you.

Mr. Curry.

STATEMENT OF THOMAS J. CURRY, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. CURRY. Chairman Shelby, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to discuss the OCC's experience with Section 165 of the Dodd-Frank Act and our approach to tailoring our regulatory and supervisory expectations to the size and complexity of the individual institutions we supervise.

Because the focus of Section 165 as it applies to the banking sector is on bank holding companies, almost all of the authorities under this section are assigned to the Federal Reserve System. The only area in which the OCC has direct rulemaking authority involves the mandated company-run stress tests for banks with consolidated assets of more than $10 billion.

To the extent permitted by the statute, we tailored our requirements to distinguish between those that apply to banks with assets between $10 and $50 billion in assets and those with assets in excess of $50 billion. Otherwise, the OCC's role in Section 165 is limited to a consultive one on matters affecting national banks.

However, national banks typically comprise a substantial majority of the assets held by bank holding companies with consolidated assets of $50 billion or more, and the national bank is typically the dominant legal entity within each company. Consequently, I would like to focus my remarks on how we use our existing supervisory tools that are similar to the provisions of Section 165 in our prudential oversight of national banks and Federal savings associations.

It is very important that the OCC retain the ability to tailor and apply our supervisory and regulatory requirements to reflect the complexity and risk of individual banks. As my written testimony describes, we have taken a number of initiatives to ensure that banks that pose heightened risk to the financial system are subject to much higher requirements than those with lower risk profiles. While a bank's asset size is often a starting point in our assessment of appropriate standards, it is rarely, if ever, the sole determinant.

For example, while most banks in our midsized portfolio fall into the $8 billion to $50 billion range, this portfolio also includes several banks that exceed $50 billion in assets. These banks have business models, corporate structures, and risk profiles that are very different from other institutions in our large bank portfolio, which typically have national or global operations, complex corporate structures, or extensive exposures in the wholesale funding and capital markets. This flexible approach, which considers both size and risk profiles, allows us to transition and adjust the intensity of our supervision and our supervisory expectations as a bank's profile changes.

Our approach of tailoring requirements to different types of institutions can also be seen in our implementation of capital, liquidity, and risk management standards for the banks we supervise. While our standards are separate from the enhanced prudential standards that the Federal Reserve issues under Section 165, we believe they are consistent with the statute's intent and provisions.

For example, the interagency capital requirements applicable to national banks, including those related to market and operational risks, and the enhanced leverage ratio requirements, generally only apply to the largest banks that have significant trading activities and complex operations. The capital rules, however, also allow the OCC to require additional capital based on an individual bank's circumstances, regardless of its size. This ability to require an individual bank to maintain capital levels above regulatory minimums is especially important when we encounter banks that have significant concentrations in certain loan products or market segments, and we regularly exercise this discretion.

For our largest banks, generally those over $50 billion in assets, we have also developed a set of heightened standards for risk management and corporate governance that reflect the greater size, complexity, and risk that these institutions represent. For example,

these standards focus on the need for an engaged board of directors that is capable of providing an independent perspective and a credible challenge to management. The standards also address the need for a robust audit function and a compensation structure that does not encourage excessive risk taking.

Finally, let me reiterate that there are very considerable differences not just between community banks and large institutions, but among the large banks themselves. Our approach recognizes the differences in size, complexity, and risk among the large banks and thrifts we supervise and it ensures that the appropriate degree of supervisory rigor is targeted to each institution.

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

Chairman SHELBY. Thank you.

Mr. Gruenberg.

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

Mr. GRUENBERG. Chairman Shelby, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify on the regulatory regime for regional banks.

Section 165 of the Dodd-Frank Act requires enhanced prudential standards for bank holding companies with total consolidated assets equal to or greater than $50 billion, while providing regulatory discretion to tailor standards to the size and complexity of the companies. The companies that meet the $50 billion threshold represent a significant portion of the U.S. banking industry and also represent a diverse set of business models.

As part of its research on community banks, the FDIC developed criteria to identify community banks. Based on that criteria, 93 percent of all FDIC-insured institutions with 13 percent of FDIC-insured institution assets currently meet the criteria of a community bank. This includes over 6,000 institutions, of which nearly 5,700 have assets under a billion dollars. By contrast, regional banks are much larger in asset size than a typical community bank and typically have expanded branch operations and lending products serving several metropolitan areas and may do business across several States. In addition, the Deposit Insurance Fund would face a substantial loss from the failure of even one of these institutions.

Section 165 provides the FDIC with explicit responsibilities in two substantive areas related to prudential standards: resolution plans and stress testing. In both areas, the FDIC has tailored requirements to fit the complexity of the affected institutions.

Resolution plans, or living wills, are an important tool for facilitating the orderly failure of these firms under the bankruptcy code. In 2011, the FDIC and the Federal Reserve jointly issued a final rule implementing the resolution plan requirements for bank holding companies with assets equal to or greater than $50 billion in consolidated assets. The agencies used their statutory discretion to develop a joint resolution planning rule which recognizes the differences among institutions and scales the regulatory requirements and potential burdens to the size and complexity of the institutions subject to the rule.

For their initial submissions, bank holding companies with less than $100 billion in total nonbank assets and 85 percent or more

of their assets in an insured depository institution were generally permitted to submit tailored resolution plans that simplify the task of creating a living will. Nearly all the U.S. institutions in this category filed tailored plans. The joint rule also allows the agencies to modify the frequency and timing of required resolution plans, which we have done.

The Dodd-Frank Act also requires the Federal banking agencies to issue regulations requiring financial companies with more than $10 billion in total consolidated assets to conduct annual stress tests. The FDIC's stress testing rules, like those of the other agencies, are tailored to the size of the institutions, consistent with the expectations under Section 165 for progressive application of the requirements. Under the agencies' implementing regulations, organizations in the $10 to $50 billion asset size range have more time to conduct the tests and are subject to less extensive information requirements as compared to larger institutions.

Section 165 establishes the principle that regulatory standards should be more stringent for the largest institutions. Certainly, degrees of size, risk, and complexity exist among the banking organizations subject to 165, but all are large institutions. Some of the specializations and more extensive operations of regional banks require elevated risk controls, risk mitigation, corporate governance, and internal expertise than what is expected from community banks.

That being said, it is appropriate to take into account the differences in the size and complexity of large banking organizations when forming regulatory standards. The agencies have made appropriate use of the flexibility built into section 165 thus far, and where issues have been raised by industry, we have tried to be responsive.

However, we do recognize that more could be done. For example, the statutory language governing stress testing is more detailed and prescriptive than the statutory language on other prudential standards, leaving the regulators with less discretion to tailor the stress testing process. The FDIC would welcome the opportunity to work with the Committee on language that would permit greater flexibility in the stress testing process.

The FDIC also remains open to further discussion on how best to tailor various enhanced prudential standards and other regulations and supervisory actions to best address risk profiles presented by large institutions, including regional banks.

Mr. Chairman, thank you, and I would be happy to answer any questions.

Chairman SHELBY. I thank all of you.

I want to ask this question—a couple of questions to begin with to all of you, and I would like a yes or no answer to these questions. We are going to have a lot of questions.

Should a bank that is systemically risky be regulated like a bank that is, one?

Two, are there any nonsystemically risky banks currently being regulated as if they were systemically risky because of the statutory $50 billion threshold?

Governor, we will start with you.

Mr. TARULLO. Senator, could I ask you to clarify just a bit the two questions. Is the systemic importance issue——

Chairman SHELBY. Let me just ask the question again. Should a bank that is not systemically risky be regulated like a bank that is?

Mr. TARULLO. I know you want yes or no, and I am going to begin by saying no, but I just do want to point out that there are varieties of systemic riskiness or importance.

Chairman SHELBY. I understand. You can elaborate.

Mr. TARULLO. OK.

Chairman SHELBY. What about are there any nonsystemically risky banks currently being regulated as if they were systemically risky because of the statutory $50 billion threshold?

Mr. TARULLO. I would say, to a degree, yes, in the stress testing area.

Chairman SHELBY. Yes, basically.

Mr. Curry.

Mr. CURRY. I would answer no to the first question, and potentially yes to the second.

Chairman SHELBY. OK.

Mr. Gruenberg.

Mr. GRUENBERG. Can you repeat the question, because I want to be careful——

Chairman SHELBY. Yes, I will. Should a bank that is not systemically risky be regulated like a bank that is? That is question one. Yes or no?

Mr. GRUENBERG. No.

Chairman SHELBY. Are any nonsystemically risky banks currently, to your knowledge, being regulated as if they were systemically risky because of the $50 billion threshold?

Mr. GRUENBERG. As a general matter, from my standpoint, no, Mr. Chairman.

Chairman SHELBY. OK. Another question for all of you. We do not get this opportunity every day. I mentioned in my opening statement a recent report by the Office of Financial Research that examines broad indicators to determine whether a bank is systemically important. Do you have any concerns with the methodology described by the OFR report to measure systemic risk, and do you believe that the automatic $50 billion threshold is superior to analytic methodology described in the OFR report to measure systemic risk? Governor.

Mr. TARULLO. Thank you, Mr. Chairman. Here is where this issue of systemic importance comes in——

Chairman SHELBY. Sure.

Mr. TARULLO. ——and there are two ways you can think about it. One is systemic importance in the sense that high stress or failure of that particular firm might itself lead to a financial crisis. So, that is the sort of systemic risk, too-big-to-fail concern that we are thinking about——

Chairman SHELBY. Absolutely.

Mr. TARULLO. ——from 6, 7 years ago.

The second form of systemic importance is, if you just reverse the syntax, importance to the financial system, and that is where just the sheer size of an institution, the fact that it has a big footprint

across the country, the fact that its credit intermediation is important for American businesses and households, gives it an importance that, for example, does not attach to a community bank. So, that is where it is important to take account of those differences.

Now, the OFR report is, to a considerable extent, focused on the institutions at the very top of the scale, what we have in our LISCC, Largest Institution Supervision Coordinating Committee portfolio at the Fed, and the institutions which internationally have been identified as of global systemic importance.

Now, there, as I think you all know, we do distinguish, first off, by segregating that group of eight and have special requirements applicable to them, and second, even among those eight, we vary the requirements, for example, in our proposal on capital surcharges. So, depending on size, complexity, interconnectedness, and substitutability, the proposed surcharge may be greater or lesser even among those eight banks.

So, although one will have a different set of views, maybe, on exactly what the right set of criteria are, and a lot of academics and people internationally, people at the Fed, OFR, have tried to give their own precise formulas, I think all of those people are engaged in the same exercise, which is to say, let us identify the systemic importance of those institutions whose failure would really put the whole system at risk.

Chairman SHELBY. Governor, again, do you disagree with the methodology in the OFR report to measure systemic risk?

Mr. TARULLO. We might have some questions about the methodology. I know you know this, Mr. Chairman, because you have heard me on this for 10 years now, but I am very focused on the vulnerabilities created by short-term wholesale funding at large capital market institutions, and I, at least my understanding of the OFR report is it does not weight that as heavily as I would. But, as I said earlier, I think we are engaged in the same broader exercise.

Chairman SHELBY. Governor, as part of the Financial Stability Board and the Basel Committee for Banking Supervision, the Federal Reserve participated in devising what we call a multifactor approach for assessing the systemic risk for financial institutions. You are very familiar with this. Could you briefly explain here this multifactor approach, and do you believe that this approach is a valid way to determine systemic risk?

Mr. TARULLO. Yes. I have already alluded to it, but let me be a bit more specific.

Chairman SHELBY. Yes.

Mr. TARULLO. What the Basel Committee did, and the Fed participated very heavily in this, was to try to construct a set of indicators, which, as I say, addressed issues like size, interconnectedness, the degree of cross-border activity——

Chairman SHELBY. Uh-huh.

Mr. TARULLO. ——and then to assign some weights to those factors. Then we took a broad range of large internationally active banks and ran their characteristics through that template——

Chairman SHELBY. Uh-huh.

Mr. TARULLO. ——to come up with a ranking of institutions that might be considered of global systemic importance. That was the basic exercise.

But, again, I just want to emphasize, that effort was oriented toward the institutions whose failure in and of themselves might create a domino effect and have a financial crisis as a result. So, we were trying to do that assessment for the very significant additional regulations that are associated with those very largest institutions.

Chairman SHELBY. Governor, you are familiar with Secretary Lew's testimony before the House Financial Services Committee, I assume, on Tuesday. He said that he is not convinced legislation, quote, "is required right now to raise the $50 billion threshold until we determine administrative flexibility is inadequate."

My question to you, does either the FSOC or the Federal Reserve currently have administrative flexibility to raise the $50 billion threshold with respect to prudential standards in Section 165? It is my understanding that is statutory.

Mr. TARULLO. That is statutory, and the FSOC has authority to raise some but not others.

Chairman SHELBY. Not that.

Mr. TARULLO. And not stress testing, right.

Chairman SHELBY. Thank you.

Senator Brown.

Senator BROWN. This chart to the witnesses' right, and all my colleagues should have a copy at their desks, highlights significant tailoring of enhanced prudential standards by the regulators for bank holding companies above $50 billion in total assets. This is an easier yes or on question than the two directed from the Chair. Just to each of you, if you would just say yes or no, does this look accurate to you?

Mr. TARULLO. No, it does not, Senator.

Senator BROWN. Why is that?

Mr. TARULLO. Well, there are at least two reasons I see, looking at it quickly. I do not quite know where the $700 billion category came from. We have breaks for statutory and supervisory reasons at 1, 10, 50, 250, and then the LISCC portfolio, but this other one, they may have inferred it from some other things, but it is not one of our categories. Also, I do not see single counterparty credit limits up there, either. There may be others.

Senator BROWN. Mr. Curry.

Mr. CURRY. I think, generally, it is correct, Senator. I believe the $700 billion figure may reflect the cut-off in the enhanced supplemental leverage ratio.

Senator BROWN. Mr. Gruenberg.

Mr. GRUENBERG. Senator, since the enhanced prudential standards are, in significant measure, a bank holding company set of standards under the Fed, I think I would probably defer to Governor Tarullo on the evaluation of this particular chart.

Senator BROWN. OK. Let us get back to that. Let me go in a slightly different direction.

Governor Tarullo and Chairman Gruenberg observed the statute allows for tailoring. You have said that. But, there are practical challenges to tailoring stress tests. Governor Tarullo said the su-

pervisory benefits of stress testing for banks around $50 or $60 or $70 billion are relatively modest. Chairman Gruenberg alluded to this when he discussed capital and liquidity, but Section 165 also includes some standards that are central to preserving safety and soundness and financial stability.

And, questions for all of you, again, start with you, Governor Tarullo. How concerned should we be by proposals that would limit your agency's longstanding authority to preserve safety and soundness and financial stability of all bank holding companies, regardless of size? And, let us go down, starting with you.

Mr. TARULLO. Very concerned, Senator. That is why I included that as one of my introductory points, that it has been a longstanding practice of the three agencies in front of you, as validated by Congress, let me see, 32 years ago, that the Federal banking agencies have discretion to apply specifically stronger expectations for particularly banks or a group of banks that pose safety and soundness risk. Any constraint upon that would be highly problematic.

Senator BROWN. Mr. Curry.

Mr. CURRY. I would agree with Governor Tarullo. The items that are in Section 165 really are tools, longstanding tools, established tools that the supervisors have used. So, any direct or, by implication, limitation on our ability to use those tools on a selective basis would be problematic.

Senator BROWN. Mr. Gruenberg.

Mr. GRUENBERG. Senator, I agree with the points made by Governor Tarullo and Comptroller Curry, and it goes to, to me, an important issue, as to what the purpose of these enhanced prudential standards are. As I read them, they basically preserve the underlying prudential authorities that the agencies have had and are basically saying to the agencies, for institutions over a certain size, they may present particular risk to the financial system. They are basically telling the regulators to pay attention and, if necessary, impose more stringent standards. I think that is the purpose and that is, in significant measure, the value. But, I think the premise was that the underlying prudential authorities that we had would be preserved, and I think that is probably for us the threshold issue here.

Senator BROWN. Thank you.

One financial sector analyst's note about this hearing said that raising the $50 billion threshold, and I quote, "would open the door to more freedom for banks to distribute capital to shareholders in the form of buy-backs and dividends and would pave the way to more M&A activity as banks worry less about crossing the $50 billion threshold designation."

Should we be giving a priority, then, to dividends and buy-backs and consolidation at the expense of financial stability? And, I will start with Mr. Gruenberg this time.

Mr. GRUENBERG. No, Senator.

Senator BROWN. Mr. Curry.

Mr. CURRY. No.

Mr. TARULLO. So, Senator, obviously not. I mean, that is not what motivates it. I think what should motivate it is the question of how much safety and soundness benefit do we get out of this

particular approach, which is the stress testing. I think that as you saw by looking at the stress test results this year, in fact the smaller regional banks are very well capitalized. So, it is really just a question of the expenditure of resources and how much safety and soundness benefit you get for that.

Senator BROWN. Mr. Gruenberg, one more question, if I could. The failure of the $30 billion thrift IndyMac, a traditional lender under $50 billion in assets, cost the FDIC fund about $12 billion. What did their failure mean for the market and for the DIF and which enhanced prudential regulations would help mitigate those effects in the future for a bank that size?

Mr. GRUENBERG. It is a good question, Senator. As you know, IndyMac was the most costly failure during this recent crisis to the Deposit Insurance Fund, and, I think, may have been the most costly failure the Fund has ever experienced for a single institution. And, it presented significant resolution challenges, because, frankly, the institution was in such bad shape that there was no available acquirer for it. We had to establish a bridge company to manage it over a period of several months to have an orderly winddown, which is one of the reasons for the cost of the failure.

And, it certainly had consequences. It was a California institution, and it had consequences for the community and region in which it operated. It is fair to say, given the fragile financial environment generally at the time, it may have had broader impacts in terms of perceptions about the vulnerability of the mortgage market.

The point is that an institution even of that size could have, certainly, significant consequences for the Deposit Insurance Fund and considerations for the financial system more broadly. Among the provisions of Dodd-Frank, of the enhanced prudential standards, the stress test is the one provision that would have applied, and in retrospect, had they had stress testing as well as a risk committee for the institution, I would argue that a stress test for that institution and a risk committee would not have had value for that institution.

Senator BROWN. Thank you.

Chairman SHELBY. Senator Heller.

Senator HELLER. Mr. Chairman, thank you, and thanks for holding this hearing on regional banks.

I also want to thank the banking agencies for being here, also, for taking time and listening to our concerns.

Before I get started with my questions, I would like to find out where that chart came from. Maybe I would ask the Ranking Member——

Chairman SHELBY. The source of it.

Senator HELLER. ——what is the source of this chart?

Chairman SHELBY. Senator Brown, I think he is directing this question to you.

Senator BROWN. I am sorry. Yes. It came from Better Markets.

Chairman SHELBY. From what, now?

Senator BROWN. Better Markets.

Chairman SHELBY. It does not have where it came from.

Senator BROWN. I apologize for it not showing that.

Senator HELLER. I mean, it is unusual to have a chart that is passed around that has no validity.

Senator BROWN. Well, it has got lots of validity. I apologize for——

Senator HELLER. Well, the banking agencies themselves said it had no validity to it.

Senator BROWN. Well, they had—we had talked to the Fed about this and we——

Senator HELLER. I just hope it is not the practice of this——

Senator BROWN. Well, I——

Senator HELLER. ——this Committee to pass around charts that have no validity——

Senator BROWN. ——do not think it has——

Senator HELLER. ——nor does it have any source connected to it.

Chairman SHELBY. It is not the practice of the Committee. We generally—I have never known anything that did not have a source on it.

Senator BROWN. OK. I apologize for not putting the source on it. It was—there were some slight problems with it, but not major problems with it. I apologize for that.

Senator HELLER. All right.

Governor, can you explain to me, based on current standards, the difference in the risk of a $49 billion bank and a $50 billion bank? Why is a $49 billion bank less risky than a $50 billion bank?

Mr. TARULLO. Well, Senator, obviously, the risk of a particular institution is going to depend substantially on the underwriting practices and quality of capital of that particular institution. I think if you are getting at the question of why a threshold at $50 billion, I mean, to a considerable extent lines do have to be drawn. And, so, with respect to, as Comptroller Curry was explaining, the supervisory portfolios that we all have, we do have these asset thresholds to make sure that we are not requiring community banks to do more than makes sense for them to do with their limited portfolios.

And, so, you draw a line at some point that seems sensible, but there is not always in supervisory practice a radical difference. There is a gradation of differences in what the expectations are. There are some things that do vary when you cut across a line that has been established in the statutory sense, like $50 billion. But, let me just say——

Senator HELLER. Governor, let me ask you a question——

Mr. TARULLO. Yes.

Senator HELLER. ——because I do not have a lot of time. You floated the idea of raising that to $100 billion.

Mr. TARULLO. Mm-hmm.

Senator HELLER. Do you endorse that?

Mr. TARULLO. I endorse it in the sense that with stress testing, in particular, I think that is the one area where the administrative flexibility we have got seems not to allow us to do something that we think is a win-win on all sides.

