S. HRG. 115–407

IMPLEMENTATION OF THE ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT

HEARING

BEFORE THE

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

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

ON

RECEIVING AN UPDATE ON EFFORTS, ACTIVITIES, OBJECTIVES, AND PLANS OF FEDERAL FINANCIAL REGULATORY AGENCIES TO IMPLEMENT THE ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT

OCTOBER 2, 2018

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C O N T E N T S

TUESDAY, OCTOBER 2, 2018

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

IMPLEMENTATION OF THE ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT

TUESDAY, OCTOBER 2, 2018

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

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

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

Today we will hear from four agencies responsible for the supervision and regulation of banks or credit unions. Each will provide an overview of its efforts, activities, objectives, and plans to implement S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act.

Providing testimony will be Federal Reserve Vice Chairman for Supervision Randy Quarles; Federal Deposit Insurance Corporation Chair Jelena McWilliams; National Credit Union Administration Chairman Mark McWatters; and Comptroller of the Currency Joseph Otting.

Each of these agencies plays an integral role in implementing key provisions of this law. As policymakers, it is our job to enact laws and regulations that not only ensure proper behavior and safety for our markets, but are also tailored appropriately.

Shortly after Dodd-Frank was signed into law, we began to see some of the unintended cumulative regulatory burden it had on certain financial institutions. For years, I and many other Members of the Committee, on both sides of the aisle, worked to find a solution to provide meaningful relief to small financial institutions, and we succeeded in crafting S. 2155.

We are now approaching 5 months since S. 2155 was signed into law by the President, having passed both the House and Senate with significant bipartisan support.

The law's primary purpose is to make targeted charges to simplify and improve the regulatory regime for community banks, credit unions, midsize banks and regional banks to promote economic growth. It right-sizes regulations for financial institutions, making it easier for consumers to get mortgages and obtain credit while also increasing important consumer protections for veterans, senior citizens, victims of fraud, and those who fall on hard financial times.

For example, just over a week ago, the Federal Trade Commission and Bureau of Consumer Financial Protection announced as effective a provision of S. 2155 that provides consumers concerned about identity theft or data breaches the option to freeze and unfreeze their credit for free.

A New York Times article commenting on this provision noted that:

> one helpful change . . . will allow consumers to 'freeze' their credit files at the three major credit reporting bureaus—without charge. Consumers can also 'thaw' their files, temporarily or permanently, without a fee.

Susan Grant, Director of Consumer Protection and Privacy at the Consumer Federation of America, expressed support for these measures, calling them "a good thing."

Although agencies have started to consider this law in some of their statements and rulemakings, there is still a lot of work to do on the bill's implementation.

It is imperative that the agencies carry out all of their responsibilities under this law expeditiously so that consumers, homeowners, veterans, and small businesses can begin to fully experience its benefits.

In addition to timing, Members of this Committee are also deeply vested in the substance of agencies' specific actions to implement this law and other actions and efforts by the regulators to provide regulatory relief.

In particular, agencies should: significantly tailor regulations for banks with between $100 billion and $250 billion in total consolidated assets, with a particular emphasis on tailoring the stress testing regime (it should be noted that the primary reason we gave the regulators time to implement this provision was to develop a streamlined stress testing regime, and I encourage you to move quickly here); tailor the Liquidity Coverage Ratio for regional banks with more than $250 billion in total consolidated assets; reassess the advanced approaches thresholds; provide meaningful relief from the Volcker Rule for all institutions, as I said in a letter to the regulators yesterday; and examine whether the regulations that apply to the stand-alone U.S. operations of foreign banks should also be tailored at the same time and in a similar manner as U.S. banks.

S. 2155 raised the threshold for the application of enhanced prudential standards under Section 165 of the Dodd-Frank Act from $50 billion, and in some cases $10 billion, to $250 billion.

Regulators have applied the Section 165 asset thresholds in various rulemakings and guidance documents in the past.

For example, the Fed's Comprehensive Capital Analysis and Review requires bank holding companies with more than $50 billion in total assets to submit capital plans to the Fed on an annual basis.

In the final capital plan rule, the Fed notes that:

> the asset threshold of $50 billion is consistent with the threshold established by Section 165 of the Dodd-Frank Act relating to enhanced prudential standards and prudential standards for certain bank holding companies.

The OCC recently raised the threshold for requiring recovery plans from $50 billion to $250 billion. I encourage the regulators to revisit all regulation and guidance thresholds that were consistent with the outdated Section 165 threshold to an amount that reflects actual systemic risk.

Regulators have two options: use a systemic risk factors-based approach, or raise all thresholds to at least $250 billion in total assets to be consistent with S. 2155.

Many of this law's provisions require agency rulemakings. In order to avoid unnecessary delays in implementation, agencies should promptly issue notice of proposed rulemakings for all relevant aspects of this law.

As S. 2155 is implemented, I suspect some of it may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking.

While I encourage the regulators to use notice and comment rulemaking generally, I recognize that sometimes policy must be communicated through more informal means.

The Congressional Review Act, however, requires agencies to submit, with certain minor exceptions, all rules to Congress for review.

By definition, a rule is:

> the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency.

This is a very broad definition.

In order to ensure that Congress can engage in its proper oversight role, as well as ensure that future Congresses do not overturn the agencies' policy statements related to implementation of S. 2155, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Our economy is finally getting back on track, and the full implementation of S. 2155 will continue to drive growth and improve economic health to the benefit of families across America.

I look forward to hearing more from each of you on how your agencies have begun and will continue to implement the Economic Growth, Regulatory Relief, and Consumer Protection Act. Thank you.

Senator Brown.

OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman. I welcome all four witnesses. Thanks for your public service.

This hearing was originally scheduled for September 13th—the same week 10 years ago that Lehman Brothers declared bankruptcy, paving the way for the worst economic crisis since the Great Depression.

We know what happened next. The Bush administration put together an alphabet soup of programs to keep the financial sector afloat, but it was not enough. Ten years ago this week, taxpayers were forced to set aside $700 billion to bail out Wall Street and save our economy from collapse. A New York Times headline from

10 years ago today, October 2, 2008, described those chaotic early days of the collapse with this headline: "36 hours of Alarm and Action as Crisis Spiraled."