Senator HELLER. Do you think risk matters or size? Which matters more, measuring risk or the size of the capital——

Mr. TARULLO. Well, the two interact with one another, obviously, because the riskiness associated—the larger the institution, a given

quantum of riskiness associated with that institution's portfolio will translate into a greater or lesser impact on the community and on the country. So, you really have to take the two things together.

Senator HELLER. You mentioned in your testimony that there was a lot of cost in these stress tests, a lot of stress to the agencies, obviously, quite a bit for the banks themselves. Is there a better way? Is there a better way that the Feds could be more transparent, perhaps communicate better to these regional banks as to what your expectations are?

Mr. TARULLO. Oh, I think we have got a substantial back and forth with the community banks—excuse me, the regional banks. We have frequent meetings at the supervisory level before, during, and after the stress tests. With respect to this group, the $50 to $100 billion group, we have met with them on several occasions and will again once the supervisory letters go out to try to, to the degree we can, to tailor things to make the expectations a little clearer. So, sure, there is always more that can be done.

Senator HELLER. Just one more follow-up question, or just one last question. Do you think it is necessary to have a new living will every year if there are no material changes in a bank's organization?

Mr. TARULLO. Well, you do not necessarily have to have a new one every year, and as Chairman Gruenberg was noting, we do have a gradated set of requirements. I think for the largest institutions, it is almost inevitable that there are going to be changes that one wants to take into account on an annual basis, just the same way we update stress tests and we update other things.

Senator HELLER. Governor, thank you.

Mr. Chairman, thank you.

Chairman SHELBY. Senator Warren.

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

I agree with Ranking Member Brown, that while certain regional banks may pose different risks than the too big to fail banks, that Dodd-Frank already gives the Fed a great deal of discretion to tailor its regulation and supervision to account for these differences. Where there is discretion, I do not think Congress should take away that discretion from the Fed and simply exempt certain large regional banks from increased Fed scrutiny. That is a recipe for missing the buildup of excessive risk in the financial system and it reflects the kind of "let the banks run free" mindset that created the last financial crisis. I just do not want to go there again.

Now, we have heard a lot today about ways to roll back Dodd-Frank, but surely there are areas where we need to strengthen Dodd-Frank to address new concerns or to address old problems that were previously overlooked.

Governor Tarullo, are there specific steps that you think Congress should take to strengthen or complement Dodd-Frank?

Mr. TARULLO. Well, Senator, there are certainly discrete areas that would be worthy of consideration. Let me mention one, which probably many of you read about in connection with the commodities issues that have been looked at by this Committee.

You know, there is a provision, Section 4(o), of the Bank Holding Company Act which exempts two institutions, essentially, from the

restrictions on commodities activities that are generally applicable to bank holding companies. This resulted from an anticipatory grandfathering clause in the Gramm-Leach-Bliley Act. It basically said, if any institution becomes a bank holding company at some point in the future, they can continue to engage in all the commodities activities they have been engaging in, and as all of you know, two such entities did become bank holding companies as a result of the crisis.

So, right now, those two firms are, by statute, allowed to engage in the extraction and transportation of potentially highly combustible materials with substantial risks associated with them. I think it would be very much worth considering treating those two firms the way we treat all other bank holding companies.

Another thing that certainly occurred to me when I was back teaching banking law was that the structure of civil money penalties that we have right now puts dollar limits on those civil money penalties that are basically on a daily basis, you know, for each day that you can find the violation, and there are two issues there.

One, the caps had to be set by the Congress with smaller banks in mind, obviously. So, the caps, particularly that middle tier cap, is really quite low. I think it is $37,000 a day for certain forms of safety and soundness problems where there was a recklessness associated with it. And, as you can imagine, that does not allow for the kind of penalty that would have an impact on a much larger institution. So, that is one issue.

A second related issue is it is not quite clear to me why a thing should be calibrated on the number of days that the violation was in place as opposed to the relative seriousness of it.

So, Senator, if the Committee was thinking in terms of discrete changes on all sides, I think it would be worth revisiting that so that our civil money penalty authority is effective for very large institutions.

Senator WARREN. Thank you very much, Governor Tarullo. I hope that the Chairman will be looking into concerns about the banks taking on more risks by speculating in commodities like aluminum and gold and oil, and also about increasing civil money penalty caps as two more ways to try to reduce risk in the system.

Since the day Dodd-Frank was enacted, banks have been looking for ways to chip away at it, roll it back. But, if anything, the last 5 years have shown that we need to strengthen our financial reforms. The too big to fail banks have grown bigger than ever and banks take on new kinds of risks every day. Just last summer, the Fed and the FDIC declared that if any one of 11 banks started to falter, they would require a taxpayer bailout to avoid bringing down the entire financial system. If Congress thinks enough time has passed to reopen Dodd-Frank, then we should consider ways to protect taxpayers and the economy, not grant give-aways that further tilt the playing field toward the bigger banks and make our financial system less safe.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman.

I do not think there is a single community in the United States today that can consider themselves to have an opportunity to grow unless they have access to capital, to be able to borrow money, to be able to magnify what they could otherwise do with the resources at hand. We have got about 300 towns, small towns, in South Dakota. On a day-to-day basis, they are impacted by the availability of their small town banks to be able to loan money.

If you look at what has happened since Dodd-Frank, there is a continued concern expressed in many rural communities about the additional cost of compliance, and that cost of compliance, while it has been laid out because of a failure, I am not so sure that the failure has occurred in the banks that serve many of our small and regional communities. And, yet, we still talk about the need to identify a particular $50 billion number as the right number.

I am just curious, when you take a look at it, and in this particular case, Governor, I would like to start with you, there is clearly a need to consider the impact to the economy with the availability of credit versus the need to protect the financial system that we have in place today. What is the impact—and you see this, you have discussed it regularly—how is the growth in our economy going based upon the ability of communities throughout the United States to access credit, and is it being impacted by the reduction in the availability of credit based upon the need for more capital at the bank level?

Mr. TARULLO. Senator, it is obviously always a difficult matter to disentangle all the causes of a particular phenomenon, but I would say that at this juncture, the areas in which credit intermediation has seemed a bit sluggish probably have as much to do with demand for credit, meaning the relative amount of growth in the economy, growth in wages, which produces consumer demand, and the lingering effects of the crisis and the Great Recession, which caused many households and businesses to have to repair their own balance sheets where they had a lot of debt.

I think, actually, the efforts that the three agencies in front of you have made to boost the capital of all of our banks will, over time, provide a much sounder basis for providing that credit intermediation because they are going to be strong and stable institutions.

Marty was referring earlier to an institution that got itself in so much trouble that it was not able to provide that credit intermediation long before the FDIC had to shut it down. They had already reduced their activities. So, I think in that sense, we are headed in the right direction.

The compliance cost issue that you note is a real one, though, for the community banks, in particular. That is why I advocated that the Congress adjust some of the limits on us in raising our small bank holding company exception, and I was delighted that you acted as quickly as you did in doing so. And, we will continue to look for ways to reduce compliance burden on smaller institutions that, again, just is not worth it for the safety and soundness benefits. I think we are all looking to try to do that.

Senator ROUNDS. Gentlemen.

Mr. CURRY. Let me just elaborate on the cost and trying to eliminate some unnecessary burden on community banks. That has real-

ly been a focus of the three agencies, particularly in the EGRPRA context that we are currently engaged in, where we are actually reviewing rules and regulations and statutes to see whether there is an undue or unnecessary burden, particularly on the community bank sector.

From a supervisory standpoint, we are constantly looking at our community bank division at the OCC, and how we can do a better job in supervising and being less intrusive and creating additional direct and indirect burden reductions for small community banks, particularly in rural areas.

We are also looking at how can we offer a means of reducing the costs for necessary regulatory burden. The OCC issued a white paper on the opportunities for collaboration. We think that may be particularly helpful for smaller institutions that can share a compliance officer, share some of those costs that necessary regulation may be imposing upon them.

Senator ROUNDS. Sir.

Mr. GRUENBERG. Senator, briefly, two points. One, the FDIC issues a quarterly banking profile every 3 months on the condition of the industry. The industry has been gradually improving now for several years and community banks' performance in particular has been improving. The banking industry, generally, and community banks in particular have made efforts over these last several years to strengthen their capital and liquidity. We actually believe that they are well-positioned to take advantage of expanding credit demand and credit opportunities. Hopefully, if we get some increased lift from the economy, our banks should be well-positioned to respond to that.

On the community bank side, though, I think there is, as has been mentioned by my colleagues, particular reason to take a look at regulatory burden and ways we can simplify and reduce costs for community banks to better enable them to respond to the credit demands from their communities. We are undertaking this EGRPRA process, which is really a comprehensive review of this. I do think there are going to be a number of ways that we are going to be able to come forward to suggest reducing regulatory costs, particularly for smaller institutions.

Senator ROUNDS. Thank you.

Mr. Chairman, I know my time has expired. I would just make the point that as we talk about the regulations involved in these banks and where they go, the one thing that seems to be lacking is a discussion about the impact, the economic impact on the entire economy, the whole thing, with whether or not when these banks can provide the necessary capital to businesses and individuals across the entire program of rural and urban areas. I think that should be an integral part of any discussion that we have about the regulation on these institutions.

Chairman SHELBY. The Senator is absolutely right. This is going to be part of the discussion and should be part of your concern, all three regulators, the impact on the economy, everything.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman.

Good morning to the panel. Thank you for taking the time to have this conversation. Mr. Chairman, thank you for holding this hearing, very important hearing——

Chairman SHELBY. I apologize for skipping you, Senator Menendez.

Senator SCOTT. ——about the adequacy of the current asset threshold for considering a bank to be a systemically important financial institution.

For me, as I translate it into what I think is important for my constituents back at home in South Carolina, this is really about the cost and the availability of small loans and consumer credit at home in South Carolina. Many of my constituents are served by a number of regional banks because they can travel throughout the State or the region and have access to banking services and ATMs. So, it is really a simple process for most of my constituents.

A regional bank, for my constituents, is a community bank with simple operations that simply expanded its footprint. We are not talking about the Wall Street banks. We are talking about banks that serve South Carolina that did not—did not—contribute to the financial crisis.

We have heard a lot of conversation today already about the $50 billion threshold, whether it is necessary and if it by itself is important for us to consider using that. I think Senator Heller asked a question about $49 billion versus $50 billion, what is the difference in the business operations, and your question had a lot to do with complexity and interconnectivity, it sounded like to me.

I personally would consider no asset threshold and designation on a case by case basis in a process that uses objective risk data and gives a bank clear notice of what it can do to choose or not to choose to be a SIFI. If objective criteria were used, I think many banks would amend their behavior to avoid SIFI-land, so to speak. They would be able to choose whether to become less risky on their own or allow the regulators to make that decision.

Governor Tarullo, I appreciate the Fed's efforts to date to tailor supervision, but I think they are no substitute for raising the $50 billion threshold. Some supervision stress testing, in particular, has certain fixed compliance costs at a bank. The big banks can weather these costs more easily than smaller regional banks that serve my constituents, as I have described earlier. So, these fixed compliance costs become like a regressive tax to my folks in South Carolina. You referred to the cost as considerable challenge in your testimony, and that regressive tax is passed right on to everyday South Carolinians.

In light of this outcome, do you believe that the $50 billion asset threshold for prudential standards and stress testing is too low, and my second question is, has the Fed done any cost-benefit analysis on the stress test requirement for banks right around that $50 billion bubble, as Senator Heller talked about earlier?

Mr. TARULLO. Senator, what I have been trying to suggest is that with respect to those banks around that size, it is what I described as a win-win situation because this is not a case in which we have to tradeoff some safety and soundness benefits against compliance costs. I think this is a case in which, for a $50 or $60 or $70 billion bank, our normal supervisory processes, the capital requirements

that we have all put in place, the examinations that one of our three agencies does, will provide adequate protection for that kind of institution. So, that is where I think the nub of the issue is.

I do want to say, I certainly agree with you on the issue of relative amount of burden for smaller and regional banks, and I would just supplement that by saying that, again, we do want all banks to be safe and sound, because when the economy turns down and the balance sheets of all banks look worse, as they always do, because they have to reserve more, some loans go into nonperforming status, we want to make sure that every one of those banks is in a position to continue to lend to the businesses and the households that are still going to need credit. And that is why we want them to have these buffers, to protect the Deposit Insurance Fund, but also to make sure that they are viable institutions.

The bigger they get, just sheerly in asset terms—when you have a $300, $350, $400 billion bank, think how many States that bank's operations cover, how many households and businesses are dependent on that bank being able to provide the credit. So, that is the other thing to keep in mind, but it does not detract from any of the points that you made.

Senator SCOTT. I think you make a very good point there, sir. I will tell you, though, that having been in business for myself for a long time, about 15 years, the fact of the matter is that the market changes. The business cycles change. The threat and the challenges to a business changes. And, so, the business itself should go through the process of, as we call in this hearing, the living wills—should go through the process of understanding and appreciating it, the risk that they have to their consumers, as well.

I think the question that we are really talking about has more to do with SIFIs. So, it is, in fact, economically on the Nation as a whole, and what those thresholds should be.

I do appreciate the fact that you and I both see the fact that smaller banks that have very consistent profiles of risk—the question that I would have for you is, if those banks—should those banks go through an annual testing, or should they be every other year? Would you recommend it or suggest that if the banking business model does not change, that the costly annual reporting should be the same or not?

Mr. TARULLO. Well, there may be a couple of different issues there. In terms of the stress testing, if one is going to be in the stress testing, it does make sense to do it annually. The systems have to be in place year-round no matter what. The cost is spread over the course of the year. Resolution plans, some other things, may be susceptible to going biannual rather than annual. But, I think on the stress testing itself, as I said, it is probably more of a binary decision. You are either in or you are out.

Senator SCOTT. Thank you.

Chairman SHELBY. Thank you.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

You know, from my perspective, regional and midsized banks are different from the smallest community banks and credit unions, and the largest, as well, most complex financial companies. During the crisis, we saw how institutions like Countrywide, Washington

Mutual, IndyMac, that were outside the largest view, but not considered small, could impose stress on the financial system and costs on taxpayers. At the same time, midsized and regional banks generally have different structures, activities, risk profiles from the largest institutions.

So, I recognize, as someone who sat here during that whole period of time and was part of the Wall Street reform legislation, that no legislation is perfect, and the Wall Street Reform Act is no exception. As stockholders and our regulators gain experience with the rules, I think we can and should look for ways to improve the law. We should be open to calibration, however, in both directions, areas where protections may need to be strengthened and areas where the law may need careful tailoring to reduce costs of compliance and unintended consequences.

As the Committee considers whether to make changes to the Wall Street reform law, a law that many on this Committee fought and bled for, I hope we can strike the right balance between reducing compliance costs without undermining regulatory objectives. That would give business sufficient freedom to operate, but at the same time ensure strong protections for taxpayers, consumers, and investors.

And, as our economy continues to recover and parties get through the initial costs of complying with the new rules, I also hope we can distinguish between the impacts of new regulations as opposed to other external factors that may be affecting access to credit or business performance. For me, that is the framework in which I come to these hearings and these issues with.

So, with that as my objectives in mind, I have a few questions for our witnesses, who I appreciate both your service and your testimony here today.

Let me ask the three of you, you discussed in your testimony some of the steps your agencies have taken to tailor regulation and supervision for banks and bank holding companies within the enhanced prudential standards regime based on the different types of risks and challenges they present. And, while it is true that a bank does not have to engage in derivatives or complicated trading operations to create risk for taxpayers on the financial system—making bad loans can be enough, obviously—the appropriate supervisory tools may be different if a bank has a relatively simple organizational structure and transparent activities.

Can you discuss how your agencies take into account factors such as organizational structure and activities when making decisions about how to tailor your regulatory and supervisory standards.

Mr. CURRY. I think we do, and the particular area that I would like to focus on is what our expectations are for risk management. There, we are taking a very tailored approach to that individual institution. We are looking at their ability to identify the level of risks inherent in their business lines, what types of mechanisms do they have in place to detect and to address those issues and to basically have a strong, independent, credible risk management function that is buttressed by an equally strong audit function and strong corporate governance. That is a highly tailored view, basically focusing in on the structure of the institution, and by its very nature is tailored.

Mr. TARULLO. Yes, Senator. I would endorse what Tom just said, and let me just add that I think this is probably true for all three of our agencies. I know it is true in ours, which is to say when you think about what supervisory portfolio a bank belongs in, the asset amount is the starting point, but if you see a smaller institution that is engaged in derivatives activities to a substantial degree, we will change the kind of supervision that we do with that institution and hold them to different kinds of risk management standards.

But, by the same token, we do not want to say, OK, so all banks at $50 billion have to meet these supervisory expectations, because, in many instances, the risk is just not present in any significant degree.

The point all three of us were making in our testimony, is that in our regulation, by definition, something we do, we put in place, those are the rules people have to abide by. Our supervision, which is the important supplement to that regulation, is where I think we all exercise a lot of discretion in the kinds of expectations based on not just group but individual firm profiles, as well.

Senator MENENDEZ. So, when we have a, well, I will call it private panel, I think it is next week, they would say that they feel that they are——

Mr. TARULLO. Oh, I suspect——

Senator MENENDEZ. ——supervised in a way that is tailored in accordance with their realities of their organization and their functions?

Mr. TARULLO. I suspect a large number of bankers will think that we all pay a bit too much attention to them, but I think that is what you all want us to do, actually, is to be paying attention. I think when they can identify areas in which efficiencies can be gained through the supervisory process, not undermining our supervisory and regulatory ends of safety and soundness, I think we are certainly very receptive to those, and that is what we will continue to do.

Senator MENENDEZ. Well, let me ask——

Mr. TARULLO. I cannot guarantee you that banks are going to come and say they think we are just fine.

[Laughter.]

Senator MENENDEZ. I did not expect that, either.

Let me, if I may, Mr. Chairman, just follow up in a different—a follow-on question. As the Committee considers proposals to change financial stability measures, it is important, in my view, to distinguish between those that are aimed to reduce costs or prevent unintended consequences, which I would be inclined to support, and those that would create opportunities to evade or roll back fundamental protections.

Very clearly, not every proposal, I think, will be pure in its motives, but there are areas where improvement is possible without undermining core regulatory objectives or effectiveness. For example, are there ways to harmonize reporting requirements or streamline reporting based on the type of activities an institution is engaged in?

Mr. TARULLO. There are, and we are thinking about some of them, part of them through the FFIEC, the Council that all three of us belong to, some of them we are doing with bank holding com-

panies reporting to the Fed. The only thing I will point out there, Senator, is that there sometimes is a bit of a tradeoff, which is to say if we get more information, that sometimes allows us to have fewer examinations. And, if the bank is giving us regular information in a broad swath of areas, our supervisors can sit in a particular Reserve Bank and do an assessment which does not require them to go out, do the onsite, which takes up a lot more of the bank's resources. So, sometimes the net supervisory burden can be reduced a little bit paradoxically through providing more information.

Having said that, we are looking for ways to streamline all the reporting.

Senator MENENDEZ. Mr. Gruenberg.

Mr. GRUENBERG. Senator, there has been a particular focus through the FFIEC on the call reports and ways we may be able to identify to reduce reporting burden while still providing the information necessary to carry out supervision. I think there may be other opportunities.

Just to come back to your previous question on the resolution plans or living wills, we have really made an effort, particularly for those institutions under $100 billion, are to focus 165 plans on the nonbank, the holding company operations. For those under $100 billion, it is really the bank that is the principal activity of the institution. We have provided tailored plans for that universe of institutions that really simplifies the reporting and planning obligation, and almost all the institutions under $100 billion have taken advantage of that tailored plan opportunity.

Senator MENENDEZ. Thank you, Mr. Chair. Thank you for your answers. I just hope you will remain open to looking at all of those possibilities, because I think there is a desire by many of us to see that happen.

Thank you, Mr. Chairman.

Chairman SHELBY. I am going to recognize Senator Cotton, and then Senator Cotton, I believe that Senator Scott would want you to yield to him for a quick question.

Senator SCOTT. Just a quick question.

Chairman SHELBY. I will recognize you, and then it is up to you to yield, if you so choose.

Senator COTTON. I would be happy to yield to Senator Scott.

Senator SCOTT. No pressure. Thank you, sir.

Governor Tarullo, just one final thought and question for you. It is possible that a regional bank with $51 billion in assets could offer traditional simple banking services abroad as a service to its U.S. customers who travel. I would like your thoughts, please, as to whether the $10 billion in foreign exposure threshold for advance approaches regulation should remain a strict asset size test or whether it, too, should be based on factors that better predict systemic risk.

Mr. TARULLO. If you have a $50 billion bank that has $10 billion in international activity, that does not look like an oversized community bank. That is going to be a different kind of banking institution. My sense is that the $10 billion in foreign activity has worked pretty well in identifying a relatively small number of institutions that do pose different kinds of risks than a bank with a

similar size balance sheet, almost all of whose activities are domestic.

Senator SCOTT. Thank you. Thank you, sir.