A decade after the most severe financial crisis since the Great Depression, today we are discussing how the financial watchdogs will roll back rules put in place after that crisis. Imagine that.

These are the same agencies, your agencies, that ignored the buildup to the 2008 collapse and, in the case of the OCC, went to court for those who were fighting to try to do something.

In some cases, they are now led by the very people that failed to prevent or who profited from the crisis.

S. 2155 was described as an effort to reduce the burden of regulation on the Nation's smallest community banks and credit unions—something many of us agreed we could and should improve. But in reality, this bill is littered with concessions to the big banks; it offers virtually nothing to American consumers.

Based on the questions and letters sent to officials by my Republican colleagues since passage of S. 2155, it seems they are most concerned about how the law will help the largest domestic and foreign banks—or to use a new Republican euphemism for companies like Deutsche Bank, "regional banks with an international parent."

"Regional banks with an international parent." These dreamers always have support in Washington.

These are the same banks that have been profitable every quarter since the second quarter of 2009. Last quarter profits at U.S. banks reached record levels—more than $60 billion dollars, a 25-percent jump from the year before. The five largest banks in this country recently announced more than $72 billion in stock buybacks, a 30-percent increase from last year. How many workers got a 30-percent raise last year? How much is enough for the Nation's very, very profitable banks?

While the banks have recovered, so many Americans have not.

Ten million Americans lost their jobs during the crisis. The unemployment rate peaked at 11 percent in my State. More than a third of workers across the country were unemployed for 27 weeks or more.

Losses in household wealth and income were devastating to families during the crisis. African Americans and Latino Americans suffered even worse losses.

Now, do not try to argue that household wealth has recovered since the crisis because aggregate measures are misleading. Recent data from the Federal Reserve Board of Governors shows that the top 10 percent of households have seen big gains in household wealth; the bottom 90 percent have experienced no gains. So this Committee and you as regulators seem to be most interested in how those 10 percent can be even more profitable.

The poverty rate rose 2.5 percentage points between 2007 and 2012, with 46.5 million people living in poverty by 2012.

Eight million children were affected by the foreclosure crisis by 2012—6 percent of children in Ohio, one out of 16 children in Ohio affected. It is even higher in States like Nevada and Rhode Island and Maryland on this Committee, and Tennessee.

We all know the lasting impact of childhood displacement, although our Government does not seem to care a whole lot about that, and there are a lot of examples of that.

Some studies suggest a correlation between the Great Recession and the opioid crisis.

In August, the Federal Reserve Bank of San Francisco released research that said the financial crisis "cost the average American $70,000 in lifetime income." The Federal Reserve Bank of Dallas estimated the loss was even higher. Numerous other studies estimate the impact of the crisis on the overall economy at $10 trillion.

But here we are today, here we are today talking about—in the Banking Committee, in front of the most important financial regulators in the world, we are talking about how Washington can do more to help the Nation's banks. How Washington can do more to help the Nation's banks.

We should be talking about how to increase wages, how to make housing more affordable and accessible, how to protect consumers, how to build up capital at banks. Many academics and Fed researchers suggest capital at banks is still too low, so that taxpayers and families—because it is too low, taxpayers and families could be forced to bail out banks again when the next crisis hits.

I do not think we will hear about any of these issues from today's witnesses.

The collective amnesia in this Administration and this Congress and this Committee is astounding. I ask the panel to start thinking more about middle-class families and less about Wall Street profits.

Thank you.

Chairman CRAPO. Thank you.

We will now proceed to the testimony of the witnesses. As you are well aware, we ask you to keep your remarks to 5 minutes. Your full statements will be made a part of the record. And I remind all of my colleagues to keep your questioning to 5 minutes as well.

With that, we will go in the order that you are seated, so we will start with Comptroller of the Currency Joseph Otting, then move to Federal Reserve Vice Chairman for Supervision Randy Quarles; then Federal Deposit Insurance Corporation Chair Jelena McWilliams; and, finally, National Credit Union Administration Chairman Mark McWatters.

Mr. Otting, please begin.

STATEMENT OF JOSEPH M. OTTING, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. OTTING. Thank you. I do appreciate choosing the order based upon beauty versus tenure and experience.

[Laughter.]

Mr. OTTING. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to discuss implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act. I am honored to be here with my regulatory colleagues to update you on our progress implementing the Economic Growth Act.

Over the last 10 months that I have served as Comptroller, a strong working relationship has developed among regulatory agencies based upon open and frequent dialogue and valuing each other's opinions and viewpoint.

I want to begin by congratulating the Chairman and the Committee on passing bipartisan, commonsense reforms that ease the unnecessary regulatory burden on small- and mid-size banks across the country. By lifting that burden, we helped small banks survive to be vital parts of their communities, serve their customers, and promote economic growth.

The reforms included in the law are an important step toward rationalizing our regulatory framework while ensuring our financial system continues to operate in a safe and sound manner, provides fair access to financial services, and treats customers fairly.

The Office of the Comptroller of the Currency recognizes the importance of this effort and is committed to implement the law as quickly as possible. We have dedicated the necessary resources to accomplish this task in a prompt and efficient manner.

The Act authorizes the OCC to issue one regulation on its own and to jointly issue 10 others with fellow safety and soundness regulators. Separately, we will consult with the Bureau of Consumer Financial Protection on a variety of consumer protection requirements included in the Act.

The one regulation that tasks individually to the OCC afford Federal saving associations greater flexibility without the burden and cost of changing charters. The OCC has advocated for greater flexibility for Federal savings associations since becoming their primary regulator in July 2011. I commend Senators Moran and Heitkamp for taking the lead on this issue.

On September 10, the agency published a notice of proposed rulemaking to implement this provision and allow Federal associations with $20 billion or less in assets on December 31, 2017, to elect to operate with national banking powers. Federal savings associations that make this election generally would have the rights and privileges as a national bank and be subject to the same duties, restrictions, penalties, liabilities, and limitations. Comments on the proposed rule are due in November. Following a review of the comments, I expect to issue a final rule in January 2019.

In August, the OCC joined the Federal Reserve and FDIC to issue two interim rules. On August 22nd, the agency issued an interim rule amending the agency's liquidity rules to treat certain municipal securities as high-quality liquid assets. The next day, the agencies issued final rules to expand the number of community banks eligible for an 18-month examination cycle to effect changes sponsored by Senators Heller and Donnelly. The rule allows qualifying entities with less than $3 billion in total assets to benefit from an extended examination cycle, greatly reducing their regulatory burden.

Most recently, on September 18, the agencies published a notice of proposed rulemaking to revise the definition of "high volatility commercial real estate," or HVCRE, subject to the heightened capital requirements as supported by Senators Cotton and Jones.

Work on the remaining interagency regulatory is well underway, and we will issue notice of proposed rulemakings to simplify capital requirements applicable to eligible community banks and reduce all call requirements later this fall. While we work expeditiously to complete these regulations, the OCC joined the Federal Reserve and the FDIC in July to issue a statement clarifying that the agencies' intent to supervise institutions consistent with the intent of the law. In doing so, the agencies will, among other things, not enforce requirements on banks that the Economic Growth Act intends to eliminate, including with respect to the amendments to the stress test requirements imposed by Dodd-Frank and exempting institutions with less than $10 billion from the Volcker Rule.

I appreciate the opportunity to update the Committee on the implementation of the Economic Growth Act and progress the OCC has made in other areas to reduce unnecessary burden and promote economic opportunity and job growth. That additional work includes encourage banks to reenter the small-dollar lending market, issue an advance notice of proposed rulemaking to begin public dialogue regarding modernizing the Community Reinvestment Act regulations, and moving forward on accepting special purpose national charters for fintechs engaged in the business of banking, and making compliance with the Bank Secrecy Act and anti-money-laundering regulations more effective and efficient.

My written testimony provides additional details on these efforts. I believe that consumers and communities alike will benefit from the reforms included in the Economic Act and the agencies' other work for many years to come. The OCC will keep the Committee apprised of our work, and I look forward to answering your questions.

Thank you very much.

Chairman CRAPO. Thank you, Mr. Otting.

Mr. Quarles.

STATEMENT OF RANDAL K. QUARLES, VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. QUARLES. Thank you, Chairman Crapo, Ranking Member Brown, Members of the Committee. I appreciate this opportunity to testify on the Federal Reserve's implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The Act calls on the Federal banking agencies to aid in promoting economic growth by further tailoring regulation to better reflect the character of the different banking firms that we supervise and recognizes that banks have a variety of risk profiles and business models. I believe that our regulation and supervisory programs can be flexible enough to accommodate this variety.

The Federal Reserve's implementation of the Act's directives is underway. In my testimony today, I will describe the progress we have made to date on tasks set out for the Federal Reserve in the Act. I will also highlight the work that will be our top priorities in the next few months.

Turning first to the progress that we have made to date, among the Act's key provisions are targeted tailoring measures to reduce the regulatory burden on community banks. To provide clarity to the public, the Board and the Federal banking agencies in July issued public statements on the regulations and associated reporting requirements that the Act immediately affected, indicating that we would give immediate effect to those provisions even before the formal regulatory changes were fully implemented. And in August, the Board began implementing these and other aspects of the law with several interim final rules.

One interim final rule raised the asset threshold from $1 billion to $3 billion for bank holding companies, or BHCs, to qualify for what is known as the "small BHC policy statement." The rule renders most BHCs and savings and loan holding companies with less than $3 billion in assets exempt from the Board's regulatory capital rules and provides corresponding relief from comprehensive consolidated financial regulatory reports.

Another interim final rule expanded the eligibility for small firms to undergo 18-month examination cycles rather than an annual cycle from less than $1 billion to $3 billion in total assets.

In addition, the task of developing a community bank leverage ratio is a high priority for the Board and our fellow regulators, and our goal is to issue a regulatory proposal in the very near future.

Turning to larger firms, the Board has placed their highest priority on issuing a proposed rule on tailoring enhanced prudential standards for banking firms with assets between $100 billion and $250 billion.

Our task is not merely to reform the current regulation of the particular institutions that are affected by the Act at this moment, but to develop a framework that will describe in a principled way when future institutions may expect enhanced regulation and why, using objective measures that account for the relative complexity and interconnectedness among large banks.

While the statute sets an 18-month deadline for this regulatory process, we expect to move much more quickly than this. Topics covered by such a proposal could include, among other things, capital and liquidity rules, resolution planning requirements for the less complex and interconnected of these firms.

The statute requires periodic supervisory stress testing by the Federal Reserve, which I believe recognizes the value of stress testing but requires a more tailored frequency and requires us to think more carefully about the burden of these tests.

Beyond thinking about how we will further tailor our regulation and supervisory programs for firms with assets between $100 and $250 billion, the Board is similarly reviewing our requirements for firms with more than $250 billion in total assets but below the G–SIB threshold. Through this review, the Board aims to ensure that our regulations continue to appropriately increase in stringency with the risk profiles of firms, consistent with the Act and the Board's extant focus on tailoring. Currently, some aspects of our regulatory regime—liquidity regulation, for example—treat banks with more than $250 billion in assets with the same stringency as G–SIBs. I see reason to apply a clear differentiation.

Let me conclude by saying that the provisions I have highlighted in my delivered remarks focus on tasks that the Board has completed or made a priority for the near term. In my written testimony, in its appendix, you can find a more fulsome list with additional important tasks and the Board's latest thinking and actions on them. Implementing the Act is an important milestone in the Federal Reserve's continuing tailoring mandate.

Thank you again for the opportunity to testify before you this morning. I am looking forward to answering your questions.

Chairman CRAPO. Thank you, Mr. Quarles.

Ms. MCWILLIAMS.

STATEMENT OF JELENA MCWILLIAMS, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. MCWILLIAMS. Thank you, Chairman.

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify today on the FDIC's efforts to implement the Economic Growth, Regulatory Relief, and Consumer Protection Act. I want to congratulate Chairman Crapo and other Members of the Committee who worked hard to craft this bipartisan legislation and former Chairman Shelby for his prior work in the area.