Chairman SHELBY. Senator Cotton.

Senator COTTON. Thank you.

I will note that since Senator Scott and I share an apartment building and my wife is due with our first child in 5 weeks, I am going to take that as a return favor for one night of babysitting.

[Laughter.]

Senator SCOTT. For the sake of your child, I would say no.

Senator COTTON. That is a fair point.

[Laughter.]

Senator COTTON. So, thank you, Mr. Chairman, thank you, gentlemen, for appearing before us today.

When you consider the automatic SIFI threshold as a somewhat arbitrary number, but we have to draw arbitrary numbers in the law all the time, at $50 billion, you could imagine that it is also going to be diminishing in a way that monetary thresholds do but nonmonetaries do not because of inflation or expanding economy. The same could also be the case for other Dodd-Frank thresholds. And, I would just like to go down the line, if we could, and ask if you would support indexing thresholds in Dodd-Frank to inflation, to real GDP growth, or to any other kind of economic measure.

Mr. TARULLO. It is probably worth considering, Senator, but as the very last clause of your question suggested, it may not be as straightforward a matter to think what you would index it to. You know, would you index it to inflation, to GDP, to the total size of institutions, to concentration. So, I think it is worth thinking about, but my instinct is that inflation probably would not be the right thing to index it to.

Senator COTTON. Do you have an instinct on what would be?

Mr. TARULLO. If there were one, it would be GDP, but I would want to think about that a little bit more.

Senator COTTON. OK. Mr. Curry.

Mr. CURRY. I think indexing has some opportunities, as Governor Tarullo mentioned. But, again, I think the theme in our testimony is that we think that the asset threshold is one consideration in determining whether or not an institution is systemically significant or of heightened supervisory concern. There is a balance, I think, between the activities that the bank is engaged in and other factors that have to be considered, as well.

Mr. GRUENBERG. Senator, I think, conceptually, it is worth thinking about, and in some sense is hard to argue against, although the methodology may raise issues. On the other side of that, the clarity of having a clear threshold without adjusting it, in particular if there are sensitivities—because when you have a threshold, there are always going to be institutions on both sides of it. Having a clear threshold is clear and transparent and understood and may have some value.

I do think the key issue goes to providing some flexibility for the agencies, if you are going to set a threshold, to differentiate among firms that may be above the threshold, because wherever the threshold is, there are clearly going to be distinctions. Even if addi-

tional scrutiny is warranted, you want an ability to distinguish among the institutions to apply the appropriate standards.

Senator COTTON. OK. Governor Tarullo, I was not here in September. I was in the House, on the Financial Services Committee. But, in your opening statement to this Committee last September, you had said, quote, "There could also be some benefit from some statutory changes. One would be to raise the current $50 billion asset threshold that determines which banks are in the systemic category," end quote. Just 2 days ago, in front of my old colleagues on the House Financial Services Committee, Secretary Lew said that he opposes raising that threshold.

Did Secretary Lew or any other administration official take issue with your statement in front of the Financial Services Committee last fall?

Mr. TARULLO. Not directly to me, no, and I have not read the transcript of what Secretary Lew said. I read the press accounts of it. I think he was pointing to the discretion, the administrative flexibility that we do have. What I have been particularly focused on is the stress testing threshold.

Senator COTTON. When he says, not directly to you, indirectly to——

Mr. TARULLO. Well, he is saying——

Senator COTTON. ——anyone on your team, or——

Mr. TARULLO. No. Whatever he may be saying publicly, yes. That is——

Senator COTTON. OK. Thank you. I will yield back the balance of my time.

Chairman SHELBY. Governor Tarullo, conceptually, would you support the redrawing of the threshold lines, but with the discretion remaining with the regulator to decide whether a particular institution is systemic or not? In other words, you would keep that power.

Mr. TARULLO. Again, Senator, so long as we have the understanding that systemic is broader than just the failure of that institution bringing down the financial system.

Chairman SHELBY. Oh, yes.

Mr. TARULLO. I think that is when the thinking of the threshold makes some sense. The two qualifications, again, are, one, and I think you just said this, that our discretion should under no circumstances be removed to do more, and second, this has not come up in the hearing today, but just so that we remind ourselves of what is important for the Congress to do.

What the Congress has done following each financial crisis that we have had in the country, whether it was Latin American debt crisis in the early 1980s——

Chairman SHELBY. Sure.

Mr. TARULLO. ——late 1980s, S&Ls, Congress has stepped in and tried to adjust the behavior of the regulators and, in some sense, made some things mandatory. Prompt corrective action—and you were there, Senator to help with that—prompt corrective action made sure that we all had to take action when capital fell below a certain standard because of what happened in the S&L crisis.

In Dodd-Frank, what the Congress said was there are some areas where we think the regulators should be required to take ac-

tion. That is, they want to take some discretion out of our hands and say, you must have this kind of regulation. I think that is a sound idea. The only issue, to me, is really around those midsized regionals with the stress testing.

Chairman SHELBY. Mr. Curry, in September of last year, you were quoted in an American Banker article as saying, quote, and I am going to read it to you, "Fifty billion dollars was a demarcation at the time, but it does not necessarily mean you are engaged in that activity that the rules are trying to target. The better approach is to use an asset figure as a first screen and give discretion to the supervisors based on the risk in their business plan and operations. It is just too easy to say, this is the cut-off. I am a little leery of just a bright line." Do you stand by your words?

Mr. CURRY. Yes, Senator.

Chairman SHELBY. Thank you.

Mr. CURRY. I do think that is the approach that we have consistently applied at the OCC. Thank you.

Chairman SHELBY. Well, I do not think anybody up here has even, I hope, not even alluded to weakening your power to regulate. You have got to do that. We are just trying to give some relief where we think maybe it is—you could still intervene in a dangerous situation. And, if you do your job, you will. You will know, would you not, Governor? If you do your job as a regulator, you are going to know what banks are doing.

Mr. TARULLO. I hope so.

Chairman SHELBY. Yes. Do you agree with that, Mr. Curry?

Mr. CURRY. Yes.

Chairman SHELBY. Senator Warren mentioned a minute ago that two banks were grandfathered in in the legislation. Of course, that is politics. We know that. And, they are still in the commodities business. Does that—could that pose a risk to the—systemic risk to the banking system? Governor.

Mr. TARULLO. So, I think it is——

Chairman SHELBY. Could it?

Mr. TARULLO. You need to understand what Section 4(o) permits.

Chairman SHELBY. Uh-huh.

Mr. TARULLO. What Section 4(o) permits is not just, for example, taking title to physical commodities, the part of trading——

Chairman SHELBY. Sure.

Mr. TARULLO. It would allow the banks, for example, to own oil tankers, to own copper mines, to own extractive industries themselves. And, I think the issue here for you and for us is that with some of these activities, which certainly seem substantially to breach the wall between banking and commerce, they are the sort of things that are very hard to get a risk management handle on——

Chairman SHELBY. Oh, yes.

Mr. TARULLO. ——as a banking regulator. When you are talking about oil spills or you are talking about collapses of mines, it is very different from——

Chairman SHELBY. You would have to regulate commerce, in a way.

Mr. TARULLO. That has been my concern, Senator.

Chairman SHELBY. Uh-huh. But, you only have two banks that can do that.

Mr. TARULLO. That is correct.

Chairman SHELBY. And the others, no matter how big or how powerful or how well run, they could not do that.

Mr. TARULLO. That is correct.

Chairman SHELBY. OK. Senator Brown, do you have any more questions?

Senator BROWN. Thank you. A couple more questions. Thank you, Mr. Chairman.

Thank you for your comments about the commodities. We did a couple of hearings about that last year. I appreciate the Fed's engagement in that, and those were done some years ago, and those two institutions became bank holding companies, which changed all that. But, the comment you made about risk, oil tankers and others, to the safety and soundness—I mean, to the financial stability of the system is really important, so thank you for that comment.

Comptroller Curry, a question for you. We have talked both privately and publicly about the culture and environment of the banks and how banks pretty clearly over the years paid less attention to risk than they do now, partly because of regulators, partly because we maybe have a more independent OCC now, partly because of your insistence in discussions with them about a risk officer. We hear complaints, though, from banks about the time that their management and their board members dedicate to compliance issues and risk management. As we have discussed institutions tend not to like business lines that do not bring in revenue, understandably.

Talk to us for a moment about the value to institutions and to the public of having more management and board time spent on risk management.

Mr. CURRY. Thank you for raising the subject, Senator. We think it is critical in terms of having an internal framework that identifies risks and takes appropriate steps to mitigate those risks. We also think it implicates corporate governance. You need to have a board that is capable and willing to interject and to challenge management. So, we pay close attention to the dynamic between the board and operating management to make sure that there is a healthy risk culture.

Another area that we have emphasized is improving the stature of the Chief Risk Officer of an organization and their ability to help guide the decision making at the organization.

At the OCC, we have promulgated heightened standards that apply to the largest banks in our portfolio that mandates an appropriately robust risk management system for those institutions. And, it also has enforcement mechanisms tied into it so that it has teeth.

In terms of culture, it is really important, and this is something we look at in the context of risk management, is making sure that management of the organization establishes and enforces standards of conduct, that the failure to do so can result in significant financial and reputational losses to the institution.

Senator BROWN. Thank you. And, stature, the risk officer's stature, I assume, implies everything from compensation to seat at the table, the background with a company, to all the things that make that person one among equals in decision making at the highest levels of all kinds of banks, correct?

Mr. CURRY. Exactly, and that is what we are looking at from a corporate governance standpoint.

Senator BROWN. Thank you.

Governor Tarullo, I have been concerned about banks' ability to calculate their own internal risk weights and use that to game their capital ratios. It is a bit like a professor letting her students grade their own tests. Last week, you released the latest round of bank stress tests. Once again, the largest banks' internal loss projections were significantly rosier than the Fed's calculations. The industry complains this makes the tests a black box, of sorts. It seems they want the Fed to provide them with the answer key for the stress test.

Talk about the value of the Fed's projections. Why should we continue to rely on the independent evaluations?

Mr. TARULLO. OK. So, a couple of things there, Senator. First, I like the conclusion, which is you should continue to rely on our evaluations, because the evaluations we do are, first off, consistent. Second, they include an appropriate conservativism, I think, which is thinking on behalf of the country about what could happen under unlikely but still plausible adverse scenarios.

I think some of the reasons why you see those gaps between our assessment and some of the other banks vary, and some of those reasons are some cause for concern and others are less cause for concern. If you see the gap and it is because, for example, as you know, we do not allow the assumption in our stress test that banks would stop paying dividends and stop making share repurchases even during a stress period. That experience that we all went through in 2007 and 2008 was one that we all took to heart, and so when we do our very conservative assumptions, we assume that the banks will do what some of them did in 2007 and 2008, which is continue to distribute capital.

In their own idiosyncratic stress testing, banks sometimes do not do that, and it would be, believe me, a sensible thing for the bank to do, to cut back on its capital distribution. So, if that is a reason for variance, that is not of great concern to us because we put it in the supervisory test, but they have got to test for other purposes.

When we see problems that result from the inability of a bank to understand its own risks, to aggregate the data, that is when we are concerned and that is why we will come forth with supervisory action.

So, the reason why you want to look at our tests is because, obviously, we do not have an interest in shifting the loss parameters to help a particular bank's balance sheet, because we do it in a way that is comparable for everybody. We review it and we subject what we are doing to the review of outside experts. We try to improve it every year, and I believe it really has become a critical supervisory instrument for us, for the bank's own self-assessment, for the ability of outside analysts and investors to understand banks, and ultimately for all of you to keep watch on us.

Senator BROWN. Thank you.

If I could have one more question, Mr. Chairman.

Chairman SHELBY. Go ahead.

Senator BROWN. And, each of you give brief answers to this, if you would. Some have suggested the advanced approach regime is out of date and should only apply to the global, systemically important banks. Do you all continue to support the current advanced approaches regime? Mr. Gruenberg, start with you, a brief answer, and just go right to left.

Mr. GRUENBERG. Yes, Senator.

Senator BROWN. Yes. OK.

Mr. Curry.

Mr. CURRY. Yes.

Mr. TARULLO. I do, Senator.

Senator BROWN. OK. Thanks. Thank you.

Chairman SHELBY. Senator Rounds.

Senator ROUNDS. Mr. Chairman, thank you.

I have got to go back into this a little bit. Very seldom do we have an opportunity to have a group like this in front of us and not at least delve a little bit into the causal effects that we see in the economy today. I think some of the numbers that I had seen over a period of years was that since 2009, there has been an increase in employment in the financial services area of about 300,000 individuals throughout the United States, which would seem to be a positive thing, and which normally would suggest economic growth, and yet the vast majority of those 300,000, if my numbers are correct, were in the areas of compliance, which most individuals would suggest is not an indication of economic growth but one of costs directly back into the financial services sector.

If my numbers are correct, and if I am wrong, I would have you correct me, but if those numbers are correct, it seems to me that we add a burden within the financial services industry, we add an additional cost to all of those businesses and individuals that would need those services, because they are going to get passed on.

But, second of all, and there is a second part that it seems that we sometimes do not look at, and that is the regulatory impact on the economy itself. Governor, I am curious, because the Federal Reserve clearly has recognized that even after a time in which we had a significant slowdown in the economy, our expectation would be that there would be an increased period of economic activity, and yet over the last 4 or 5, 6 years, the Fed has continued to maintain a very inexpensive money policy, seemingly because there is the need to make this economy start to move.

Any possibility that the cause and effect of this is the Dodd-Frank Act and the impact that it has had on the availability of capital because of the regulatory environment that financial institutions find themselves in today?

Mr. TARULLO. So, Senator, let me just begin by saying that you did not really ask a question about monetary policy, but we are still in our blackout period, so I am not going to comment on the monetary policy.

Senator ROUNDS. OK.

Mr. TARULLO. Happy to comment on the regulatory issue, and let me begin with the compliance point. And, here again, I want to

really draw a distinction between compliance function at a community bank and compliance function at those largest institutions, and I am going to do it, if you will bear with me a bit, with an anecdote.

Back in 2009 at the height of the crisis, when we were conducting the first set of stress tests, we sent out in February a request for data to, at that time, the 19 largest financial institutions in the country. Some of those institutions more or less immediately were able to get back to us and say, here is the data, and it proved to be pretty accurate. Most took a while and then eventually gave us something that was more or less accurate. And, some of them, after a number of days, were still unable to put together an accurate picture of what their risks actually were.

The lesson I drew from that is that the inattention to risk management, which is the most important compliance function for the safety and soundness of institutions, had led to a situation in which the banks did not really know their own risks, much less allow us to do the job that Chairman Shelby just indicated we need to do, which is to go in and make sure we understand those risks.

I understand that there has been a big run-up in the number of people devoted to compliance at these institutions, at the big institutions, and I do not know whether the precise numbers are what we need, but I do know we needed a lot more attention to that.

Now, on the other end of the spectrum, I am concerned when I hear stories like the following, which is a community banker—I think he was about a $2 billion bank—and he said, "You know, we thought we would merge. We did merge with a bank just about our size. We thought that in doing so we would get some benefits of some modest economies of scale, serving a slightly bigger area while retaining the same business model." And, then, he sort of shook his head and he said, "So, our examiner comes in and says to us, 'Well, you are twice as big now. You should add a second compliance officer.'" That was what he was trying to avoid, and I have a lot of sympathy for that. I do have a lot of sympathy for that.

Tom mentioned the EGRPRA process. I think that is where our efforts are really focused, because the size of the portfolios of those community banks are sufficiently small that they cannot amortize those costs very well. But, this is, again, where I really do want to draw a distinction between the most complex institutions with heavy capital market activities, on the one hand, and the small bank, as Senator Scott was saying, in Columbia or Charleston or Orangeburg, that has a very limited base of assets.

Senator ROUNDS. I think in many cases, on the smaller banks, they feel as if their examiners are looking at them saying a lot of the things are coming downstream to them that are being applied to the larger banks.

Mr. TARULLO. The trickle down? The supervisory trickle-down effect?

Senator ROUNDS. I had a similar discussion with a small town banker who literally said, "Look, I cannot do home loans anymore. I just cannot do the compliance." And, when you start to see that in small communities in places like South Dakota, these are not the folks that were involved in any of the problems to begin with,

and yet they are the ones that are feeling the impact of this regulatory activity.

Thank you, sir. Thank you.

Chairman SHELBY. I am looking at the systemic importance indicators reported by large U.S. bank holding companies, $5 billion or more, and if you look at the methodology in the OFR report—this is part of it, we have referred to it—to measure systemic risk, the table here shows those two banks that we were talking about that were grandfathered in as being significantly more systemically risky than the regional banks to our system. Do you think that the methodology that the OFR report works here? Do you have a comment?

Mr. TARULLO. Senator, here, I would say the Basel Committee methodology, the Fed methodology for our SIFI surcharge, and the OFR methodology would all agree with that proposition.

Chairman SHELBY. OK. Thank you.

Do you disagree with that?

Mr. CURRY. No.

Mr. GRUENBERG. No, Mr. Chairman.

Chairman SHELBY. Thank you. I think we all basically agree here, we want banks that are healthy, that are strong, capitalized, well regulated, well managed, because without that, the economy, as Senator Rounds alluded to, it is all tied into our economy, the ability to access capital. Everybody—you, as regulators, know this. So, let us hope we can work together and try to give some relief here. Although Dodd-Frank was legislation, no legislation is perfect. Even Senator Menendez referred to that. Maybe we can work together. I hope so.

This concludes the hearing.

[Whereupon, at 11:39 a.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF DANIEL K. TARULLO

GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 19, 2015

Chairman Shelby, Ranking Member Brown, and other Members of the Committee, I appreciate the opportunity to testify on the threshold in section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for application of enhanced prudential standards to bank holding companies. In my testimony this morning I will try to provide, from a regulator's perspective, some context for the Committee's consideration of this subject by explaining how the Federal Reserve has differentially implemented prudential regulations based on the size, scope, and range of activities of banking organizations, as well as how we have organized our supervisory portfolios. In both our supervisory and regulatory practices, we are pursuing a tiered approach to prudential oversight.

Regulatory Differentiation in the Dodd-Frank Act

Traditionally, statutes creating prudential regulatory requirements or authorities generally took what might be termed a unitary approach. That is, the statutes simply made a particular requirement or authority applicable to banks or banking organizations generally, with few clear distinctions based on the characteristics of the regulated entities. The Federal banking agencies did adopt some regulations with requirements that applied only to larger institutions. And, as I will describe a bit later, through supervisory practice they administered some statutory requirements differently based on the size of banks and the scope of their activities. But the starting point was a more or less similar set of statutory requirements.

The Dodd-Frank Act explicitly broke with this traditional approach by creating prudential requirements that vary with the size or systemic importance of banking organizations. Of particular importance is the Dodd-Frank Act emphasis on financial stability, both in markets generally and with respect to the largest financial firms, which had been associated with market perceptions that they were too big to fail. The law created some new authorities for financial regulators and instructed regulators to use authorities they already had to put in place regulations to contain systemic risk. As to regulations applicable to individual firms, the Dodd-Frank Act creates thresholds for various prudential regulations at asset sizes of $1 billion, $10 billion, and $50 billion. Of special note is that section 165 of the Dodd-Frank Act requires the Federal Reserve to establish enhanced prudential standards for bank holding companies with total assets of $50 billion or more and other financial firms designated as systemically important by the Financial Stability Oversight Council. Among other areas, these standards include capital, liquidity, risk management, resolution planning, and single-counterparty credit limits. Of particular significance is the section 165 requirement that these enhanced standards increase in stringency depending on the size, interconnectedness, role in credit intermediation, and other factors specified in the law. In addition to these enhanced, graduated standards, section 165 requires that firms with greater than $50 billion in assets be subject to annual supervisory stress tests.

The Federal Reserve has implemented the section 165 requirement of graduated stringency for enhanced prudential standards by creating what are, in effect, three categories within the universe of banking organizations with $50 billion or more in assets. As required by statute, all firms within this universe are subject to basic enhanced standards. Firms with assets of between $50 billion and $250 billion are subject only to these basic enhanced standards. Firms with at least $250 billion in assets or $10 billion in on-balance-sheet foreign assets are also subject to more stringent requirements, including the advanced approaches risk-based capital requirements, the supplementary leverage ratio, the countercyclical capital buffer, and the fullscope liquidity coverage ratio.

Finally, the eight U.S. bank holding companies that have been designated as global systemically important banking organizations will be subject to an additional set of regulatory requirements. An enhanced supplementary leverage ratio, equally applicable to all eight firms, has already been adopted. We are also working on two requirements that will vary in stringency even among these eight firms, based on their relative systemic importance. One is the set of risk-based capital surcharges for which we issued a notice of proposed rulemaking late last year. The other, on which we anticipate issuing a notice of proposed rulemaking in the coming months, is a long-term debt requirement designed to support effective orderly resolution processes.