When I testified during my confirmation hearing, I stated that one of my top priorities at the FDIC would be the health of the Nation's community banks and their ability to effectively serve their communities. Community banks play a vital role in their local economies, and our regulatory regime must do what it can to ensure their continued vitality. The Committee's efforts on S. 2155 have provided a strong foundation for delivering on this priority with a number of directives to reduce regulatory burden on the Nation's small banks.

I particularly appreciate the Committee's efforts to give regulators the requisite flexibility to tailor regulations to the size and risk profile of an institution. As my written statement details, the agencies have already taken steps to conform existing regulations to the new law, including on items such as extending the examination cycle for small banks and amending the capital treatment of commercial real estate loans. We are also working expeditiously on the community bank leverage ratio, which will exempt a large number of community banks from the complex Basel III requirements. Taken together, these provisions and others will help community banks focus on serving their customers and communities. I can assure you that the FDIC takes the law's requirements very seriously.

Since I became Chairman, the FDIC has also commenced to work on a number of complementary initiatives to eliminate requirements that are duplicative, unnecessarily burdensome, or that fail to contribute materially to the safety and soundness of the financial system.

One of my initial priorities is to make sure that our supervisory guidance is clear and concise and that outdated or superseded supervisory communications are archived. As a result, we are looking to rescind more than one-half of our financial institution letters. Over 400 letters will be retired.

Yesterday we issued a request for comment on how the FDIC communicates with regulated institutions with a goal of streamlining communication and further reducing compliance burden. In the coming weeks and months, we will also address a number of additional regulatory priorities, including issues such as small-dollar lending, consistency of CAMELS ratings, and resolution planning.

Beyond addressing regulatory burdens on existing banks, we are actively considering how we can more effectively encourage new entities to enter the market while still ensuring that they are strong enough to survive. This includes improving the *de novo* application process and providing additional technical assistance to applicants.

Since 2010, only 11 new deposit insurance applications for start-up FDIC-insured banks have been approved and opened, and most of those within the last 15 months. To ensure the long-term vibrancy of the banking industry, we must attract new financial institutions and their capital. The FDIC's review process must support that crucial goal, particularly for those communities that do not have access to a bank or are served by a single institution.

We are also reviewing the application process for industrial loan companies. Congress authorized the FDIC to act on applications for deposit insurance for ILCs, and the FDIC stands ready to fulfill its mandate to review any application and approve them when they meet statutory requirements.

The FDIC has also begun a holistic review of its regulation of brokered deposits and national rate caps. We recently issued a proposed rule to implement Section 202 of S. 2155, which provides that certain reciprocal deposits are not considered brokered deposits. Additionally, we will seek comments later this year on the FDIC's brokered deposit regulations more generally. The banking industry has undergone significant changes since these regulations were put in place, and we will consider the impact of changes in technology, business models, and products since the brokered deposit requirements were adopted.

Last, I have embarked on a Chairman's Listening Tour to visit with bankers in each State during my 5-year term to gather their input and meet with some of their customers, including small businesses, farmers, and consumers. My goal is to reverse the longstanding trend of having those affected by our regulations come to Washington to be heard. It is long overdue that we come to them instead.

By increasing transparency, engaging more effectively and directly with our regulated entities and consumers, and by eliminating unnecessary regulatory burdens, the FDIC will be better positioned to support the health of the Nation's banks to ensure economic growth and job creation. I look forward to working collaboratively with the Committee on these efforts, and thank you again for the opportunity to appear before you today.

Chairman CRAPO. Thank you, Ms. McWilliams.

Mr. MCWATTERS.

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

Mr. MCWATTERS. Good morning, Chairman Crapo, Ranking Member Brown, and Members of the Committee. Thank you for the opportunity to participate in this important hearing on the implementation of S. 2155.

S. 2155 includes a number of amendments applicable to credit unions that provide regulatory relief, promote economic growth, and protect consumers. Specifically, Section 103 exempted from appraisal requirements certain rural real estate transactions. At its

September 2018 meeting, the NCUA Board proposed an appraisals rule incorporating this exemption and making additional burden-reducing changes. Section 105 amended the statutory definition of a member business loan to exempt all loans fully secured by a one-to-four-family dwelling, regardless of the borrower's occupancy status. The NCUA incorporated this amendment into its regulations less than 1 week after S. 2155's enactment.

Finally, Section 212 requires the NCUA to annually publish the agency's draft budget and hold a public hearing. The NCUA has been compliant with the spirit of Section 212 since the fall of 2016 when we restarted public budget hearings and posted significant budgetary analysis on the agency's website.

I wish to thank my Democratic colleague Rick Metsger for diligently working with me in a collegial, collaborative, and bipartisan manner for 2 ½ years to reorganize the agency and to develop sensible and targeted relief for the Main Street credit union system, including: one, establishing a Regulatory Reform Task Force to develop a comprehensive review of the agency's regulations; two, providing flexibility to corporate credit unions' capital standards; three, recognizing that Federal credit unions may securitize loans they make; four, improving the NCUA's examination appeals process to ensure due process and fairness; five, improving the efficiency of the NCUA's capital planning and stress testing rules; six, adding flexibility to the NCUA's field-of-membership process; seven, proposing additional options for Federal credit unions to offer payday alternative loans that present a viable alternative to traditional payday lenders; and, eight, proposing a more tailored risk-based capital rule that does not needlessly burden the smallest credit unions.

Additionally, the NCUA promulgated an advance notice of proposed rulemaking on the issuance of supplemental capital for risk-based net worth purposes. The NCUA also undertook initiatives to improve the agency's efficiency and reduce unnecessary examination and reporting burdens.

Specifically, the agency has: one, reorganized by eliminating two of our five regional offices and streamlining several agency functions to reduce costs and increase efficiencies; two, extended our examination cycle to 18 months, reducing the agency's presence in well-run credit unions; three, undertaken a modernization of the agency's call report; and, four, implemented a program to incorporate emerging and secure technology that supports the agency's examination, data collection, and reporting efforts.

Finally, I would like to offer two suggestions for legislative action that would benefit the credit union system and the underserved and assist the NCUA in carrying out its safety and soundness mission.