In sum, the stringency of the Federal Reserve's prudential regulations increases in proportion to the systemic importance of the banking organizations. With this tiered approach to regulation, the Federal Reserve aims not only to achieve the

Dodd-Frank Act goal of mitigating risks to U.S. financial stability, but to do so in a manner that limits regulatory costs and the expenditure of supervisory resources where not needed to promote safety, soundness, and financial stability.

Tiered Regulatory and Supervisory Experience

The Federal Reserve also takes a tiered approach to supervision. We organize the firms we supervise into portfolios based predominately, although not exclusively, on asset size. We have four such groups: (1) community banking organizations, which are generally those with $10 billion or less in total assets; (2) regional banking organizations, which have total assets between $10 billion and $50 billion; (3) large banking organizations, which have total assets over $50 billion but are not among the largest and most complex banking organizations; and (4) firms overseen by the Large Institution Supervision Coordinating Committee (LISCC), which are the largest and most complex banking organizations. [1]

As with tiered regulation, our tiered supervision is intended to take into account differences in business models, risks, relative regulatory burdens, and other salient considerations. Where specific regulatory goals for the different portfolios vary, the supervisory programs reflect those differences. And even where the goals are similar across portfolios, supervisory programs should nevertheless take account of the differences among the firms in the four portfolios. In general, we shape our supervisory expectations for each portfolio by considering the increase in safety and soundness that we are likely to achieve through a specific practice or requirement, in light of the regulatory costs for the banking organizations in the portfolio and the impact that the stress or failure of those institutions would likely have on credit intermediation, the deposit insurance fund, and financial stability.

So, for example, there are heightened expectations with regard to corporate governance for large banking organizations that are not applied to regional or community banking organizations. Among other areas, the Federal Reserve expects the boards of directors of these larger firms to set direction and oversight for revenue and profit generation, risk management, and control functions; to ensure that senior management has the expertise and level of involvement required to manage core business lines, critical operations, banking offices, and other material entities; and to maintain a corporate culture that emphasizes the importance of compliance with laws, regulation, and consumer protection. While strong corporate governance is important at all banking organizations, it is vital at large banking organizations, given that their systems and operations are typically much broader and more complex than those of the smaller-scale and more localized regional and community banking organizations.

While asset size is the principal determinant of the general supervisory program for a banking organization, other factors are taken into account as appropriate. For example, if a regional banking organization were to become involved in activities typically undertaken only by larger banking organizations, we might add to that firm's supervision an expectation or practice drawn from the large banking organization portfolio. Moreover, in determining which banking organizations belong in the LISCC portfolio, the Federal Reserve has focused on the risks to the financial system posed by individual firms—size has not been the dispositive factor. For example, three large banking organizations are not in that portfolio, even though they have larger balance sheets than the processing- and custody-focused bank holding companies that are in the LISCC portfolio. The stress or failure of these large, essentially regional banking organizations could have a serious effect on credit intermediation across a significant part of the country and, in some situations of generalized stress, might have consequences for the financial system as a whole. However, we judge that the functions of the two processing- and custody-focused LISCC firms implicate systemic concerns to a greater extent than the substantial balance sheets of the larger regionals.

The Role of Statutory Thresholds

As I hope by now is apparent, the Federal Reserve has done considerable work to tailor our supervision of banking organizations by reference to their size, business model, and systemic importance. Similarly, using the statutory discretion granted us, and frequently in cooperation with other regulatory agencies, we have also tailored the application of certain statutory requirements to different groups of banks. The question of statutory thresholds is thus a fairly narrow one: Does a threshold specify a cut-off point that is appropriate for mandatory application of a particular

[1] For more information on the LISCC, see *http://federalreserve.gov/bankinforeg/large-institution-supervision.htm.*

regulatory requirement, taking into account whatever discretion is given to the implementing regulatory agencies?

In answering this question, it is first worth noting the case for establishing such statutory thresholds. In the past, Congress has at times not simply given the banking agencies authority to engage in a particular form of prudential regulation, but has required that they do so. Capital regulation and prompt correction action are two examples. Not coincidentally, I think, congressional action followed banking crises that revealed possible shortcomings in the regulatory and supervisory structures that had existed preceding the crisis. In requiring certain kinds of prudential regulation, Congress was in effect protecting against memories of those problems fading and the consequent possibility of supervisory relaxation, which might allow for a recurrence of similar banking problems in the future.

The creation of mandatory thresholds for certain enhanced prudential standards is an important advance in the traditional congressional role of specifying a set of mandatory regulations. This statutory structure recognizes the substantially divergent risks presented to the economy and the financial system by the potential stress or failure of banking organizations of different sizes and with different activities, while preserving considerable discretion for the banking agencies in implementing those regulations. Here again, statutory enactment of mandatory measures for banking organizations of a certain size or systemic importance serves as a form of safeguard against the erosion of prudential oversight that could occur were predominant reliance to be placed on the details of firm-specific supervision, which are sometimes hard for the public to discern. Removal or change of such thresholds, as with generally applicable prudential requirements, will thus require congressional action and an occasion for considered public debate on the merits of such change.

Experience to date, however, suggests that there are some statutory thresholds that might bear reexamination. One pertains to the applicability of some Dodd-Frank Act provisions to community banks. For example, the Volcker rule and the incentive compensation requirements of section 956 of the Dodd-Frank Act are directed at concerns generally present only with larger institutions, but the Volcker rule by its terms applies to all banking organizations, and the incentive compensation provisions apply by their terms to all banking organizations with $1 billion or more in assets. The banking agencies have done their best to tailor the application of these rules to smaller banks and, indeed, to make clear the limited extent to which they should affect those banks. However, some compliance effort on these rules is still needed at community banks. Raising the asset threshold for these two requirements to $10 billion would eliminate this compliance burden, the cost of which is probably not worth whatever incremental prudential benefits might be gained at these small banks. Even in the relatively unusual circumstance in which a practice at a smaller bank might raise safety and soundness concerns, the supervisory process would remain available to rectify any problems.

The second threshold that is worth discussing is the $50 billion level established by section 165 of the Dodd-Frank Act. As noted earlier, the import of this threshold is to require enhanced prudential standards and supervisory stress testing for banking organizations whose assets exceed that amount. As also noted, the Federal Reserve has tailored those standards in accordance with the increasing stringency requirement of section 165, so that they are more flexible for institutions closer to the $50 billion threshold and most demanding for the eight firms of global systemic importance. It has been somewhat more difficult to customize supervisory stress testing. While some elements of the test, such as the market shock and single-counterparty default scenarios, are applied only to larger firms, the basic requirements for the aggregation and reporting of data conforming to our supervisory model and for firms to run our scenarios through their own models do entail substantial expenditures of out-of-pocket and human resources. This can be a considerable challenge for a $60 billion or $70 billion bank. On the other side of the ledger, while we do derive some supervisory benefits from inclusion of these banks toward the lower end of the range in the supervisory stress tests, those benefits are relatively modest, and we believe we could probably realize them through other supervisory means.

These are the factors that lay behind my suggestion last year that it might be worth thinking about the level of this threshold, which I understand to be a purpose of today's hearing. That said, I want to emphasize a few points. First, consideration of potential increases in the threshold for mandatory prudential measures should not remove the discretion of the banking agencies to require additional measures—including such things as more capital or liquidity—for specific firms or groups of firms in appropriate circumstances. That is, while it is sensible to limit mandatory measures for classes of firms where most banks in that class are unlikely to present

a particular kind of risk, it would be very ill-advised to preclude supervisors from requiring such measures of firms where that risk may become more of a concern.

Second, any consideration of raising the threshold to take account of the factors I mentioned earlier should not extend to removal of the application of enhanced standards and other rules to the largest banking organizations. As senators and regulators have discussed many times before in this Committee, the tasks of combating the reality and the perception of too big to fail, and of vulnerabilities in broader financial markets, are crucial and ongoing.

Conclusion

The innovation in the Dodd-Frank Act that requires tiered regulation is central to our shared goals of protecting financial stability and ensuring the availability of credit. Smaller banks do not pose risks to financial stability, though they can suffer collateral damage when stress builds throughout the financial system. And, while enhanced prudential standards are important to ensure that larger banks can continue to provide credit even in periods of stress, some of those same enhancements could actually inhibit credit extension by rendering the reasonable business models of middle-sized and smaller banks unprofitable. The Federal Reserve will continue to use statutory authorities to calibrate our regulation and supervision to the risks posed by the different classes of banks, avoiding a one-size-fits-all approach. We and, I believe, many others are committed to the dual goals of protecting systemic stability and fostering the efficient intermediation of credit by the overwhelming majority of American banks that do not pose systemic or far-reaching risks.

Thank you. I would be pleased to take any questions you may have.

PREPARED STATEMENT OF THOMAS J. CURRY

COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

MARCH 19, 2015

Introduction

Chairman Shelby, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to discuss the Office of the Comptroller of the Currency's (OCC) experience with, and views on, section 165 of the Dodd-Frank Act and the OCC's approach to tailoring our regulatory and supervisory expectations, especially with respect to regional banks, which include banks in the OCC's midsize program and many of those in our large bank program. Because the focus of section 165, as it applies to the banking sector, is on bank holding companies, almost all of the authorities under this section are assigned to the Board of Governors of the Federal Reserve System (Federal Reserve). The OCC's only direct rulemaking authority under section 165 is with respect to the company-run stress test requirements under section 165(i)(2). Otherwise, the OCC's role in section 165 is limited to a consultative one on matters affecting national banks. Nonetheless, the provisions of section 165 are extremely important to the OCC and our supervisory programs as national banks typically comprise a substantial majority of the assets held by bank holding companies with consolidated assets of $50 billion or more. Indeed, the national bank is typically the dominant legal entity within each company. Consequently, the provisions of section 165 have a significant effect on national banks and our supervisory oversight of those institutions.

My testimony today provides a brief overview of the key provisions of section 165 as they apply to bank holding companies. I then describe how the OCC's supervisory and regulatory tools complement and support the objectives of these provisions. As I will discuss, the OCC believes that the supervisory areas addressed in section 165 for which the Federal Reserve is required to develop prudential standards are fundamental to safe and sound banking and are essential elements of our ongoing supervision of national banks and Federal savings should reflect the complexity and risk of a bank's activities. This is why the OCC has tailored its supervisory programs into three distinct portfolios—community banks, midsize banks, and large banks. It is also why the OCC seeks to tailor the application of our supervisory standards and expectations to the size and complexity of each individual bank. In some areas, such as capital standards, we do this by setting explicit regulatory minimums that apply to all banks. We then augment these minimums with additional requirements for the largest banks that reflect the complexity and risk of their operations and their interconnections with the broader financial market. In other areas,

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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.

such as corporate governance, while our approach is more qualitative, we have higher expectations and apply higher standards as the complexity, risk, and scale of banks' operations increase. The OCC believes this flexibility to tailor supervisory and regulatory requirements to reflect our assessment of the risk of individual banks promotes an effective and efficient supervisory regime while minimizing undue burden.

As the Committee considers and evaluates the effectiveness of section 165 and the banks that are affected by its provisions, I would stress two points. First, I believe it is essential for the OCC to retain the ability to tailor and apply our supervisory and regulatory requirements to reflect the complexity and risk of individual banks. We believe our risk-based supervisory approach is consistent with the tailored application that Congress provided for in section 165. While a bank's asset size is often a starting point in our assessment of appropriate standards, it is rarely, if ever, the sole determinant. For this reason, we would be concerned with any proposal that would inhibit our ability to apply specific regulatory or supervisory tools to an individual bank or group of banks. We need access to these tools should we, through our supervision, determine that they are needed to address a bank or a group of banks' risk. Second, although the OCC in our role as the primary supervisor of national banks. We would be happy to work with the Committee should the Committee determine that changes are needed to make the application of section 165 more effective and efficient.

Overview of Key Section 165 Standards and Requirements for Bank Holding Companies

Section 165(a) of the Dodd-Frank Act authorizes the Federal Reserve on its own or pursuant to recommendations from the Financial Stability Oversight Council (FSOC) to establish certain heightened prudential standards for bank holding companies with total consolidated assets equal to or greater than $50 billion. Standards are required for five areas: (1) leverage and risk-based capital; (2) liquidity; (3) overall risk management; (4) resolution plan and credit exposures; and (5) concentration limits. The Federal Reserve is given discretionary authority to establish standards for: (1) contingent capital; (2) enhanced public disclosures; (3) short-term debt limits; and (4) any other prudential standards that the Federal Reserve, on its own or pursuant to a recommendation by the FSOC, determines are appropriate.

Section 165 directs that the standards should be more stringent than those required for bank holding companies that do not present similar risks to the financial stability of the United States (and thus, are not covered by section 165), and that the standards should increase in stringency, based on various qualitative risk factors. It also permits the standards to be tailored to individual or groups of banking organizations based on their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Federal Reserve deems appropriate. Finally, section 165 permits the Federal Reserve, pursuant to a standards related to the discretionary standards, listed above, and for the resolution plans and credit exposure reports.

Section 165 has two provisions that use a lower asset threshold than is used for the other prudential standards. These are the stress testing requirements in section 165(i) and the risk committee requirements in section 165(h). Under section 165(i), all banks and other financial companies (not just bank holding companies) with assets above $10 billion are required annually to conduct and publicly report the results of stress tests using scenarios developed by their primary Federal financial regulator. Section 165(h) requires publicly traded bank holding companies with assets of $10 billion or more to establish risk committees.

The Complementary Nature of Section 165 and the OCC's Supervisory Approach

A key principle underlying section 165 is that the rigor of capital, liquidity, and risk management standards and the intensity of supervisory oversight should increase with, and be reflective of, the risk and complexity of a banking organization's structure and activities. This principle also underlies the OCC's risk-based supervisory approach and programs, and it is one that we fully support.

As noted earlier, we begin the application of this principle by structuring our bank supervisory activities into three distinct portfolios—community banks, midsize banks, and large banks—to reflect the inherent differences in these banks' business models, risk profiles, and complexity. In this respect, while asset size is important and is generally the starting point in determining to which portfolio an individual bank is assigned, it is not the sole determinant. Thus, for example, while most banks in our midsize portfolio fall into the $8 to $50 billion range, model, corporate structure, and risk profile that are distinctly different from the banks in our large

bank portfolio, which typically have national or global operations, complex corporate structures, extensive activities and exposures in the wholesale funding and capital markets, or are part of a larger, complex financial conglomerate. This flexible approach, which considers both size and risk profiles, allows us to transition and adjust the intensity of our supervision and our supervisory expectations as a bank's profile changes.

Our midsize bank program is an example of how we tailor and transition our supervisory expectations as a bank's size and complexity increase. As noted above, the banks in this program range in size and, at the low end, may overlap with some banks that are in our community bank portfolio, and at the high end, overlap with banks that are in our large bank portfolio. Banks in our midsize portfolio are generally those that through growth and mergers have acquired a regional or multistate footprint, yet do not present the same level of complexity and interconnectedness as banks in our large bank program. A major focus of midsize supervision is ensuring that as the scale of each bank's operations and activities increases, so does its risk management and control systems. Banks in this program have a dedicated examiner-in-charge and a team of specialists for each core risk function that provide ongoing monitoring and continuity in our supervision of each bank. The individual examination program for each bank is tailored and may, depending on the complexity and risks of the particular area, draw examiners and blend examination procedures from both our community bank and large bank programs.

As I noted earlier, section 165 requires the development of prudential standards in various areas, including capital, liquidity, risk management, and concentrations. The OCC has, areas that we expect national banks and Federal savings associations to meet. This combination is reflected, for example, in our approach to assessing capital adequacy. Through regulation, we have established explicit, minimum capital requirements that all banks must meet. There are additional, explicit requirements related to market and operational risks that generally apply only to the largest banks that have significant trading activities and complex operations. Our capital rules, however, also allow us to require additional capital based on factors that are not explicitly covered by our quantitative capital rules, including for example, exposures to interest rate risk and credit concentrations. Our supervisory guidance on interest rate risk, concentrations, and capital planning set forth factors that examiners will consider when determining whether additional capital may be needed. The ability to require an individual bank to maintain capital levels above regulatory minimums is especially important when we encounter banks, regardless of size, that may have significant concentrations in certain loan products or market segments.

In the aftermath of the financial crisis, we, along with our U.S. and international supervisory colleagues, have been revising the standards for many of the areas specified in section 165 to strengthen those that apply to the most complex banking organizations and to better align them with risk in the system. With respect to leverage and risk-based capital requirements, the OCC, along with the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC), has implemented a number of enhancements that improve the quality and quantity of capital and impose additional, more stringent leverage ratio requirements for large, internationally active banks, with even higher levels required for the largest, most systemically important banks.[1] With respect to liquidity, in 2010, the OCC and other banking agencies issued an interagency policy statement on funding and liquidity risk management.[2] Consistent with our risk-based approach to supervision, the policy applies to all banks, but specifies that the processes and systems used by banks will vary, based on their size and complexity. In 2013, we, the Federal Reserve, and the FDIC augmented these qualitative expectations with explicit, quantitative liquidity requirements for large, internationally active banks.[3] These requirements, known as the Liquidity Coverage Ratio (LCR), set minimums for the level of high-qualityliquid-assets that a bank must maintain to cover its projected net cash outflows over a

[1] See September 9, 2014, testimony of Comptroller of the Currency Thomas J. Curry before the Committee on Banking, Housing, and Urban Affairs available at: *http://www.occ.gov/news-issuances/congressionaltestimony/2014/pub-test-2014-122-written.pdf* for a fuller description of these enhancements.

[2] See OCC Bulletin 2010-13 available at *http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-13.html.*

[3] Generally, these are banks with $250 billion or more in total consolidated assets or $10 billion or more in onbalance-sheet foreign exposure and any consolidated bank or savings association subsidiary of one of these companies that, at the bank level, has total consolidated assets of $10 billion or more.

30-day period.[4] The Federal Reserve separately adopted a modified LCR requirement for bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have $50 billion or more in total consolidated assets but are not internationally active.

As I discussed in an appearance before this Committee in September,[5] the OCC also has taken action to apply heightened risk management and corporate governance standards to large institutions. These standards address: comprehensive and effective risk management; the need for an engaged board of directors that exercises independent judgment; the need for a robust audit function; the importance of talent development, recruitment, and succession planning; and a compensation structure that does not encourage inappropriate risk taking. We issued the final standards as a new appendix to Part 30 of our regulations. Part 30 codifies an enforcement process set out in the Federal Deposit Insurance Act that authorizes the OCC to prescribe operational and managerial standards and is a valuable part of our regulatory toolbox. Under Part 30, if an insured bank fails to satisfy a standard, the OCC may require it to submit a compliance plan detailing how it will correct the deficiencies and how long it will take. Rather than prescribing a "one-size-fits-all" remedy, this approach allows us and the bank to implement actions that are appropriate to the bank's unique circumstances. The approach, however, does not diminish our ability to take more forceful action: we can issue an enforceable order if the bank fails to submit an acceptable compliance plan or fails in any material way to implement an OCC-approved plan.

We believe the expectations for a strong risk management culture, effective lines of defense against excessive or imprudent risk taking, and an engaged board of directors as set forth in our heightened standards are essential for all large banks with significant operations and size. We also recognize, however, that systems and processes that a bank may need to implement, such as culture and risk controls, will vary according to the size and complexity of the bank. Thus, our expectations for how the largest banks implement these standards are substantially more demanding than our expectations for banks with less extensive operations. This difference in expectations is reflected in the phased-in compliance dates we established such that the guidelines were effective immediately for the largest banks but are being phased-in for the other banks covered by our standards with lesser risk profiles. While our heightened standards generally apply to all insured national banks and Federal savings associations with consolidated assets equal to or greater than $50 billion, our rule provides us with the flexibility to determine that compliance with the standards is not required if a bank's operations are no longer highly are consistent with and complement the objectives of section 165, and they illustrate how we are able through our supervisory processes to apply, tailor, and adjust our standards to risks inherent in individual banks.

The only provision of section 165 for which the OCC has direct rulemaking authority is section 165(i)(2) with respect to the annual company-run stress testing requirements. As previously noted, this provision mandates that all banks with consolidated assets of more than $10 billion must conduct stress tests using at least three sets of economic conditions. The OCC issued its final rule to implement section 165(i)(2) in October 2012. The rule, which is consistent with and comparable to the stress test rules issued by the other Federal banking agencies, establishes methods for conducting stress tests and requires that the tests be based on at least three different economic scenarios (baseline, adverse, and severely adverse). The rule also requires banks to report test results in the manner specified by the OCC and publish a summary of their results.

In drafting the rule to implement this provision of the Dodd-Frank Act, the OCC, FDIC, and Federal Reserve worked to tailor the requirements as appropriate for the smaller, less complex firms. Thus, banks with consolidated assets of between $10 and $50 billion are only required to conduct the stress test once per year (versus the two submissions per year required for bank holding companies with consolidated assets in excess of $50 billion). They also do not have to develop their own stress testing scenarios, nor are they subject to a supervisory stress test. The rule provided a delayed implementation date for banks with between $10 and $50 billion in assets, thereby giving them time to prepare for their first stress test submission. The rule also extended the annual due date for submission of stress test results three months beyond the submission date required for banks with consolidated assets in excess of $50 billion, thereby providing the smaller banks more time in which to conduct their stress tests and report the results. Additionally, we developed a sub-

[4] See OCC Bulletin 2014-51 available at *http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-51.html.*

[5] See September 9, 2014, testimony noted above.

stantially abbreviated data reporting template for these smaller banks, thereby reducing the amount and granularity of data the institutions are required to provide to the agencies. The abbreviated data reporting templates have a further benefit of permitting these banks to publish simpler, less detailed public disclosures relative to the requirements for the $50 billion and over banks. The rule also delayed for a year the initial public disclosure for banks with less than $50 billion in assets. In addition, to reduce burden and avoid duplicative regulatory requirements, the OCC's rule permits disclosure of the summary of the stress test results by the parent bank holding company of a covered institution if the parent holding company satisfactorily complies with the disclosure requirements under the Federal Reserve's company-run stress test rule.

As the OCC noted in its final rule, the annual stress tests required by the Dodd-Frank Act are only one component of the broader stress testing activities that the OCC expects of banks. The OCC's more general and qualitative expectations are set forth in the 2012 interagency guidance on "Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets."[6] That guidance emphasizes that stress tests should be an integral part of a bank's risk management and capital planning framework and tailored to a bank's exposures, activities, and risks. It also sets out the broad principles that we expect banks to adhere to when conducting their stress tests. We have tailored separate guidance and tools for community banks to use to assess the impact of various stress scenarios on concentrations within their loan portfolios.[7]

Conclusion

The OCC is committed to a supervisory approach that appropriately tailors supervisory expectations and requirements to the scale, complexity, and risks of individual and groups of banks. We have structured our supervisory programs in a manner that allows us to adjust effectively and efficiently the intensity of our supervisory oversight as a bank's risk profile changes. We have used our regulatory tools and authorities to enhance and apply more rigorous capital, liquidity, and risk management requirements to large banks whose size, scope of operations, complexity, and interconnections with other financial institutions pose more risk to financial stability. While the OCC has taken most of these actions outside of Dodd-Frank section 165 authorities, we believe our actions and supervisory approach are consistent with and complement the objectives of section 165. As the primary supervisor of the Nation's largest banks, the OCC has a vital interest in ensuring a robust regime of prudential standards for these institutions and retaining the tools we have to effect such a regime.

PREPARED STATEMENT OF MARTIN J. GRUENBERG

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 19, 2015

Chairman Shelby, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify on the regulatory regime for regional banks. My testimony will begin with a profile of the large companies subject to the enhanced prudential standards requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). I then will describe how regulators have implemented the enhanced standards requirements. Finally, I will review various considerations important to any discussion of proposals to change these requirements.

Profile of Large Companies Subject to Section 165

Section 165 of the Dodd-Frank Act requires the Board of Governors of the Federal Reserve System (Federal Reserve) to establish enhanced prudential standards for certain groups of institutions. The Act defines these institutions to include bank holding companies with total consolidated assets equal to or greater than $50 billion and nonbank financial companies that the Financial Stability Oversight Council (Council) has designated for Federal Reserve supervision.

The companies that meet the $50 billion threshold for enhanced prudential standards represent a significant portion of the U.S. banking industry. As of December 31, 2014, 37 companies with combined assets of $15.7 trillion reported total assets greater than $50 billion. They owned a total of 72 FDIC-insured subsidiary banks

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[6] See OCC Bulletin 2012-14, available at: *http://www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-14.html.*

[7] See OCC Bulletin 2012-33, available at: *http://www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-33.html.*

and savings institutions, with combined assets of $11.3 trillion, or 73 percent of total FDIC-insured institution assets.

The 37 companies represent a diverse set of business models. The four largest companies, holding combined assets of $8.2 trillion, are universal banks that engage in commercial banking, investment banking, and other financial services. Another 20 companies holding $3.3 trillion in assets are diversified commercial banks that essentially take deposits and make loans. The remaining 13 companies, with a combined total of $4.2 trillion in assets, do not engage predominantly in traditional commercial banking activities. These companies include two investment banks, four custodial banks, two credit-card banks, one online bank, and four specialty institutions. The 37 institutions include eight U.S.-owned institutions that are designated as global systemically important banks by the Financial Stability Board. They include the four universal banks, two investment banks, and two custodial banks.

By way of contrast, the FDIC's *Community Banking Study* of December 2012 profiled institutions that provide traditional, relationship-based banking services. The FDIC developed criteria for the *Study* to identify community banks that included more than a strict asset size threshold. These criteria included a ratio of loans-to-assets of at least 33 percent, a ratio of core deposits-to-assets of at least 50 percent, and a maximum of 75 offices operating in no more than two large metropolitan statistical areas and in no more than three States. Based on criteria developed in the *Study*, 93 percent of all FDIC-insured institutions with 13 percent of FDIC-insured institution assets currently meet the criteria of a community bank. This represents 6,037 institutions, 5,676 of which have assets under $1 billion. The average community bank holds $342 million in assets, has a total of six offices, and operates in one State and one large metropolitan area.

The FDIC does not have a similar set of criteria to identify regional banks. Regional banks may be thought of as institutions that are much larger in asset size than a typical community bank and that tend to focus on more traditional activities and lending products. These institutions typically have expanded branch operations and lending products that may serve several metropolitan areas and they may do business across several States. Regional banks are less complex than the very largest banks, which may have operations and revenue sources beyond traditional lending products.

The 20 holding companies identified as diversified commercial banks—the subset of the 37 institutions with total assets over $50 billion noted earlier—have a traditional banking business model that involves taking deposits and making loans, and they derive the majority of their income from their lending activities. Operationally, however, the 20 diversified commercial banks are much more complex than traditional community banks. They operate in a much larger geographic region, and have a much larger footprint within their geographic region.

Of the 20 holding companies:

- Seven have total assets from $50 billion to $100 billion. They have an average of nearly 700 offices, and operate in 12 States and 22 large metropolitan areas.
- Nine have assets from $100 billion to $250 billion. They have an average of nearly 1,200 offices, and operate in 12 States and 24 large metropolitan areas.
- Four have total assets from $250 billion to $500 billion. They have an average of nearly 1,800 offices, and operate in 18 States and 24 large metropolitan areas.

The operational complexity of these 20 diversified commercial bank holding companies presents challenges that community banks do not. Supervisory tools and regulations need to match the complexity of these large $50 billion plus organizations. Any particular institution at the lower to middle part of the grouping may be a dominant player within a particular geographic or market segment and as such may require greater regulatory attention. If there would be a failure, the resolution of any one of these organizations may present challenges. In addition, the failure of more than one of these institutions during a period of severe financial stress could present challenges to financial stability.

Implementation of Enhanced Prudential Standards

Section 165 provides the FDIC with explicit responsibilities in two substantive areas related to prudential supervision: resolution plans and stress testing. In both areas, the FDIC has tailored requirements to fit the complexity of the affected institutions.

Resolution Planning

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. The plans also provide important information to regulators, so they can better prepare for failure to protect markets and taxpayers.

In 2011, the FDIC and the Federal Reserve jointly issued a final rule implementing the resolution plan requirements of Section 165(d) of the Dodd-Frank Act (the 165(d) rule) for bank holding companies. The FDIC also issued a separate rule that requires all insured depository institutions (IDIs) with greater than $50 billion in assets to submit resolution plans to the FDIC for their orderly resolution through the FDIC's traditional resolution powers under the Federal Deposit Insurance Act (FDI Act). The 165(d) rule and the IDI resolution plan rule are designed to work in tandem by covering the full range of business lines, legal entities, and capital-structure combinations within a large financial firm.

Bank holding companies with $50 billion or more in total consolidated assets and nonbank financial companies regulated by the Federal Reserve are subject to the requirement to prepare resolution plans. However, the FDIC and the Federal Reserve used our statutory discretion to develop a joint resolution planning rule which recognizes the differences among institutions and scales the regulatory requirements and potential burdens to the size and complexity of the institutions subject to that rule. The joint rule also allows the agencies to modify the frequency and timing of required resolution plans.

Our resolution plan regulations also are structured so that both firms and regulators are focused on the areas of greatest risk. Smaller, simpler, and less complex institutions have much smaller and simpler resolution plans than more systemic institutions, with complex structures, multiple business lines, and large numbers of legal entities.

In implementing the requirement for resolution plans, the FDIC and the Federal Reserve instituted a staggered schedule for plan submissions to reflect differing risk profiles. The first group of companies required to file plans on or before July 1, 2012, included bank holding companies with $250 billion or more in nonbank assets. This group comprised 11 institutions—seven U.S. bank holding companies and four foreign banking organizations. These institutions generally ranked among the largest institutions in the United States, although some equally large institutions with smaller amounts of nonbank assets, did not file in this group.

The second group was comprised of bank holding companies with $100 billion or more, but less than $250 billion, in total nonbank assets. These firms submitted their initial resolution plans on or before July 1, 2013. The remaining companies, those subject to the rule with less than $100 billion in total nonbank assets, submitted their initial plans on or before December 31, 2013.

Grouping the firms by their holdings of nonbank assets provided the agencies with an initial proxy for firm complexity. By delaying the submission of plans for those with fewer nonbank assets, less complex firms were given more time to prepare. The FDIC and the Federal Reserve also were able to focus on those firms that are more likely to pose serious adverse effects to the U.S. financial system should they need to be resolved under the Bankruptcy Code. Based on their groupings and measured by asset size as of December 2011, no U.S. bank holding company (BHC) with less than $200 billion in total consolidated assets was required to file with either the first or second group of filers.

For their initial submissions, bank holding companies with less than $100 billion in total nonbank assets and 85 percent or more of their assets in an insured depository institution also were generally permitted to submit tailored resolution plans. Tailored resolution plans simplify the task of creating a living will by aligning it with the FDIC's IDI resolution plan requirement and focusing on the firm's nonbank operations. Since the initial filings, the FDIC and Federal Reserve have further recognized differences among institutions with less than $100 billion in nonbank assets and nearly all U.S. institutions in this category filed tailored plans.

Though smaller firms are less systemic, appropriately tailored resolution plans or other enhanced prudential supervision requirements for these firms provide important benefits. Any particular institution at the lower to middle part of the grouping may be a dominant player within a particular geographic or market segment, and its failure would likely have a sizeable impact for those markets. The Deposit Insurance Fund also would face a substantial loss from the failure of even one of these firms. Finally, the size of these firms presents an obstacle in arranging the sale to another firm as only other larger firms would be likely acquirers. Therefore, the FDIC and Federal Reserve should continue to receive and review resolution plans in order to ensure that a rapid and orderly resolution of these companies through bankruptcy could occur in a way that protects taxpayers and the economy.

Stress Testing

Section 165(i)(2) of the Dodd-Frank Act requires the Federal banking agencies to issue regulations requiring financial companies with more than $10 billion in total consolidated assets to conduct annual stress tests. The statutory language governing stress testing is more detailed and prescriptive than the language covering other prudential standards, leaving the regulators with less discretion to tailor the stress testing process. The Act requires IDIs and BHCs with assets greater than $10 billion to conduct an annual company-run stress test, while BHCs with assets greater than $50 billion must conduct semiannual, company-run stress tests and also are subject to stress tests conducted by the Federal Reserve. The company-run tests must include three scenarios and the institutions must publish a summary of the results.

In October 2012, the FDIC, OCC, and the Federal Reserve issued substantially similar regulations to implement the company-run stress test requirements. The FDIC's stress testing rules, like those of the other agencies, are tailored to the size of the institutions consistent with the expectations under section 165 for progressive application of the requirements. Under the agencies' implementing regulations, organizations in the $10 billion to $50 billion asset size range have more time to conduct the tests and are subject to less extensive informational requirements, as compared to larger institutions. Currently, 107 IDIs are subject to the banking agencies' stress testing rules, with the FDIC serving as primary Federal regulator for 28 of these IDIs.

Stress testing requirements are an important risk-assessment supervisory tool. The stress tests conducted under the Dodd-Frank Act provide forward-looking information to supervisors to assist in their overall assessments of a covered bank's capital adequacy and to aid in identifying downside risks and the potential impact of adverse outcomes on the covered bank. Further, these stress tests are expected to support ongoing improvement in a covered bank's internal assessments of capital adequacy and overall capital planning.

Other Regulatory Standards Affecting Regional Banks

Many of the standards required under section 165 address issues that are within the longstanding regulatory and supervisory purview of the Federal banking agencies. For example, with respect to banking organizations, the agencies have preexisting authority to establish regulatory capital requirements, liquidity standards, risk-management standards, and concentration limits, to mandate disclosures and regular reports, and to conduct stress tests or require banking organizations to do so. 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.

The FDIC's capital rules are issued pursuant to its general safety and soundness authority and the FDI Act. In many cases, FDIC capital regulations and those of other Federal banking agencies are consistent with standards developed by the Basel Committee on Banking Supervision. For example, recent comprehensive revisions to the agencies' capital rules and the liquidity coverage ratio rule incorporated aspects of the Basel III accord, which was developed separate and independent from, and mostly before, the Dodd-Frank Act was finalized.

These capital and liquidity rules play an important role in promoting the safety and soundness of the banking industry, including regional and larger banks. The agencies' capital rules are entirely consistent with the statutory goal in section 165 of progressively strengthening standards for the largest institutions. As a baseline, a set of generally applicable capital rules apply to all institutions. A defined group [1] of large or internationally active banking organizations are subject to more extensive U.S. application of Basel capital and liquidity standards. In addition, eight Global Systemically Important Banks (G–SIBs) are subject to enhanced supplemental leverage capital requirements.

Policy Considerations

Section 165 establishes the principle that regulatory standards should be more stringent for the largest institutions. This idea is rooted in the experience of the financial crisis, where the largest financial institutions proved most vulnerable to sudden market-based stress, with effects that included significant disruption of the real economy. The thresholds in the enhanced prudential standards legislative framework state Congress's expectation for the asset levels at which enhanced regu-

[1] This group consists of banking organizations with total assets of at least $250 billion or foreign exposures of at least $10 billion.

latory standards should start to apply, while providing for regulatory flexibility to set the details of how those standards should progress in stringency.

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.

That being said, it is appropriate to take into account differences in the size and complexity of banking organizations when formulating regulatory standards. The Federal banking agencies have taken into account such differences in a number of contexts separate and apart from section 165. Examples include asset thresholds for the interagency capital rules, trading book thresholds for the application of the market risk rule, and proposed notional derivatives thresholds for margin requirements. These examples and other size thresholds illustrate that precedents exist apart from section 165 for the application of different and heightened regulatory standards to larger institutions, and that different size thresholds may be appropriate for different types of requirements. Finally, many of the rules that apply to more complex capital market activities do not apply, as a practical matter, to the types of traditional lending activities that many regional banks conduct.

Conclusion

Section 165 provides for significant flexibility in implementation of its 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. The FDIC remains open to further discussion on how best to tailor various enhanced prudential standards and other regulations and supervisory actions to best address risk profiles presented by large institutions, including regional banks.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM DANIEL K. TARULLO

Q.1. Governor Tarullo, we talked about the Federal Reserve's tiering of enhanced prudential standards, however, there seemed to be some disagreement about how the tiering works.

Please explain: Each enhanced prudential standard that applies to bank holding companies with $50 billion in total assets.

A.1. In February 2014, the Federal Reserve adopted a final rule implementing enhanced prudential standards under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for bank holding companies and foreign banking organizations, each with $50 billion or more in total consolidated assets (Regulation YY). For bank holding companies with total consolidated assets of $50 billion or more, Regulation YY incorporated as enhanced prudential standards the previously issued capital planning and stress-testing requirements, and imposed enhanced liquidity requirements, enhanced risk-management requirements, and a debt-to-equity limit for those companies that the Financial Stability Oversight Council (Council) has determined pose a grave threat to the financial stability of the United States.

For a foreign banking organization with total consolidated assets of $50 billion or more, Regulation YY implemented enhanced risk-based and leverage capital requirements, liquidity requirements, risk-management requirements, stress testing requirements, and the debt-to-equity limit for those companies that the Council has determined pose a grave threat to the financial stability of the United States. In addition, it required foreign banking organizations with U.S. non-branch assets, as defined in Regulation YY, of $50 billion or more to form a U.S. intermediate holding company and imposed enhanced risk-based and leverage capital requirements, liquidity requirements, risk-management requirements, and capital-planning and stress-testing requirements on the U.S. intermediate holding company.

In addition to the enhanced prudential standards in Regulation YY, the Board has strengthened capital requirements applicable to all banking organizations through comprehensive revisions to its capital framework (revised capital framework). Further, the Resolution Plans rule (Regulation QQ), adopted in October 2011, requires bank holding companies with assets of $50 billion or more and nonbank financial firms designated by the Council for supervision by the Board to annually submit resolution plans to the Board and the Federal Deposit Insurance Corporation (FDIC).

Finally, as part of the liquidity coverage ratio (LCR) rule (Regulation WW), adopted in September 2014 as an enhanced prudential standard, the Board will apply a less stringent modified LCR requirement to bank holding companies and certain savings and loan holding companies that have $50 billion or more in total assets, but less than $250 billion in total consolidated assets or $10 billion in on-balance-sheet foreign exposure. As described in (b) below, the Federal Reserve also will apply the more stringent LCR requirement to all banking organizations with $250 billion or more in total consolidated assets. In addition, the banking organizations subject to the less stringent modified LCR requirements are required to report their LCR monthly rather than daily as required of those

banking organizations with $250 billion or more in total consolidated assets.

Q.2. Each enhanced prudential standard that applies to bank holding companies with $250 billion in assets or $10 billion in foreign exposures; and

A.2. Regulation WW also will apply to all banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure (advanced approaches banking organizations) and to these banking organizations' subsidiary depository institutions that have assets of $10 billion or more.

Advanced approaches banking organizations are subject to heightened risk-based and leverage capital requirements under the Federal Reserve's revised capital framework. For instance, these firms must reflect changes in accumulated other comprehensive income in regulatory capital, and hold an additional buffer of capital if the Federal banking agencies determine that the economy is experiencing excessive credit growth, as well as meet a minimum supplementary leverage ratio requirement of 3 percent.

Q.3. Any other enhanced prudential standards that may apply, including the thresholds upon which that applicability is based.

A.3. The Board has adopted risk-based and leverage capital surcharges applicable to the largest, most systemically important U.S. bank holding companies globally systemically important financial banking organizations (G–SIBs). Effective January 1, 2016 (subject to transition arrangements), a bank holding company that is designated as a G–SIB is subject to a risk-based capital surcharge (G–SIB surcharge) above its minimum regulatory capital requirements. The amount of the G–SIB surcharge is calibrated to each firm's overall systemic risk. In addition, effective January 1, 2018, a G–SIB must maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3 percent, for a total of more than 5 percent (enhanced supplementary leverage ratio).[1] Failure to maintain capital above the G–SIB surcharge or supplementary leverage ratio will result in restrictions on capital distributions and certain discretionary bonus payments.

Q.4. Governor Tarullo, we talked about stress tests.

In a submission for the record, one regional bank stated that the leverage a risk-based capital requirement under section 165(b) of the Dodd-Frank Act "is primarily manifested through higher risk-based capital standards and through the annual Comprehensive Capital Analysis and Review (CCAR)." We have heard from other regional banks that the Federal Reserve is using CCAR to satisfy 165(b)'s enhanced risk-based capital and leverage standards.

What is the legal authority for CCAR and which enhanced prudential standard does CCAR satisfy?

A.4. In the Comprehensive Capital Analysis and Review (CCAR), the Federal Reserve evaluates whether a bank holding company

[1] IDI subsidiaries of covered bank holding companies must maintain at least a 6 percent supplementary leverage ratio to be considered "well capitalized" under the banking agencies' prompt corrective action framework.

has effective capital planning processes and sufficient capital to absorb losses during stressful conditions, while meeting obligations to creditors and counterparties and continuing to serve as credit intermediaries. The Federal Reserve derives its authority for CCAR from the Bank Holding Company Act (BHC Act) and the International Lending Supervision Act. Specifically, section 5 of the BHC Act (12 U.S.C. 1844) authorizes the Board to issue regulations and orders, and to collect and require reports from bank holding companies.[2] Further, the Federal Reserve's rulemaking authority to set regulatory capital requirements and standards for bank holding companies is found in sections 908 and 910 of the International Lending Supervision Act, as amended (12 U.S.C. 3907 and 3909).

In addition, the Dodd-Frank Act expressly directed the Federal Reserve to impose enhanced prudential standards on large bank holding companies to prevent or mitigate risks to the financial stability of the United States. These standards must include enhanced risk-based and leverage capital requirements, among other requirements. The capital plan rule, which governs CCAR, serves as enhanced risk-based and leverage capital standards for large bank holding companies.[3] In addition, the Dodd-Frank Act mandates that the Federal Reserve conduct annual stress tests on large bank holding companies to determine whether large bank holding companies have the capital needed to absorb losses in baseline, adverse, and severely adverse economic conditions. These stress tests are integrated into the ongoing assessments of a bank holding company's required capital and are an important component of the annual assessment of capital plans.[4]

Q.5. How is the Federal Reserve satisfying the 165(b) enhanced risk-based capital and leverage standards?