First, permit all credit unions, not just multiple common bond institutions, to add underserved areas to their field of membership so as to expand access to financial services for the unserved and the underserved and those of modest means; and, second, provide the NCUA with examination and enforcement authority over certain third-party vendors, including credit union service organizations, information security, and fintech-related vendors. We stand ready to work with you on your legislative priorities.

I look forward to your questions. Thank you.

Chairman CRAPO. Thank you, Mr. McWatters. I thank each of you for the attention you are giving to implementing S. 2155 and encourage you to continue to do so. The benefit that we are seeing from this regulatory reform is evident in our economy, and I think the people who pay these costs, whether it be business owners, consumers, or workers, will continue to benefit from your enhanced efforts.

Ms. McWilliams, my first question today will be on the community bank leverage ratio. Section 201 of S. 2155 simplifies the capital regime for community banks by presuming community banks not engaged in certain activities and meeting a minimum level of capital to be compliant with generally applicable capital requirements. The provision requires Federal banking regulators, in consultation with State banking regulators, to develop a simple leverage ratio and establish a minimum level of capital for banks to qualify for the presumption.

When do you plan to release a notice of proposed rulemaking on the community bank leverage ratio? And can you provide us an insight into how regulators may be approaching setting this minimum?

Ms. MCWILLIAMS. Sure. Thank you, Senator Crapo. Very soon. The answer is very soon. We are hoping to have the proposed rule out shortly, certainly before the year end, if not much sooner.

We are approaching the capital regime for community banks from a very, I would say, simple perspective. We have made things too complicated. They should not be subject to the Basel III requirements. Those requirements should apply to internationally active large banks. The system that we put in place now needs to be commensurate to the risk profile of small community banks and primarily banks below $10 billion.

Letter submitted to Chairman Crapo from Jelena McWilliams

Federal Deposit Insurance Corporation

October 17, 2018

Honorable Michael Crapo
United States Senate
Washington, DC 20510

Dear Mr. Chairman,

Thank you for the opportunity to testify before the Committee at the October 2, 2018, hearing on "Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act." I am writing in response to the question you posed to the witnesses at the hearing pertaining to the review of thresholds contained in agency guidance documents and rules.

As you note, Section 401 of S. 2155 generally raised the asset thresholds for application of enhanced prudential standards for bank holding companies (BHCs) under Section 165 of Dodd-Frank from $50 billion to $250 billion, while giving the Federal Reserve flexibility to apply certain standards to BHCs below $250 billion in total consolidated assets under certain conditions. In addition, Section 401 raised the asset threshold for company-run stress testing by financial companies, including insured depository institutions, from $10 billion to $250 billion.

Following the passage of Dodd-Frank, the banking agencies also applied certain other standards or adopted other policies that apply to banks using the thresholds found under Section 165 of Dodd-Frank. Two examples of note for the FDIC are (1) the interagency supervisory guidance on stress testing issued in 2012 and (2) the FDIC's rule on resolution plans for insured depository institutions initially proposed in 2010 and finalized in 2012.

Since the passage of S. 2155, the banking agencies have prioritized finalizing rulemakings required by the legislation. For example, as I mentioned at the hearing, the agencies have been working hard on a notice of proposed rulemaking to implement Section 201, establishing a community bank leverage ratio, which we plan to issue soon.

At the same time, the FDIC has also been undertaking a holistic review of all of its rules, regulations, guidance documents, and policies. This includes a close look at the guidance on stress testing and the rule on resolution planning mentioned above. We are reviewing the stress testing guidance both in light of the passage of S. 2155 and the interagency statement on guidance issued on September 11, 2018. The stress testing guidance was issued jointly by the banking agencies, and discussions with the other agencies related to the guidance in light of the statutory changes made by S. 2155 are ongoing.

The FDIC has also been looking very closely at the 2012 final rule on resolution planning for insured depository institutions. As I mentioned in my opening statement at the hearing, I have made changes to the resolution planning process a priority of mine, and it is something that we plan to address in the near future.

Thank you again for the opportunity to testify before the Committee earlier this month. I look forward to continued engagement with the Committee on implementation of S. 2155 and other regulatory initiatives.

Sincerely,

Jelena McWilliams

Chairman CRAPO. Well, thank you.

My next question is for you, Mr. Quarles, and it deals with tailoring the supervisory stress tests. You referenced this in your testimony, but Section 401 of S. 2155 requires a periodic supervisory stress test for banks with between $100 billion and $250 billion in total consolidated assets. Consistent with right-sizing and simplifying regulations for regional banks, such supervisory stress tests should be streamlined and tailored accordingly.

When do you expect to release a notice of proposed rulemaking on supervisory stress tests for banks between $100 and $250 billion in total assets? And can you describe how such stress tests could be simplified from the current approach applied to these institutions and what factors the Fed may be considering for tailoring such stress tests?

Mr. QUARLES. Thank you. So with respect to the timing of our rulemaking with regard to stress tests and other provisions applicable to banks between $100 and $250 billion, that is our highest priority in the sort of necessary sequencing of tasks associated with the implementation. I expect, as Chairman McWilliams said, that we will be completed with that task very soon, certainly by the end of the year, and I hope well before that.

For the elements of the stress tests, I think that, as I indicated in my testimony, we have a clear instruction with the use of the term “periodic” replacing the term “annual,” that we certainly need to tailor the frequency of those tests. And we need to consider some of the burden appropriate to stress testing even on that less frequent basis for banks in that category.

We have not completed our analysis of exactly how we will look at the burden of the tests or the timing of the tests, and I do not want to front-run the formal Board decision on those measures, but it is a high priority, and we will have an NPR out for consideration by the Committee soon.

Chairman CRAPO. All right. Thank you very much, and I appreciate the attention you are both giving to these two important issues.

This last question is for all of you, and there will not be enough of my time left after I ask it for you to answer here, so I am going to ask you to provide your answer in writing. You may get some additional written questions, as you know, but I would like you to take this as your first written question.

Section 165 of Dodd-Frank established a $50 billion and in some cases a $10 billion threshold in total consolidated assets for the application of enhanced prudential standards. Such thresholds were applied in rulemakings and guidance documents consistent with Dodd-Frank's requirements. Supervisory guidance on company-run stress testing for banks with more than $10 billion in assets issued jointly by regulators in 2012 is just one example.