A.5. The Federal Reserve has strengthened the capital requirements applied to all banking organizations it supervises and, in keeping with the mandate established by section 165 for progressively more stringent prudential standards to be applied to banks of greater systemic importance, the Federal Reserve has also established several tiers of enhanced requirements.[5] In July 2013, the Federal Reserve issued a final rule to comprehensively revise the capital regulations applicable to banking organizations (revised capital framework).[6] The revised capital framework strengthens the definition of regulatory capital, generally increases the minimum risk-based capital requirements, modifies the methodologies for calculating risk-weighted assets, and imposes a minimum generally applicable leverage ratio requirement of 4 percent for all banking organizations.

The Federal Reserve's capital plan rule serves as an enhanced risk-based capital and leverage standard by helping to ensure that bank holding companies with assets above the threshold estab-

[2] Section 616(a) of the Dodd-Frank Act amended section 5(b) of the BHC Act (12 U.S.C. 1844(b)) to specifically authorize the Board to issue regulations and orders relating to capital requirements for bank holding companies.

[3] See 12 CFR 225.8.

[4] See 12 CFR part 252, subpart E.

[5] See 12 CFR part 252. Regulation YY imposes risk-based capital and leverage requirements on U.S. intermediate holding companies of foreign banking organizations. These requirements are generally the same as those described above for bank holding companies.

[6] See 78 FR 62018 (October 11, 2013).

lished by Congress in section 165 hold sufficient capital to meet obligations to creditors and other counterparties and serve as financial intermediaries during periods of stress.

The revised capital framework imposes additional requirements on large, complex organizations that are internationally active and subject to the banking agencies' advanced approaches risk-based capital rules. For instance, these firms must reflect changes in accumulated other comprehensive income in regulatory capital, hold an additional buffer of capital if the Federal banking agencies determine that the economy is experiencing excessive credit growth, and meet a minimum supplementary leverage ratio requirement of 3 percent.[7] This supplementary leverage ratio is developed to help reduce risk to U.S. financial stability and improve the resilience of the U.S. banking system by limiting the amount of leverage that a banking organization may incur.

Finally, the Federal Reserve has adopted both a risk-based and leverage capital surcharge applicable to the largest, most systemically important U.S. bank holding companies (G–SIBs). A bank holding company that is designated as a G–SIB will be subject to enhanced supplementary leverage ratio standards through application of a "leverage buffer" of 2 percent (in addition to the minimum supplementary leverage ratio of 3 percent).[8] In addition, the G–SIB will be subject to a risk-based capital surcharge that is calibrated to each firm's overall systemic risk.[9] These enhanced risk-based and leverage capital standards are designed to help reduce the probability of failure of systemically important banking organizations, thereby mitigating the risks to the financial stability of the United States posed by these organizations.

Q.6. During the Committee hearing on March 24th, Deron Smithy, the Treasurer for Regions Bank, said:

> [A]t the $50 billion level, we are subject to enhanced standards, which, again, as I mentioned, includes stress tests, which frankly we think are a good idea. I will fully stipulate that pre-crisis the banking industry was in greater need of enhanced risk management practices and stronger internal modeling, stronger capital planning activities. I think the stress test that emanated from the original SCAP and have evolved into CCAR are a good thing. As a matter of fact, we built our whole entire capital planning process and strategic planning process around the stress testing framework . . . Where it becomes more challenging or restrictive is, as part of the CCAR process, there is a stress test that the Fed conducts on banks, and

[7] A U.S. banking organization is subject to the advanced approaches rule if it has consolidated assets of at least $250 billion, if it has total consolidated on-balance sheet foreign exposures of at least $10 billion, if it elects to apply the advanced approaches rule, or it is a subsidiary of a depository institution, bank holding company, or savings and loan holding company that uses the advanced approaches to calculate risk-weighted assets. See 78 FR 62018, 62204 (October 11, 2013); 78 FR 55340, 55523 (September 10, 2013); 79 FR 57725 (September 26, 2014).

[8] See 79 FR 24528 (May 1, 2014). In addition, all insured depository institution subsidiaries of such bank holding companies would be subject to an enhanced supplementary leverage ratio of 6 percent in order to be considered well-capitalized under the prompt corrective action framework.

[9] See "Regulatory Capital Rules: Implementation of Risk-based Capital Surcharges for Global Systemically Important Bank Holding Companies", available at: *www.federalreserve.gov/newsevents/press/bcreg/bcreg20150720a1.pdf*.

> there is an outcome from that stress test in terms of losses. And at the end of the day, our capital levels that we must manage to, despite what we calculate internally, the binding constraint becomes what the Fed calculates for us. And so one of the challenges—there are certain asset classes and products where the Fed sees risk just inherently higher than do the banks.

Do you continue to believe that stress testing is not appropriate for regional banks?

A.6. Rigorous stress testing helps to compensate for the somewhat backward-looking nature of conventional capital requirements by assessing on a forward-looking basis the losses that would be suffered by a bank under stipulated adverse economic scenarios. In doing so, capital can be built and maintained at levels high enough for banks to withstand such losses and still remain viable financial intermediaries. The importance of this aim is reflected in Congress' mandate, via the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), to require annual supervisory stress tests for bank holding companies (BHCs) with $50 billion or more in assets and to require company-run stress tests for institutions with $10 billion or more in assets. These stress tests allow supervisors to assess whether firms have enough capital to weather a severe economic downturn and contribute to the Federal Reserve's ability to make assessments of the resilience of the U.S. banking system under stress scenarios.

As I stated in my testimony, it has been somewhat difficult to customize the supervisory stress tests that are required by the Dodd-Frank Act. While some elements of the test, such as the market shock and single counterparty default scenarios, are applied only to larger firms, the basic requirements for the aggregation and reporting of data conforming to our supervisory model and for firms to run our scenarios through their own models entail substantial expenditures of out-of-pocket and human resources. This can be a considerable challenge for a $60 billion or $70 billion bank. On the other side of the ledger, while we do derive some supervisory benefits from the inclusion of these banks toward the lower end of the range in the supervisory stress tests, those benefits are relatively modest, and we believe we could probably realize them through other supervisory means. This is why I have suggested that it may be appropriate to raise the threshold to $100 billion.

Dodd-Frank Act stress testing is a complementary exercise to the Comprehensive Capital Analysis and Review (CCAR), an annual exercise by the Federal Reserve to assess whether bank holding companies with $50 billion or more in assets have rigorous, forward-looking capital planning processes and sufficient capital to continue to operate through times of extreme economic and financial stress. Because we generally believe that smaller institutions would not impose sizable negative externalities on the U.S. financial system in the event of their stress or failure and that the regulatory costs to these institutions of complying with CCAR far outweigh any supervisory benefit that might result, we do not subject them to CCAR. We believe, however, that all banking organiza-

tions, regardless of size, should have the capacity to analyze the potential impact of adverse outcomes on their financial condition.

Q.7. We discussed the importance of the Fed's separate stress testing evaluations. How do you respond to Mr. Smithy's comments?

A.7. As noted above, with the CCAR, the Federal Reserve evaluates whether BHCs with total consolidated assets greater than $50 billion have sufficient capital to continue operations throughout times of economic and financial market stress. To do so, the Federal Reserve uses its own independent, validated models, with detailed data provided by the banks, to project post-stress capital ratios that are applied consistently across all subject firms. By using the same set of scenarios, models, and assumptions, the supervisory stress test ensures the comparability of results across various firms. The results of supervisory stress tests and a BHC's own stress tests may differ for a number of reasons, including modeling techniques, key assumptions, and accounting treatments. For example, the Federal Reserve uses an expected loss framework for estimating loan losses, which pulls losses forward, while firms may produce accounting-based loss estimates, which tend to be more spread out over time. These differences can result in divergence in projected loan losses for the same portfolio.

Qualitative assessments in CCAR do not consider differences in quantitative outcomes between supervisory stress tests and the banks' own stress tests, but rather focus on the banks' capital planning processes, including banks' internal stress testing practices. We want to encourage firms to think innovatively about risk management and that can mean adopting different modeling approaches. We believe that looking at capital adequacy from multiple perspectives and under multiple models is useful for understanding vulnerabilities under a range of scenarios.

Q.8. Should Members of the Committee be concerned by the March 23 *Wall Street Journal* report that there is a $400 million discrepancy between the loss estimates of the Federal Reserve and Zions Bank related to Zions' CDO portfolio? If not, why not?

A.8. As noted in response to Question 2, there are numerous reasons why a bank's own estimate of losses may vary from the estimate generated in our supervisory stress tests. An assessment of the reasons for significant variations is part of our qualitative assessment of a firm's capital planning process. In any case, investors and the public know that the Federal Reserve's estimates are based on models and assumptions applied consistently to all CCAR banks.

Q.9. Governor Tarullo, you have said—both in speeches and your testimony—that it may be appropriate to lift the $50 billion threshold for enhanced prudential standards generally, and particularly for stress tests. In addition to section 165, a number of other provisions of Dodd-Frank use a $50 billion threshold.

Would you also support lifting the $50 billion thresholds for the following provisions:

a. Section 163
b. Section 164
c. Section 166

d. Section 210
e. Section 726
f. Section 763
g. Section 765

A.9. In the Dodd-Frank Act, Congress used the $50 billion threshold for the mandatory application of a number of regulatory requirements, including those cited above. Establishing such statutory thresholds is a useful means of not merely giving banking agencies the authority to engage in a particular form of prudential regulation, but requiring that they do so. In that way, Congress was in effect guarding against memories of the problems the provisions were meant to protect fading and the consequent possibility of supervisory relaxation, which might allow for a recurrence of similar banking problems in the future.

The requirements for mandatory application of the provisions in sections 163, 164, 166, and 210 seem to me similar to those in section 165. Thus I would be inclined to raise the threshold in these sections, with the important caveat—as with section 165—that Congress should be clear it is not restricting the authority of the Federal Reserve to use its discretion to apply additional requirements to any bank, as needed for prudential reasons.

The thresholds in Title VII have a somewhat different purpose and effect, more relevant to the activities of market regulators, to whose judgment I would defer on the issue of raising these thresholds.

Q.10. At our Committee hearing on March 24th, one of the majority witnesses, Oliver Ireland from Morrison & Foerster, testified: "I find the statutory language a little bit confusing myself, but one of the listed criteria or requirements in subsection (b) which is not accepted is resolution plans. And so it appears that they cannot lift the resolution plans if they are adhering to that statutory language." As I read the text of the Dodd-Frank Act, the Federal Reserve has the authority to lift the $50 billion threshold for resolution plans because they are contained in section 165(d).

Does the Federal Reserve interpret the statute as providing the Federal Reserve the authority to lift the threshold for resolution plans, pursuant to a recommendation by the Financial Stability Oversight Council (FSOC)?

A.10. Section 165(a)(2)(B) of the Dodd-Frank Act grants authority to raise the asset threshold for resolution plans, though only pursuant to a recommendation from the Financial Stability Oversight Council. While Mr. Ireland is correct that the statutory language is potentially a little confusing, the Federal Reserve believes that the adjustments authorized in subsection (a)(2)(B) to the enhanced prudential standards established in subsections (c) through (g) also apply to those same enhanced prudential standards generally referenced in subsection (b) (i.e., contingent capital, resolution plans, concentration limits, enhanced public disclosures, and short term debt limits).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM DANIEL K. TARULLO

Q.1. Mr. Tarullo in your written statement you suggested raising the asset threshold to $10 billion for regulating small banks under the Volcker rule and the incentive compensation requirements of Sec. 956 of the Dodd-Frank Act.

What criteria led you to determine that $10 billion in assets is an appropriate line where the benefits of compliance are not exceeded by the costs of the regulations?

A.1. Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which added a new section 13 to the Bank Holding Company Act of 1956 (BHC Act), also known as the Volcker Rule, generally prohibits any banking entity from engaging in proprietary trading, and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. Under the terms of the statute, section 13 applies to any banking entity regardless of its size. As a result, section 13 and the final rules apply to community banks of all sizes.

Section 956 of the Dodd-Frank Act requires the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the National Credit Union Administration Board, and the Federal Housing Finance Agency (the Agencies) to jointly issue regulations or guidelines that would prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that regulators determine encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss to a covered financial institution. Under the terms of the statute, covered financial institutions with assets of less than $1 billion are exempt; larger institutions, including those with assets between $1 billion and $10 billion, would be covered.

The Federal Reserve makes substantial efforts to tailor its supervisory practices in accordance with the size, business models, risks, and other salient considerations of the institutions supervised. Requirements are the least stringent for smaller, local institutions and increase with factors including the size, complexity, and geographic reach of firms. In general, we shape our supervisory practices by considering the increase in safety and soundness that we are likely to achieve through a specific practice or requirement, in light of the regulatory costs for the banking organization at issue and the impact that the stress or failure of that organization would likely have on credit intermediation, the deposit insurance fund, and financial stability.

In a number of instances in the Dodd-Frank Act where Congress showed an intent to distinguish between smaller and larger, more complex institutions, a $10 billion threshold was used. For example, formal stress testing was required only for banks with total assets of $10 billion or more. In addition, the Dodd-Frank Act required the Federal Reserve to issue regulations requiring that publicly traded bank holding companies with more than $10 billion establish risk committees. Furthermore, banks with less than $10 billion in total assets were exempted from a number of the debit interchange restrictions.

With respect to the Volcker Rule, the Agencies charged with implementing that statutory provision endeavored to minimize the compliance burden on banking entities. As part of the implementing rules, the Agencies reduced 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.[1] Exempting community banks from section 13 would provide relief for thousands of community banks that face ongoing compliance costs incurred simply to confirm that their activities and investments are indeed exempt from the statute. At the same time, an exemption at this level likely would not increase risk to the financial system. The vast majority of the activity and investment that section 13 of the BHC Act is intended to address takes place at the largest and most complex financial firms whose failure would have a significant effect on the stability of the U.S. financial system. Moreover, were an exemption granted, the Federal banking agencies could continue to use their existing prudential authority in the event that these small institutions engage in imprudent investment activities that raise safety and soundness concerns.

Similarly, with respect to incentive compensation, the $10 billion threshold would reflect the fact that the types of incentive compensation concerns intended to be addressed by section 956 apply almost exclusively to larger financial institutions. Community banking organizations are less likely to be significant users of incentive compensation arrangements and any incentive compensation issues at these organizations would be less likely to have adverse effects on the broader financial system. While the Agencies expect to tailor application of section 956 to make clear the limited extent to which it should effect small institutions, it may be appropriate for Congress to consider exempting community banking organizations with less than $10 billion in total consolidated assets completely from the requirements of the rule.

Q.2. Mr. Tarullo, in your written statement you concluded "while enhanced prudential standards are important to ensure that larger banks can continue to provide credit even in periods of stress, some of those same enhancements could actually inhibit credit extension by rending the reasonable business models of middle-sized and smaller banks unprofitable."

In light of this statement, do you believe these regulations on smaller community banks has led to the sharp consolidation in their number? Are these regulations in any way responsible for the slow-moving economic recovery the United States is experiencing since the financial crisis of 2008?

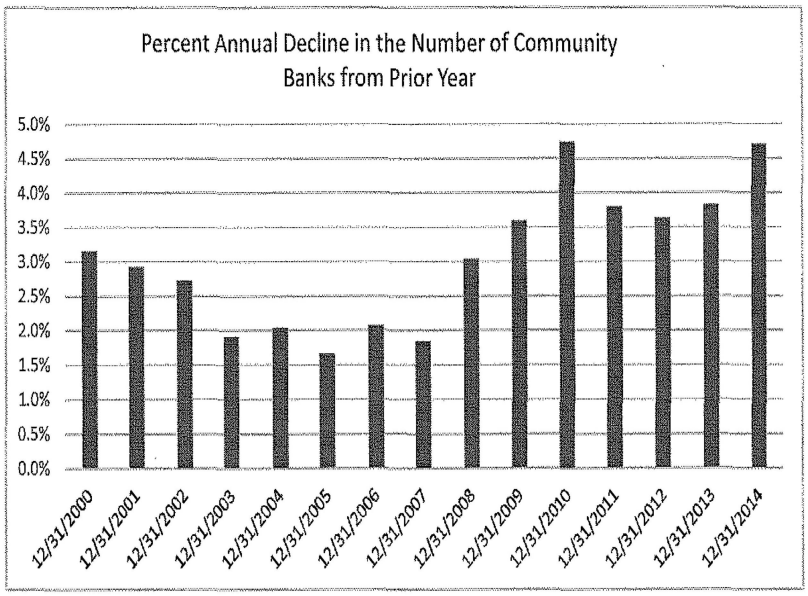
A.2. Relevant data suggests that the economic reverberations of the financial crisis and recession were a major cause of the consolidation that has taken place in recent years. Figure 1 displays the percent decline in the number of community banks from the prior

[1] See "The Volcker Rule: Community Bank Applicability" (Dec. 10, 2013), available at: *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a4.pdf.*

year.[2] The annual rate of community bank consolidation was generally trending lower before the financial crisis, but then began to increase during and after the crisis.

However, even if the main drivers of consolidation have been the challenges of an adverse economic environment, we surely do not want to add to those challenges through the application of regulations that are unnecessary to protect the safety and soundness of small banks, and in many cases, were developed in response to the quite different activities and risks at the larger banks.

Figure 1



RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM DANIEL K. TARULLO

Q.1. Regulators clearly already have some flexibility on how they apply the same regulatory principles to different kinds of institutions. For example, the Liquidity Coverage Ratio (LCR) rule allows for "modified" applications to firms that are not complex enough to warrant full treatment. But even in the LCR, where regulators knew they had this flexibility, a line was drawn at $250 billion that seemed to take sheer size into account more than the actual business activities firms were engaged in. In fact, banking regulators appear to have a sensible methodology in place to determine which firms are "globally systemically important banks."

Testimony by the Federal Reserve for this hearing acknowledged that banking regulators begin with the same "unitary approach" to supervising regional banks, regardless of their size. Why then, is this principle not followed when promulgating regulations?

[2] The decline includes both failed banks and acquired banks.

A.1. In September 2014, the Federal Reserve adopted a final LCR rule which provides for different liquidity requirements based on the size and complexity of a banking organization. Under the LCR rule, large banking organizations—those with total consolidated assets of $250 billion or more or total consolidated on-balance sheet foreign exposure of $10 billion or more, and their bank and thrift subsidiaries with total consolidated assets of $10 billion or more—are subject to the most stringent quantitative liquidity requirement and to daily calculation requirements. The Federal Reserve's modified LCR rule applies less stringent requirements to certain depository institution holding companies with total consolidated assets of at least $50 billion but less than $250 billion. The LCR is designed to promote the short-term resilience of the liquidity risk profile of large banking organizations and to improve the banking sector's ability to absorb shocks during periods of significant stress. The LCR does not apply to community banking organizations.

The Federal Reserve recognizes that, when setting an asset threshold in a regulation, relatively similar banking organizations on different sides of that threshold will be affected differently. Nonetheless, the Federal Reserve believes that the LCR rule's asset thresholds appropriately address the liquidity risks that covered banking organizations could pose to the funding markets and the overall economy taking into account factors such as their size, complexity, risk profile, and interconnectedness. In implementing internationally agreed upon regulatory standards in the United States, the Federal banking agencies have historically applied a consistent threshold for determining whether a U.S. banking organization should be subject to such standards based upon similar factors. The thresholds in the LCR rule are consistent with this approach. The Federal Reserve's modified LCR's $50 billion asset threshold is consistent with the enhanced prudential standards required under section 165 of the Dodd-Frank Wall Street and Consumer Protection Act.

The LCR rule takes into account individual characteristics of a covered company in several ways. For example, the rule calibrates the net cash outflow requirement for an individual covered company based on the company's balance sheet, off-balance sheet commitments, business activities, and funding profile. Sources of funding that are considered less likely to be affected at a time of a liquidity stress are assigned significantly lower outflow rates. Conversely, the types of funding that are historically vulnerable to liquidity stress events are assigned higher outflow rates. The Federal Reserve expects that covered companies with less complex balance sheets and less risky funding profiles will have lower net cash outflows and will therefore require a lower amount of high quality liquid assets to meet the rule's minimum standard. Furthermore, systemic risks that could impair the safety of banking organizations are also reflected in the rule, including provisions to address wrong-way risk, shocks to asset prices, and other industry-wide risks. Banking organizations that have greater interconnectedness to financial counterparties and have liquidity risks related to risky capital market instruments may have larger net cash outflows. Conversely, banking organizations that choose to rely on a more

traditional funding profile may limit or avoid such outflows under the rule.

In promulgating the LCR rule, the Federal Reserve recognized that some financial institutions could face operational difficulties implementing the rule in the near term. To address these difficulties, the LCR rule provides relief to non-G–SIB financial institutions by differentiating among the transition periods for the LCR daily calculation requirement. Accordingly, the Federal Reserve provided an extended implementation schedule for calculation of the LCR on a daily basis. The Federal Reserve anticipates finalizing liquidity reporting requirements for companies subject to the LCR rule in the near future. Banking organizations subject to the Federal Reserve's modified LCR requirements will calculate the LCR on a monthly basis.

Q.2. Wouldn't it be better to apply "modified" treatment of the LCR, or other rules, to banks of similar operational activities or risk profiles, even if their sizes differ substantially?

A.2. The Federal Reserve sought to calibrate the LCR requirement so that a banking organization holds an amount of highly liquid assets commensurate with both the organization's liquidity risk profile and the wider impact of the organization facing a liquidity shortfall at a time of significant stress. For example, the LCR rule considers not only the resilience of the organization's short-term funding but also the interconnectedness of the organization with the financial sector and its ability to continue lending to retail and corporate counterparties. The Federal Reserve fully expects firms with less complex, more resilient near-term funding profiles to have a lower requirement under the rule. Liquidity risk can also be a function of the scale of an organization's funding profile. Banking organizations with historically more stable funding sources, such as certain types of deposits, may still face significantly greater funding needs in a period of severe liquidity stress based on the overall volume and regional distribution of their funding sources. Larger banking institutions are typically more significant contributors to the provision of credit in a regional economy. The Federal Reserve believes that the ability of an institution to continue to be able to provide credit in a period of significant stress should be a consideration in a banking organization's wider liquidity risk management practices.

Q.3. Would you be open to setting a break-point for regulatory treatment where there seems to be a natural delineation in terms of the systemic risk arising from those firms? As an example, would you be open to reserving full treatment under the LCR for firms that have been designated as globally systemically important banks (G–SIBs)?

A.3. The Federal Reserve issued the LCR rule consistent with its responsibility to promulgate, on a tailored basis, enhanced prudential standards for large, complex banking organizations. The LCR ensures that important aspects of the liquidity risk profile of large banking organizations are addressed in a prudent, consistent, and sophisticated manner. While the rule incorporates aspects of financial interconnectedness, the Federal Reserve believes that such prudent practices are important for the continued safety and

soundness of large banking institutions individually, beyond the wider impact of their failure on the financial system as a whole. The G–SIB designation takes into account size, interconnectedness, substitutability, complexity, and crossjurisdictional activities and is applied only to the largest, most complex institutions. The Federal Reserve's regulations, including risk-based prudential regulations such as the LCR rule, recognize the need to apply higher standards to a wider set of large and internationally active banking organizations.

Q.4. In July of 2013, the Treasury Borrowing Advisory Committee reported that new regulations stemming from Basel III and Dodd-Frank will likely result in constrained liquidity in the market. Even well-intentioned rules like the Supplementary Leverage Ratio (SLR) may constrain liquidity in markets as deep and understood as those for U.S. Treasury securities.

What work have you done to take into account the views of the TBAC and other market participants?

A.4. The Federal Reserve has a strong interest in market liquidity across a range of key financial markets, as conditions are relevant to the conduct of monetary policy and financial stability. Federal Reserve staff monitor a variety of markets on an ongoing basis to keep abreast of current liquidity conditions and emerging trends. Board members meet regularly with market participants, including the Treasury Borrowing Advisory Committee (TBAC), who provide their views on market liquidity conditions and trends.

We have been listening to the concerns expressed about reduced bond market liquidity, and we are monitoring a wide range of indicators of liquidity. Federal Reserve System staff worked with staff at the Department of the Treasury, the Securities and Exchange Commission, and the Commodities Futures Trading Commission to produce the report "The U.S. Treasury Market on October 15, 2014" that analyzed reductions in market depth in the Treasury securities and futures markets during a 12-minute event window that day. The report also highlights important changes in market structure in recent years, including the increased role of high-speed electronic trading and the reduced share of traditional bank-dealer activity in the interdealer market. We are committed to further studying liquidity in the Treasury markets, including monitoring of trading and risk management practices of market participants, assessing available data, and strengthening monitoring efforts. Overall, many price-based and volume-based measures do not indicate a notable deterioration in liquidity, although average trade sizes have fallen.

There are a number of reasons for why liquidity in markets may be changing. Currently there are fewer active trading participants and an increase in "buy and hold" investors. Broker-dealers may now be willing to buy and sell bonds at the request of their clients because of new regulatory requirements, as the question suggests, but also importantly because of changes to risk management practices that they have made on their own. Technological changes also may be affecting the provision of liquidity. Increased reporting requirements have reduced trading costs, but also perhaps trading sizes. In Treasury markets, greater high-speed electronic trading

may be leading to fundamental changes in trading practices. Federal Reserve staff, along with other regulatory agencies, are studying the potential role of these various factors. An important consideration in any analysis is that some of the possible changes may be transitory, reflecting an adjustment to new regulations and technology, and a low interest rate environment. As a result, fully understanding the effects of these various factors on market liquidity may take time so that a sufficient amount of data and experience can be brought to bear on the question.

Q.5. What has been done specifically to address concerns regarding market liquidity in anticipation or as a result of new regulations?

A.5. As noted above, Federal Reserve staff have been working with other agencies to monitor liquidity conditions across a range of key financial markets and are talking to market participants. As post-crisis reforms go into effect and begin to have perceptible impacts on financial markets, Federal Reserve staff will continue these monitoring efforts, including exploring the effects of financial reforms on market liquidity and financial stability.

Q.6. Given the views and commentary of the TBAC and other market participants, which rules have you considered revisiting?

A.6. Given that many of the post-crisis reforms in question have either recently been implemented or are still in the process of being implemented, the Federal Reserve is not actively considering any specific changes at this time. Changing rules shortly after their implementation can create confusion and uncertainty in markets that may outweigh any benefits that the changes might produce. As market participants adjust to the reforms, the Federal Reserve will consider whether changes are necessary to improve the regulatory framework's ability to achieve the goal of enhancing financial stability without unduly constraining market liquidity.

Q.7. As the Federal Reserve contemplates an increase in interest rates, wouldn't it be prudent systemic risk management to foster liquidity rather than hampering it?

A.7. The Federal Reserve has a strong interest in fostering a level of robust market functioning while maintaining financial stability. Some degree of liquidity risk will always be present in securities markets. A key consideration for financial stability is whether the bearers of liquidity risk are sufficiently resilient to provide liquidity in most situations. The Federal Reserve is committed to designing and implementing policies consistent with the objectives of fostering efficient markets and financial stability.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM THOMAS J. CURRY

Q.1. Regulators clearly already have some flexibility on how they apply the same regulatory principles to different kinds of institutions. For example, the Liquidity Coverage Ratio (LCR) rule allows for "modified" applications to firms that are not complex enough to warrant full treatment. But even in the LCR, where regulators knew they had this flexibility, a line was drawn at $250 billion that seemed to take sheer size into account more than the actual busi-

ness activities firms were engaged in. In fact, banking regulators appear to have a sensible methodology in place to determine which firms are "globally systemically important banks."

Testimony by the Federal Reserve for this hearing acknowledged that banking regulators begin with the same "unitary approach" to supervising regional banks, regardless of their size. Why then, is this principle not followed when promulgating regulations?

Wouldn't it be better to apply "modified" treatment of the LCR, or other rules, to banks of similar operational activities or risk profiles, even if their sizes differ substantially?

Would you be open to setting a break-point for regulatory treatment where there seems to be a natural delineation in terms of the systemic risk arising from those firms? As an example, would you be open to reserving full treatment under the LCR for firms that have been designated as globally systemically important banks (G–SIBs)?

A.1. The OCC believes that the final LCR rule is calibrated appropriately so that it applies in a tailored fashion to the financial institutions with the most significant liquidity risk profiles. In September 2014, the agencies adopted a tailored LCR regime that increases in stringency based on the asset size of a financial institution. Under the LCR rule, large financial institutions—those with total consolidated assets of $250 billion or more or total consolidated on-balance sheet foreign exposure of $10 billion or more, and their bank and savings association subsidiaries with total consolidated assets of $10 billion or more—are subject to the most stringent liquidity buffer and daily reporting requirements. The Federal Reserve Board separately adopted a less stringent, modified LCR requirement for bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have $50 billion or more in total consolidated assets but are not internationally active. Those holding companies are permitted to hold a lower amount of a liquidity buffer and report the LCR monthly, rather than daily.

As the preamble to the final rule explains, the agencies believe that the LCR rules' asset thresholds appropriately address the liquidity risks that covered financial institutions could pose to the funding markets and the overall economy taking into account their size, complexity, risk profile, and interconnectedness. The LCR rule's $250 billion total consolidated asset and $10 billion foreign exposure thresholds also are consistent with the thresholds that trigger the more stringent capital requirements for larger financial institutions under the agencies' capital rules. The tailored LCR asset thresholds appropriately address the liquidity risks that financial institutions could pose to the funding markets and the overall economy.

In promulgating the final LCR rule, the agencies recognized that some financial institutions, including regional financial institutions, could face operational difficulties implementing the rule in the near term. To address these difficulties, the LCR final rule provides relief to non-G–SIB financial institutions by differentiating among the transition periods for the LCR daily calculation requirement. Accordingly, regional financial institutions subject to the

LCR rule were granted a delay by the agencies and do not have to calculate the LCR on a daily basis until July 1, 2016.

Q.2. In July of 2013, the Treasury Borrowing Advisory Committee reported that new regulations stemming from Basel III and Dodd-Frank will likely result in constrained liquidity inthe market. Even well-intentioned rules like the Supplementary Leverage Ratio (SLR) may constrain liquidity in markets as deep and understood as those for U.S. Treasury securities.

What work have you done to take into account the views of the TBAC and other market participants?

What has been done specifically to address concerns regarding market liquidity in anticipation or as a result of new regulations?

Given the views and commentary of the TBAC and other market participants, which rules have you considered revisiting?

As the Federal Reserve contemplates an increase in interest rates, wouldn't it be prudent systemic risk management to foster liquidity rather than hampering it?

A.2. The OCC generally receives comments on proposed regulations from a variety of market participants, including U.S. and foreign firms and trade associations representing them, public officials (including members of the U.S. Congress and State and local government officials), public interest groups, private individuals, and other interested parties. The OCC carefully reviews all comments we receive to identify areas where changes would be appropriate, and we often modify or adjust a proposed rule in response to commenters' concerns. For example, in the LCR final rule, based on the banking agencies' consideration of requests by several commenters to the proposed rule, the agencies expanded the pool of publicly traded common equity shares that may be included as high quality liquid assets (HQLA).

Many post-crisis regulations were developed to provide increased stability to the banking system and strengthen banking system risk management throughout the economic cycle, taking into account interest rates and other economic factors. The final LCR rule, in particular, requires banks to hold sufficient HQLA to cover outflows over a 30-day stress period, which reduces systemic risk by ensuring adequate liquidity at banking organizations. A bank's stock of HQLA provides a means of meeting obligations during times of stress and is independent of the current interest rate environment. It helps to strengthen a bank's ability to meet its obligations during both rising and falling interest rate scenarios. Furthermore, the final LCR rule requirement will enable a bank to continue to meet its liquidity needs during times of stress, thereby helping to reduce the depth and duration of the systemic stress.

The OCC prepared an assessment of the economic impact of the liquidity rule and considered potential effects related to market liquidity and economic growth. Such effects are difficult to quantify before a regulation takes effect, but our assessment describes them qualitatively. The OCC's ongoing supervision of national banks and Federal savings associations facilitates our ability to monitor market liquidity, and will enable us to evaluate the effects on market liquidity of the LCR rule and other rules over time.

The OCC, along with the Federal Deposit Insurance Corporation and the Federal Reserve Board, are currently engaged in a review of their regulations, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). Specifically, the EGRPRA requires that, at least once every 10 years, the agencies seek public comment on rules that are outdated or otherwise unnecessary. The agencies specifically request public comment on ways to reduce unnecessary burden associated with their regulations. The agencies will solicit comment on all of our regulations issued in final form up to the date that we publish our last EGRPRA notice for public comment, including the LCR, SLR, and other Basel and Dodd-Frank regulations.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

SYSTEMIC IMPORTANCE INDICATORS FOR 33 U.S. BANK HOLDING COMPANIES: AN OVERVIEW OF RECENT DATA, SUBMITTED BY CHAIRMAN SHELBY

OFR BRIEF SERIES
OFFICE OF FINANCIAL RESEARCH

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Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data

by Meraj Allahrakha, Paul Glasserman, and H. Peyton Young

The authors used a new dataset collected by the Federal Reserve System to evaluate the systemic importance of the largest U.S. bank holding companies by comparing their scores on size, interconnectedness, complexity, global activity, and dominance in certain customer services (known as "substitutability"). They also applied an OFR financial connectivity index to the data to measure interconnectedness. Overall, the analysis reinforces the need for measuring, monitoring, and evaluating multiple aspects of systemic importance.

The Basel Committee on Banking Supervision, a group of banking supervisors from 28 jurisdictions, in 2011 created a set of 12 financial indicators to identify global systemically important banks (G-SIBs). These are banks whose failure could pose a threat to the international financial system.[1] The most recent list identified 30 banks across the world as G-SIBs, including eight U.S. bank holding companies.

A bank designated as a G-SIB must meet a higher risk-based capital ratio to enhance its resilience, and is subject to additional regulatory oversight. This capital buffer represents an important new structural macroprudential tool for containing systemic risk. On December 9, 2014, the Federal Reserve proposed a draft rule implementing the G-SIB buffer for U.S. bank holding companies that could result in some banks holding larger capital buffers than those proposed by the Basel Committee.[2]

The largest U.S. bank holding companies reported in August 2014 their systemic importance indicators as of December 31, 2013. This important new dataset provides more transparency and is a significant step in quantifying specific aspects of systemic importance. Our analysis showed:

- The largest U.S. banks generally scored highest for all systemic risk indicators, but had relatively low Tier 1 leverage ratios compared to smaller banks.
- Several of the largest banks scored high in systemic importance because they dominate specific businesses, such as payments and asset custody services. Others scored high in complexity because of their trading and derivatives businesses.
- Seven of the eight U.S. G-SIBs had high values under the OFR's connectivity index, introduced in an earlier OFR working paper.
- Basel Committee-recommended capital buffers would still leave U.S. G-SIBs with generally lower capital ratios than other large U.S. banks.

The Purpose of the Indicators

Annual systemic risk scores for major banks around the world all use the same indicators. In the United States, each U.S. bank holding company with over $50 billion in assets is required to annually disclose its systemic risk indicators to the Federal Reserve by filing a Form Y-15, or Banking Organization Systemic Risk Report.[3] A total of 33 banks — including eight subsidiaries of foreign banks[4] — filed the Y-15 for 2013 and the Federal Reserve published the data on its National Information Center website.[5]

The Basel Committee designates banks with the highest scores as G-SIBs and each must hold an additional capital buffer of up to 3.5 percent of its risk-weighted assets. The Financial Stability Board (FSB) in November 2011 published its first annual list of G-SIBs using a process developed with the Basel Committee.

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Figure 1. Systemic Importance Indicators Reported by Large U.S. Bank Holding Companies ($ billions)

Systemic risk scores are based on size, interconnectedness, substitutability, complexity, and cross-jurisdictional activities

Bank Holding Company (stock ID)	Size	Interconnectedness			Substitutability			Complexity			Cross-Jurisdictional Activity		2013 Score (percent)
	Total exposures	Intrafinancial system assets	Intrafinancial system liabilities	Securities outstanding	Payments activity	Assets under custody	Underwriting activity	Amount of OTC derivatives	Adjusted trading and AFS securities	Level 3 assets	Foreign claims	Total cross-jurisdictional liabilities	
Weight (percent)	20	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	10	10	
JPMorgan Chase & Co. (JPM)	3,570	422	544	599	321,458	21,320	508	68,004	446	69	693	674	**5.05**
Citigroup Inc. (C)	2,895	421	513	596	300,783	11,096	331	59,472	130	46	839	742	**4.27**
Bank of America Corp. (BAC)	2,696	294	220	489	83,705	136	390	54,887	203	32	387	246	**3.06**
Wells Fargo & Co. (WFC)	1,961	110	129	508	28,761	2,400	86	4,880	128	37	70	130	**1.72**
Goldman Sachs Group, Inc. (GS)	1,518	337	107	310	9,585	866	371	50,355	138	43	347	319	**2.48**
Morgan Stanley (MS)	1,283	535	182	231	9,812	1,369	262	43,611	316	23	353	470	**2.60**
U.S. Bancorp (USB)	525	11	22	139	6,918	959	17	106	13	4	3	34	**0.35**
PNC Financial Services (PNC)	425	18	13	68	2,004	161	10	252	26	11	5	2	**0.30**
Bank of New York Mellon Corp. (BK)	410	79	230	61	166,279	23,590	6	1,158	39	0	87	164	**1.50**
HSBC N.A. Holdings Inc. (HSBC)	406	36	55	50	1,061	43	49	5,194	40	4	43	1	**0.38**
State Street Corp. (STT)	345	30	209	43	59,122	20,411	-	1,141	54	8	47	125	**1.48**
Capital One Financial Corp. (COF)	336	14	2	94	914	3	2	63	16	4	9	2	**0.19**

Notes: This list shows BHCs with assets over $250 billion. The eight gray-shaded BHCs were G-SIBs as of 2013. HSBC North America is a holding company for the U.S. operations of HSBC Holdings, plc, incorporated in the United Kingdom.

Sources: Company Y-15 reports, OFR analysis

The committee in July 2013 updated the methodology it uses to calculate a systemic risk score for each bank and released the latest scores on November 6, 2014.[6]

Based on their 2013 scores, the 30 banks would be required to hold extra capital of 1 percentage point to 2.5 percentage points under the Basel Committee methodology.[7] As noted, the Federal Reserve proposed potential alternative requirements with respect to funding which could result in even higher capital buffers for some U.S. bank holding companies. The Basel Committee suggests that national regulators phase in G-SIB capital buffers beginning in January 2016.

The systemic risk indicators are grouped into five categories, as shown across the top of **Figure 1**. Each category has a total weight of 20 percent divided equally among its indicators.[8] A description of the five categories and their indicators follows.

Size. This category has a single indicator, a comprehensive measure showing a bank's total exposures. The indicator reflects total assets plus the net value of certain securities financing transactions plus credit derivatives and commitments as well as counterparty risk exposures. This measure of size is also used to calculate a bank's supplementary leverage ratio under the Basel III international banking accord. (Basel III established a supplementary leverage ratio requiring large banks to hold Tier 1 capital of at least 3 percent of total exposures to absorb losses; the U.S. rule set the ratio at 5 percent for bank holding companies.)

Interconnectedness. The failure of a bank to meet payment obligations to other banks can accelerate the spread of a financial system shock if the bank is highly interconnected. This category includes measurements of a bank's total claims on the financial system, its total liabilities to the financial system,

and the total value of debt and equity securities issued by a bank. For the first two of these indicators, the financial system includes banks, securities dealers, insurance companies, mutual funds, hedge funds, pension funds, investment banks, and central counterparties.

Substitutability. A bank is more systemically important if it provides important services that customers would have difficulty replacing if the bank failed. Three indicators measure this effect: a bank's payments activity, assets under custody at the bank, and the bank's total underwriting transactions.[9] The Basel Committee methodology applies a cap to the substitutability categories when the indicators are combined into an overall score. The draft U.S. rule would take the higher of the Basel Committee methodology or an alternative methodology which replaces the substitutability component with a score based on banks' short-term wholesale funding usage, effectively giving substitutability indicators a zero weight in determining a bank's G-SIB buffer.

Complexity. A bank with highly complex operations is more difficult to resolve and has a broader impact if it fails. Complexity is measured by a bank's notional amount of over-the-counter (OTC) derivatives; total amount of trading and available-for-sale securities; and total illiquid and hard-to-value assets, which are also known as Level 3 assets.

Cross-Jurisdictional Activity. Banks with international operations can transmit problems from one region to another during a financial crisis. Global banks are also more difficult to resolve because they require coordination among national regulators. The scale of a bank's global activity is measured by its total foreign claims and its total cross-jurisdictional liabilities.

Each systemic risk category raises significant measurement challenges. Even the size measurement is far from straightforward. The current indicators and G-SIB capital buffer are important steps in an ongoing process to strengthen prudential regulation of the largest financial institutions.

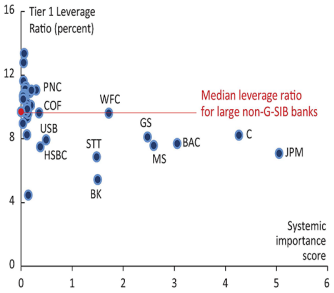
Analysis of 2013 U.S. Data

In the United States, each bank reported its systemic importance risk indicators as of December 31, 2013. The names of the banks and the financial data each submitted are summarized in **Figure 1**, along with each bank's overall score of systemic importance.