The agencies have also applied numerous other standards using either the $10 billion or $50 billion asset threshold to be consistent with Section 165. For example, banks with $50 billion or more in total assets have historically been subject to CCAR, a supervisory stress test not required by statute.

My question with regard to this set of issues is: Are you reviewing all rules and guidance documents referencing such thresholds? And can you provide your thinking on revising these rules and documents in light of S. 2155? My staff will be glad to give you further thought on exactly what that question is, but it is literally making sure that we accomplish the intent of S. 2155 across the regulatory spectrum.

Chairman CRAPO. With that, Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

To start with, I would like yes or no answers to the first question I ask, if you would, and we have a lot of issues to go through, and I appreciate the conversations that we have had privately and individually.

I will start with you, Mr. Otting. If one of your employees made racist and sexist comments and his first instinct was to stick by them, would you leave that person in charge of fair lending at your agency?

Mr. OTTING. I do not think it is a yes or no answer. I think there is a comprehensive analysis that would need to be done.

Senator BROWN. Well, that is sort of a yes or no——

Mr. OTTING.——[inaudible] that would have to be done.

Senator BROWN. OK. And use your mic, if you would.

Mr. Quarles.

Mr. QUARLES. I would have to support Comptroller Otting's answer on that. I think it is a facts and circumstances determination.

Senator BROWN. Well, I am asking if the facts are your employee made racist and sexist comments, his first instinct was to stick by them, would you leave that person in charge of fair lending at your agency? That is the fact that I am asserting.

Mr. QUARLES. Racism has no place in the workplace.

Senator BROWN. Ms. McWilliams?

Ms. MCWILLIAMS. Senator, if my employee made sexist or racist comments in our workplace, that would certainly be subject to a disciplinary action. There is no room for that at the FDIC.

Senator BROWN. Thank you.

Mr. McWatters?

Mr. MCWATTERS. If a background analysis yielded exactly the facts as you stated them, no, I would not leave that person in charge of that area.

Senator BROWN. Thank you for your candor.

Vice Chair Quarles, I predicted that S. 2155 would be used to justify weakening rules for banks over $250 billion and foreign mega banks. Five months later, groups of House and Senate Republicans have written letters to you and Chairman Powell saying that the Fed has a responsibility under the law to do more favors for them. That letter also was the letter I cited about regional banks with international parents.

Do you agree with the Republican letter that the Fed has a responsibility to do more favors for mega banks?

Mr. QUARLES. Favors for mega banks is not how I would at all characterize anything that we are doing at the Federal Reserve or that we are required to do under any law.

Senator BROWN. Banks—well, favors by definition of doing things that make them more profitable, that relax the rules on them for capital standards, and the like.

Mr. QUARLES. So I do think that we have an obligation as responsible regulators to consider the efficiency of our regulatory scheme in addition to its effectiveness in promoting safety and soundness. We have a public interest in the efficiency of the financial sector because it supports economic growth, it supports job creation, and that economic growth is the basis of the ability we will have to solve a lot of other problems in the country.

Senator BROWN. The efficiency, when I hear conservative regulators who were in charge a decade ago when all this happened, I hear about efficiency, but efficiencies always seem to mean more profits for the banks and less stability for the banking system. But it just seems like never enough for them.

Now let me say something. Ten years later, the eight largest U.S. banks are asking the Fed to lower their risk-based capital surcharge. If there was anything that Republicans and Democrats agreed on after the crash, if there was anything, it was that the largest banks needed more capital to make them safer. Research indicates that bank capital is below the level needed to insulate taxpayers from risk. The Independent Community Bankers Association of America in an op-ed asked the Fed—in a letter asked the Fed not to lower the surcharge since big banks still benefit, they think and I think and most of the world thinks, from a "too big to fail" subsidy.

Do you agree we should not lower big bank capital standards?

Mr. QUARLES. As I said before, Chairman Powell has also said, I think, that the capital levels, the total loss absorbency capacity in our system is roughly about right.

Senator BROWN. So if the Fed looks at the surcharge, as you have said to me on the phone that you would—and I cannot quarrel with that—will you consider the option that big bank capital should actually increase? Are you open to that possibility, as many have called for?

Mr. QUARLES. I think we should go where the analysis would lead it to go. We have taken actions during my tenure that have had the effect of increasing capital for the system and for the large banks. We ran the toughest stress tests in history over the course of last year, and that had the effective increase in capital in the system and for the largest banks.

Senator BROWN. Mr. Chairman, if I could do what you did, ask the last question, go a few seconds over and they can write the answer, Mr. Chairman?

Chairman CRAPO. Go ahead.

Senator BROWN. Thank you. Some of the sponsors of S. 2155 and Chairman Powell have said in front of this Committee and other times they do not intend for the bill to benefit large foreign banks operating in the United States. You, Mr. Quarles, Vice Chair Quarles, have given speeches saying the Fed should take a look at reducing the regulatory burden on these banks, saying the Fed should reconsider its calibration of foreign bank rules.

As you run to head the Financial Stability Board, a crucial position, obviously, leading international bank regulators, do you think it is important for the United States to offer a united perspective that we must maintain the post-crisis regulatory framework for all large banks? And you could either answer really briefly or give us the written answer.

Chairman CRAPO. We will have to take it in writing.

Senator BROWN. OK.

Chairman CRAPO. Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman.

Let me begin by just thanking the Chairman for holding this important hearing. I also appreciate the time that each of our witnesses have taken to come in and discuss the implementation of our legislation.

Governor Quarles, I would also like to acknowledge your public comments and congressional testimony on making our regulatory system more efficient and transparent. A number of my colleagues from the Committee and I have also recently reached out to you regarding new capital rules that the Fed is considering, including the G–SIB surcharge. I just wanted to say a brief word of thanks for that response and for the Fed's commitment to continuing its review and recalibration of post-crisis regulatory reforms.

I am just curious with regard to that—and I want to follow up because I think this is one area in which we have—we are concerned about competition. And it is not so much about favoritism. It is about trying to level the playing field. And what our concern was is that we have competition on an international basis right now. What we did not want to have happen is that because of our regulatory purview that we be mandated that we increase the cost of operating for those organizations currently identified at G–SIBs.

Could you comment just a little bit, please, in terms of the thought process that you intend to employ as you review the supplemental leverage ratio regarding this? And I think the important part about this and what I really wanted to give you an opportunity to do is to correct any misunderstanding that this is designed to be favoritism to a certain select group of institutions.

Mr. QUARLES. Thank you, Senator. So the G–SIB surcharge is part of a complex of regulations that apply to our largest firms and really needs to be considered as part of that overall complex—the capital framework, the liquidity rules, the special stress testing requirements that we have for those institutions, our proposal to change some of those frameworks, including particularly the stress testing framework to something called the "stress capital buffer," which we have discussed as well. And so I think that to the extent that we consider that entire complex, the G–SIB surcharge will inevitably be part of considering whether we have appropriately calibrated this complex of rules to ensure that we have both protected the safety and soundness of those firms, that we have protected the ability of the financial sector in the United States, and it is relevant that we try to ensure that we have a level playing field internationally, not as a way of trying to seek a benefit for our firms, but because when you have an international system that has an unlevel playing field, over time pathologies will develop as activity moves to different areas of that global system, not on the basis of— or driven by incentives other than purely economic incentives, incentives by the cost of capital.

So I think we have to consider all of that. It is a very complex question. As I indicated in my answer to Senator Brown, I do not think we should prejudge what the outcome of an honest consideration of that whole complex of rules will be, that it will move things in one direction or another. But I think that that principle is quite important in general as we consider all of those rules.

Senator ROUNDS. Thank you, sir.

Chair McWilliams, you referenced Section 103, which provides appraisal relief for rural borrowers, in your testimony. In particular, you mentioned the implementation of this section is ongoing. Can you please discuss how the FDIC intends to implement this section and what more can be done to provide appropriate relief when it is difficult for borrowers to find appraisals? We are not talking about just a couple of days. We are talking about months sometimes?

Ms. MCWILLIAMS. Months.

Senator ROUNDS. Can you please share your thoughts?

Ms. MCWILLIAMS. Sure. Thank you, Senator. I believe it is very difficult for rural communities to find appraisals for in some cases both residential and certainly for commercial property and farmland. We are looking at ways in which we can go potentially even above and beyond—within our authority, above and beyond S. 2155 to ensure that the appraisal requirements as well as other burdens that we can deal with for rural communities can be addressed as soon as possible.

We are looking at providing extended periods of time, looking at providing some more relaxed standards for appraisals in rural areas, and we will do what we can within our jurisdiction to address those issues.

Senator ROUNDS. Thank you.

Thank you, Mr. Chairman. I will yield back my last 5 seconds.

Chairman CRAPO. I appreciate that, Senator Rounds.

Senator Reed.

Senator REED. Well, thank you very much. Thank you, lady and gentlemen, for your testimony today.

I want to focus in on a specific issue that has been of great concern to me for many, many years, and that is the Military Lending Act. Your colleagues over at the CFPB have indicated they are going to downgrade their review process by not reviewing their subject institutions for compliance with the Military Lending Act, which I find upsetting. Forty major veterans organizations took an ad out. They are upset. So I would like, if I could, your commitment, beginning with Mr. Otting and going down the line, to fully and vigorously enforce the Military Lending Act for the benefit of servicemembers.

Mr. OTTING. Senator Reed, you have our commitment. We are in full support of enforcing the Military Lending Act and the SCRA, which is another important provision for people that are serving our country.

Senator REED. Mr. Quarles, please.

Mr. QUARLES. Yes, absolutely, Senator.

Senator REED. Thank you.

Ms. MCWILLIAMS. Yes, Senator.

Senator REED. Thank you very much.

Mr. McWatters?

Mr. MCWATTERS. Yes, Senator. There are two very, very large credit unions, Navy and Penn Fed. This is a safety and soundness issue to the NCUA. It is also an issue of helping our soldiers, sailors, airmen, and marines, and we will enforce it.

Senator REED. Thank you. And are there any specifics that you could add as to how you are going to carry that out, messaging your member institutions or whatever? And I will ask the same question of everyone else.

Mr. MCWATTERS. We are on the job now doing that. And, if the CFPB, the Bureau, decides that they do not have the authority to examine or supervise, we are already there.

Senator REED. Thank you. Ma'am?

Ms. MCWILLIAMS. Nothing changes for us. We will continue to do what we have done in the past, and servicemember protection is high on our list of priorities.

Senator REED. Governor?

Mr. QUARLES. Similarly, that has always been a high priority of the Federal Reserve, and where we have the enforcement authority to act, we will do that.

Senator REED. Thank you.

Mr. OTTING. You asked about how that is communicated. We do both bulletins and policies and procedure issuance, and that will be part of our normal examination cycle.

Senator REED. Thank you very much.

We have all talked about the 10 years that have passed since the last great crisis, and, unfortunately, there is always—even though it seems to be clear sailing, always—maybe it is because I am Irish. There is always an iceberg out there someplace.

Starting with the NCUA, what do you think is the systemic danger right now that we are facing?

Mr. McWATTERS. Well, Senator, that is a great question. It is difficult to answer. If I go back during my 36 years of practicing law, starting with the S&L crisis, the LBO crisis, lesser developed country crisis, dot-com crisis, and then what happened 10 years ago, there are common denominators: one, is regulators missed every one of them; and, two, they were all caused by lending, improperly underwritten loans, and an overconcentration of those loans. So looking and trying to specifically identify today what that is is difficult. So I take a more simplistic view.

What causes a bubble to inflate? What causes a bubble to inflate is money going after a certain deal. The first deals are very good. People make money on the deals. More money flows in. The deals get dumber and dumber. They are not underwritten. There is an overconcentration. So the answer to your question: Simply follow the money.

Senator REED. Thank you.

Ms. McWilliams?

Ms. McWILLIAMS. I generally agree with the Chairman's comments. I would also add we need to be cognizant of potential exposures the companies have and the financial institutions have to cybersecurity and cyber breaches. A colossal breach could bring a financial institution down for a number of days. There are also issues with, in general, technology and how the companies are handling the technological issues as we move forward. An issue of a technological kind would not necessarily bring the company down, but it is going to be on the front line of the defense.