We followed the Basel Committee procedure in scoring banks by first normalizing each indicator by the total value for that indicator among the world's 75 largest banks.[10] For example, if a bank has a value of $4 billion for one indicator and the group's total value for that indicator is $100 billion, the bank's score for the indicator is 4 percent. This approach puts the scores for different indicators on a common scale. The normalized scores for indicators were averaged within each category to produce a subscore. The five category subscores were then averaged to produce an overall score. We capped the category score for substitutability at 5 percent, in keeping with the Basel procedure.[11]

Figure 2. Tier 1 Leverage Ratios (percent)

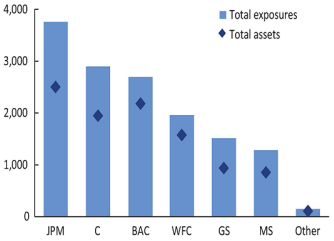
Peer banks that are not G-SIBs have a higher median Tier 1 leverage ratio of close to 10 percent



Sources: Federal Reserve BHC Performance Reports, OFR analysis

Figure 3. Exposures and Assets ($ billions)

Total exposures are considerably greater than assets for U.S. G-SIBs



Note: Analysis includes JPMorgan Chase & Co., Bank of America Corporation, Citigroup Inc., Wells Fargo & Company, Goldman Sachs, Morgan Stanley, and the median of remaining bank holding companies with assets greater than $50 billion.

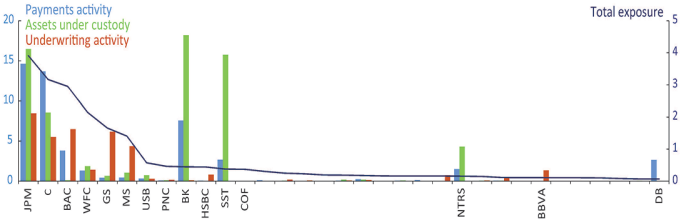
Sources: Federal Reserve Y-15 and Y-9C reports

Of the 33 U.S. banks, the eight designated as G-SIBs in 2012 had the highest systemic importance scores in 2013. JPMorgan Chase & Co. had the highest score at 5.05 percent, followed by Citigroup Inc. (4.27 percent), Bank of America Corp. (3.06 percent), Morgan Stanley (2.60 percent), Goldman Sachs Group, Inc. (2.48 percent), and Wells Fargo & Co. (1.72 percent).

The eight U.S. G-SIBs already have sufficient capital to meet their risk-based capital ratios, inclusive of the Basel G-SIB buffer on a fully phased-in basis. Even so, their Tier 1 leverage ratios, which are not risk-weighted, remain below those of large U.S. banks that are not G-SIBs. **Figure 2** illustrates that banks with higher overall G-SIB systemic importance scores tended to have lower Tier 1 leverage ratios than the median large non-G-SIB.

Figure 4. Substitutability (percent)

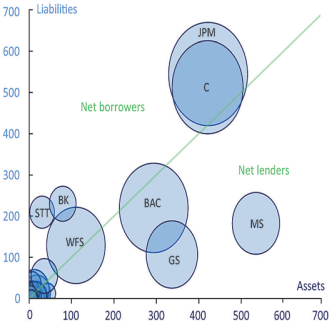
Some smaller banks scored higher on substitutability due to custodian, underwriting, and payments businesses



Sources: Federal Reserve Y-15 reports and Basel Committee on Banking Supervision

Figure 5. U.S. G-SIBs' Liabilities and Assets ($ billions)

Banks vary in their use and provision of funding



Note: Bubble size shows total exposures.
Source: Federal Reserve Y-15 reports

Size

Bank size is an important component of systemic risk. **Figure 3** presents two measures of size, total assets and total exposures, the size measure used in the G-SIB methodology that includes derivative positions and securities financing transactions, such as repurchase agreements and securities lending. By either measure, the six largest U.S. banks dominated the others, accounting for nearly 70 percent of total assets and 72 percent of total exposures. The same six had total exposures 44 percent larger than their total assets. By comparison, the other banks' total exposures were just 27 percent larger than their total assets.

Substitutability

Six banks scored higher on the substitutability indicator than their size would suggest, as shown in **Figure 4**.[12] The horizontal axis orders the 33 banks by size. Bank of New York Mellon Corp., State Street Corp., and Northern Trust Corp. (NTRS) have large operations as custodian banks. Goldman Sachs and Morgan Stanley have large underwriting businesses. Deutsche Bank Trust (DB), a U.S. subsidiary of the largest German bank, has a high level of payment activity despite being the smallest of the 33 banks. The indicators were normalized (as described above) so they are all on a scale from zero to 100 percent. The figure does not reflect the 5 percent cap on the substitutability indicators that is used in the Basel methodology — without the cap, the overall scores for Bank of New York Mellon, Citigroup, JPMorgan, and State Street would be even higher.

Interconnectedness

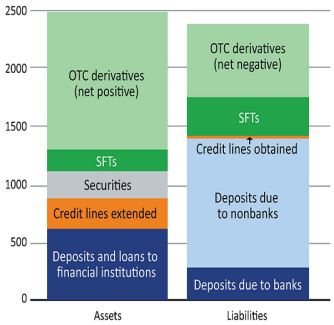
In the Y-15 data, a bank's interconnectedness is measured by the intrafinancial system assets it owns and the intrafinancial system liabilities that it owes. Averaged over the 33 U.S. banks, intrafinancial system assets and liabilities were nearly equal at $75 billion and $72 billion, respectively.[13] But the averages do not reflect notable differences for individual banks (see **Figure 5**). In the figure, the bubble sizes are proportional to each bank's total exposures. Banks above the diagonal line had net obligations to the financial system, and banks below the diagonal line had net claims on the financial system. Differences in these indicators of interconnectedness partly reflect differences in activities measured by the substitutability and complexity indicators: those above the line generally have large payments activities or assets under custody, while those below the line generally have large trading, derivatives, and underwriting operations.

Total intrafinancial system assets and liabilities of the bank holding companies were nearly equal — $2.5 trillion for assets and $2.4 trillion for liabilities. The largest component of total intrafinancial system assets was the fair value plus potential future exposure (PFE) of OTC derivatives, at $1.2 trillion (48 percent).[14] Deposits and loans to other financial institutions were a distant second at $615 billion (25 percent). Securities financing transactions (SFTs) accounted for just 7 percent (see **Figure 6**).

Intrafinancial system liabilities primarily took the form of deposits, which made up $1.4 trillion or 59 percent. Most of the deposits, $1.1 trillion, were due to nonbank financial institutions. Surprisingly, OTC derivatives contributed only about half as much to intrafinancial system liabilities ($632 billion) as to intrafinancial system assets ($1.2 trillion). Across all OTC

Figure 6. U.S. G-SIBs' Combined Intrafinancial Assets and Liabilities ($ billions)

Nearly half of assets are OTC derivatives and most liabilities are deposits from nonbanks



Source: Federal Reserve Y-15 reports

market participants, derivatives assets must equal derivatives liabilities, so this imbalance indicates that the U.S. banks held large positive OTC derivatives positions with financial institutions outside this group.

In contrast, securities financing transactions were a net source of funding to the U.S. banks from the rest of the financial system. Securities lending contributed $336 billion to intrafinancial system liabilities and $186 billion to intrafinancial system assets. Bank holding companies are allowed to report both securities financing transactions and derivatives transactions on a net basis (subject to a valid master netting agreement). However, OTC derivatives are reported on a more expansive basis that includes PFE. As a result, smaller reported numbers for securities financing transactions may have underweighted their risks relative to firms' OTC derivatives risks.

Figure 7 shows individual banks' OTC derivatives positions with positive value (intrafinancial system assets) and OTC positions with negative value (intrafinancial system liabilities) as a percentage of the bank's total exposures. This comparison shows that the imbalance in OTC positions was primarily due to the positions of just two U.S. banks, Goldman Sachs and Morgan Stanley.

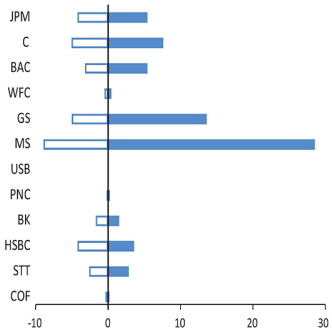
A similar comparison of the 12 largest banks' securities financing transactions shows that the imbalance varied across banks (see **Figure 8**). Four of the six largest banks were net borrowers from the financial system. Bank of New York Mellon and State Street, which run large securities lending businesses, had large negative net positions.

Complexity

The three activities measured by the systemic risk indicators for complexity — derivatives, trading assets, and illiquid (Level 3) assets — played a large role in the financial turmoil of 2007-08.

Figure 7. OTC Derivatives Exposures (percent)

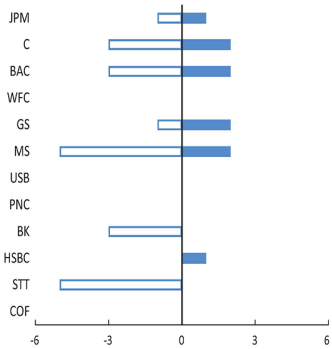
Banks' positive and negative OTC derivatives values are shown as a percent of their total exposures



Source: Federal Reserve Y-15 Reports

Figure 8. Securities Financing Transactions (percent)

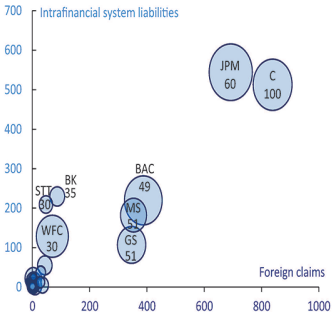
Banks' net borrowings and net lending from the financial system are shown as a percent of their total exposures



Source: Federal Reserve Y-15 Reports

Figure 9. Foreign Claims ($ billions)

Banks with large foreign claims are also highly interconnected to the financial system

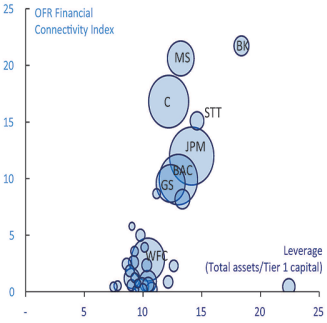


Note: Bubble size shows total exposures. Bubble label shows number of jurisdictions in which the BHC operates.

Source: Federal Reserve Y-15 reports

Figure 10. Leverage and the OFR Financial Connectivity Index

Highly leveraged banks are also the most interconnected



Note: Bubble size shows total exposures.

Sources: Federal Reserve BHC Performance Reports, OFR analysis

The six largest banks scored highest on the complexity indicators, with OTC derivatives largely confined to five of those six (see **Figure 1**).

Cross-Jurisdictional Activity

A bank that has large foreign assets and large intrafinancial system liabilities is a potential source of spillover risk. If a large loss in value in foreign assets caused such an institution to fail, the losses could be transmitted to the rest of the U.S. financial system. Five banks had large foreign assets (exceeding $300 billion) and Citigroup and JPMorgan had large figures for both foreign assets and intrafinancial system liabilities. The bubble sizes in **Figure 9** reflect firm size, based on total exposures.[15] Again, the largest banks are the most interconnected and they are involved in the most cross-jurisdictional activity.

OFR's Financial Connectivity and Contagion Indexes

In addition to analyzing the Y-15 data, we also estimated a financial connectivity index for each bank holding company, as defined in an OFR working paper in 2013.[16] The index measures the fraction of liabilities held by other financial institutions. All else being equal, the default of a bank with a higher connectivity index would have a greater impact on the rest of the banking system because its shortfall would spill over onto other financial institutions, creating a cascade that could lead to further defaults.

High leverage, measured as the ratio of total assets to Tier 1 capital, tends to be associated with high financial connectivity and many of the largest institutions are high on both dimensions (**see Figure 10**). Seven of the eight U.S. G-SIBs had high financial connectivity index values; Bank of New York Mellon and State Street were high on both dimensions despite their relatively smaller sizes.

The same OFR working paper also introduced a contagion index that combined the connectivity index with measures of a bank's size and leverage. The larger the bank, the greater the potential spillover if it defaults; the higher its leverage, the more prone it is to default under stress; and the greater its connectivity index, the greater is the share of the default that cascades onto the banking system. The product of these three factors provides an overall measure of the contagion risk that the bank poses for the financial system. Five of the U.S. banks had particularly high contagion index values — Citigroup, JPMorgan, Morgan Stanley, Bank of America, and Goldman Sachs.

Conclusions

The collection of systemic importance indicators is a significant step in providing information to banking supervisors and the public about the potential impact of the failure of a major financial institution. Additional capital requirements for G-SIBs could enhance the resilience of the financial system. The indicators agreed upon through the Basel Committee recognize several dimensions to systemic importance. Although the largest

banks tend to dominate all indicators of systemic importance, the indicators of substitutability, interconnectedness, complexity, and global activity provide useful additional information to understand differences among these institutions.

Some dimensions of systemic importance are not captured by the indicators. One is the extent to which a bank engages in maturity and liquidity transformation. Funding long-term illiquid assets with short-term liabilities can make a bank resolution more difficult. A second dimension is the extent to which a bank's home sovereign relies on the bank for funding activities and financial services; this type of reliance can contribute to a bank's systemic importance. A third dimension is that the current substitutability indicators do not directly measure all critical services, such as clearing and settlement operations.

The type of analysis reported here can help drive future data collections and can point to further work on indicators. These efforts are needed for monitoring risks as well as for identifying systemically important banks.

Endnotes

[1] The Basel Committee said the measures were not meant to reflect the probability that an institution will fail. "The Committee is of the view that global systemic importance should be measured in terms of the impact that a bank's failure can have on the global financial system and wider economy, rather than the risk that a failure could occur." See Basel Committee on Banking Supervision (BCBS), *Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement,* Bank for International Settlements, Basel, July 2013, p. 5 (available at www.bis.org/publ/bcbs255.pdf, accessed December 2, 2014). The list of G-SIBs is available at www.bis.org/press/p141106.htm.

[2] Board of Governors of the Federal Reserve System, Press Release, December 9, 2014 (see www.federalreserve.gov/newsevents/press/bcreg/20141209a.htm, accessed December 10, 2014).

[3] Form Y-15 follows the Basel Committee's template for collecting the systemic indicators (see www.bis.org/bcbs/gsib, accessed December 2, 2014).

[4] These include subsidiaries of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA); BNP Paribas Group; Deutsche Bank AG; Mitsubishi UFJ Financial Group, Inc.; Royal Bank of Scotland Group plc; and Banco Santander. Each of these parent companies has been designated a G-SIB. The other two foreign parent companies are TD Bank and Bank of Montreal. Only the U.S. holding companies file Form Y-15, not their foreign-based parent companies. A comparison of indicators across international banks will be the subject of a future OFR Brief.

[5] See www.ffiec.gov/nicpubweb/nicweb/NicHome.aspx.

[6] See BCBS, *Global Systemically Important Banks.*

[7] The complete list of institutions is available on the FSB's website (see www.financialstabilityboard.org/2014/11/2014-update-of-list-of-global-systemically-important-banks, accessed December 2, 2014).

[8] Information on the weights and the descriptions of the indicators that follow are from BCBS, *Global Systemically Important Banks,* and Board of Governors of the Federal Reserve System, *Instructions for Preparation of Banking Organization Systemic Risk Report* (available at www.ny.frb.org/banking/reportingforms/FR_Y_15.html, accessed December 2, 2014).

[9] A high score on these substitutability indicators means a lack of readily available substitutes to replace the bank's services if it were to fail.

[10] To be consistent with the Basel Committee's procedure, in calculating normalized scores we divided by the totals for the group of 75 international banks and not the 33 U.S. banks. We normalized by the totals for 2013 as reported by the BCBS at www.bis.org/bcbs/gsib/denominators.htm (accessed December 3, 2014).

[11] The 5 percent cap was imposed in the committee's July 2013 updated methodology because substitutability was found to have a greater than intended effect on the overall score.

[12] U.S. G-SIBs are even more leveraged relative to non-G-SIB U.S. peers on an enhanced supplementary leverage ratio basis, which uses total exposures instead of total assets.

[13] They are not equal because the 33 bank holding companies do not make up the entire financial system.

[14] Potential future exposure (PFE) is defined as the maximum exposure estimated to occur on a future date at a high level of statistical confidence.

[15] The number of jurisdictions is reported as an ancillary indicator in the Basel template and in Form Y-15.

[16] Specifically we estimated the numerator from the Y-15 data as an institution's intra-financial system liabilities (which include derivative liabilities) minus deposits from nondepository institutions such as mutual funds, pension funds, and insurance companies. We excluded these deposits because we wanted to estimate a given institution's potential spillover effect on other banks. If these deposits were included, the estimated connectivity index would be larger. See Paul Glasserman and H. Peyton Young, "How Likely is Contagion in Financial Networks?," OFR Working Paper no. 0009, June 21, 2013, forthcoming in the *Journal of Banking and Finance*; and Office of Financial Research, *2013 Annual Report,* Washington, pp. 63-70.

BCBS SYSTEMIC IMPORTANCE INDICATORS, SUBMITTED BY CHAIRMAN SHELBY

BCBS Systemic Importance Indicators Reported by Large U.S. Bank Holding Companies ($ billions)*

Bank Holding Company	Size	Interconnectedness			Substitutability			Complexity			Cross-Jurisdictional Activity		2013 SCORE (percent)
	Total exposures	Intrafinancial system assets	Intrafinancial system liabilities	Securities outstanding	Payments activity	Assets under custody	Underwriting activity	Amount of OTC derivatives	Adjusted trading and AFS securities	Level 3 assets	Foreign claims	Total cross-jurisdictional liabilities	
Weight (percent)	20	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	10	10	
JPMorgan Chase & Co.	3,570	422	544	599	321,458	21,320	508	68,004	446	69	693	674	5.05
Citigroup Inc.	2,895	421	513	596	300,783	11,096	331	59,472	130	46	839	742	4.27
Bank of America Corp.	2,696	294	220	489	83,705	136	390	54,887	203	32	387	246	3.06
Wells Fargo & Co.	1,961	110	129	508	28,761	2,400	86	4,880	128	37	70	130	1.72
Goldman Sachs Group, Inc.	1,518	337	107	310	9,585	866	371	50,355	138	43	347	319	2.48
Morgan Stanley	1,283	535	182	231	9,812	1,369	262	43,611	316	23	353	470	2.60
U.S. Bancorp	525	11	22	139	6,918	959	17	106	13	4	3	34	0.35
PNC Financial Services	425	18	13	68	2,004	161	10	252	26	11	5	2	0.30
Bank of New York Mellon Corp.	410	79	230	61	166,279	23,590	6	1,158	39	0	87	164	1.50
HSBC N.A. Holdings Inc.	406	36	55	50	1,061	43	49	5,194	40	4	43	1	0.38
State Street Corp.	345	30	209	43	59,122	20,411	-	1,141	54	8	47	125	1.48
Capital One Financial Corp.	336	14	2	94	914	3	2	63	16	4	9	2	0.19
TD Bank U.S.	277	15	5	8	2,393	10	-	151	18	2	35	1	0.14
SunTrust Banks, Inc.	229	3	1	50	644	64	11	183	15	3	2	2	0.14
BB&T Corp.	212	1	10	69	972	35	6	59	4	2	1	1	0.12
American Express Co.	177	7	37	162	144	-	-	42	4	-	30	20	0.17
Fifth Third Bancorp	174	4	9	38	1,187	240	5	64	7	0	4	1	0.10
BMO Financial Corp.	163	16	1	26	5,245	257	8	22	11	0	7	6	0.12
Ally Financial Inc.	153	6	17	108	290	-	-	62	9	0	2	2	0.11
UnionBanCal Corp.	146	10	6	20	1,058	120	-	64	8	2	2	3	0.09
RBS Citizens Financial Group, Inc.	146	4	4	1	2,816	7	-	43	1	0	2	1	0.05
Regions Financial Corp.	146	1	7	27	755	22	45	74	5	0	1	0	0.11
Northern Trust Corp.	142	44	12	16	32,997	5,576	-	255	12	0	28	51	0.49
Key Corp.	134	6	1	26	984	82	5	62	2	3	2	0	0.08
M&T Bank Corp.	105	2	5	22	1,594	101	26	21	1	0	0	0	0.08
Bancwest Corp.	103	1	8	12	443	3	-	16	1	0	1	1	0.04
BBVA Compass Bancshares, Inc.	101	4	2	13	199	3	80	18	1	0	1	2	0.12
Santander Holdings USA, Inc.	98	4	0	12	24	-	-	18	12	0	4	1	0.05
Comerica Inc.	98	8	4	17	246	53	1	21	2	0	2	2	0.05
Discover Financial Services	96	7	0	74	321	-	-	12	1	0	0	0	0.06
Zions Bancorp.	75	3	3	11	437	3	0	3	3	1	0	2	0.04
Huntington Bancshares Inc.	65	2	0	16	303	80	1	8	3	1	1	-	0.04
Deutsche Bank Trust Corp.	64	20	26	12	58,495	-	-	14	0	0	4	0	0.20

* Basel Committee on Banking Supervision
Sources: Company Y-15 reports, OFR analysis

Tailored Key Elements of Enhanced Prudential Regulation

Source: Better Markets