Senator REED. And very quickly, Mr. Quarles?

Mr. QUARLES. For me, cyber risk is the issue that we should be focusing on that we have not—you know, we have taken a number of measures with respect to the financial stability risk, and those have been effective in my view. And the risk that we really need to focus on is cyber.

Senator REED. Comptroller, please?

Mr. OTTING. Senator, we believe credit quality is a big determinant of the future, and so in our semiannual risk statements, we continue to be focused on that. We recently introduced what our 2019 priorities will be. It is definitely around the credit risk in the institutions. But I would echo my colleagues on cybersecurity. We do spend a significant amount of time looking at perimeter software updates, patches, hardware, and the ability to recover from a cybersecurity issue. But that is the one area that we would have concerns that consumers would be influenced if a bank they were banking with were shut down for a number of days.

Senator REED. And, again, I think Mr. McWatters pointed out, most of these have shocked the system. We are thinking about it, but it is a big surprise, and the best life preserver—my nautical analogy continuing—is capital. And so you should think very carefully as you start thinking about reducing capital because we might not know what is around the corner.

Thank you.

Chairman CRAPO. Thank you, Senator Reed.

Senator Tillis.

Senator TILLIS. Thank you, Mr. Chairman. Welcome to all of you, and thank you for the work that you are doing.

Mr. McWatters, you made a comment about additional congressional action you think would be helpful. Could you get a little bit more specific about your recommendations?

Mr. McWATTERS. In my oral statement, there are really two recommendations. Credit unions want to serve the unserved and the underserved. There is a provision in the Federal Credit Union Act that says that only multiple common bond credit unions can add underserved areas. Since credit unions want to serve underserved areas, want to serve the unserved, it would be helpful if the Federal Credit Union Act was amended to allow credit unions to do what they want to do. Credit unions are not subject to the CRA, and one reason they are not subject to the CRA is that they actually want to extend credit to those individuals, those businesses that the CRA would require them to. They want to do it anyway. So it would be helpful to amend the Federal Credit Union Act accordingly.

Also, there is a request for vendor authority. All of the other regulators at this table have the authority to regulate to examine and supervise vendors. Credit unions, many of them, are very small, so they operate sort of on an economy-of-scale basis by pulling together and hiring outside third parties to assist them. Particularly in cybersecurity, as my three colleagues just articulated, we really cannot go in and examine those vendors. Our hands are tied. It would be very helpful for that to happen.

Senator TILLIS. Ms. McWilliams, you mentioned you are starting a listening tour. Have you completed any of those yet?

Ms. McWILLIAMS. I have been to your State, Senator, and——

Senator TILLIS. What did you hear?

Ms. McWILLIAMS. Bankers generally have issues with some of the accounting changes through FASB. There are issues with some of the BSA/AML compliance which is very complicated for community banks to do. In general, in rural communities, they are struggling, as Mr. Rounds mentioned, with appraisals and some of the lending activity. The agricultural prices and the farmland prices are of concern to some folks. So it is a hodgepodge of things. In general, they are very appreciative for the regulatory changes that are ongoing, and I believe that in general the forum helped them in many ways.

Senator TILLIS. I have got several questions I am going to submit for the record, and I look forward to your responses. But in my remaining time, first off, I do not think that S. 2155 was trying to do any favor to any bank. It was actually to do a favor to consumers, to do a favor to unserved and underserved areas to the people who actually need banking options that they do not have today, because we have seen the ecosystem and community banks, we have seen a lot of pressure on credit unions. We have simply got to get more access to more consumers. That was my reason for supporting S. 2155.

But, also, when you have a bank that is spending almost $700 million a year related to stress testing, there is something wrong. We have to be able to understand the risks, but there is something fundamentally wrong with the regulatory process when you are spending that amount of money for nothing more than compliance.

It is going out of any efforts to support or maybe serve underserved areas.

So, Mr. Quarles, and for the rest of you in my remaining time, number one, we have not only got to get to the regulatory relief for the $250 billion threshold; I think we have to go beyond that. And part of that is just streamlining the regulatory process. And for all of you at any given point in time, you could be in the same bank taking a look at your piece of the regulatory responsibility, but what are you all doing to make sure that these examiners, the people that are going on board, are actually being as lean as they can possibly be to get their job done? I think there is a lot of inefficiency. I think there is a lot of uncertainty, there is a lot of costs associated with that. And at the end of the day, it is the consumer, it is the business, it is the small business that gets harmed. It is not doing a favor to these banks.

So what are you doing to try to streamline and provide better regulatory certainty? I will not have enough time for all of you to answer the question, but I would really like to see how you amongst your organizations are working to show me real progress in leaner regulatory execution.

I will yield back my 10 seconds and look for your response. I would like to know precisely what you are doing between the agencies to get better at what you do.

Thank you.

Chairman CRAPO. Senator Menendez.

Senator MENENDEZ. Thank you.

Chair McWilliams, during your confirmation hearing, you committed to adhering to the requirements that attend to the Community Reinvestment Act, and you added, and I will quote, "I can also assure you that on a personal level, as somebody who was part of a low- and moderate-income community, the mission of the CRA resonates profoundly with me on a personal level as well." This commitment is one of the reasons that I voted in support of your nomination.

The OCC recently released a proposal without input from the FDIC or the Fed contemplating sweeping changes to implementation of the CRA. So I would like to ask you and Vice Chair Quarles about that.

First, do you both agree that discrimination in lending exists?

Ms. MCWILLIAMS. Senator, we actually look for discrimination, and if we find it, we send those referrals to DOJ. So, yes, occasionally we come across incidents of discrimination in banking, and those cases get promptly referred to DOJ for prosecution.

Senator MENENDEZ. Mr. Quarles?

Mr. QUARLES. Similarly, we have the same program of looking for fair lending violations, referring them to the DOJ. We do find them. We continue to find them. And so it does exist.

Senator MENENDEZ. Would you support a final rule that de-emphasizes the importance of a bank's physical presence in terms of branches in low- and moderate-income communities?

Ms. MCWILLIAMS. I am sorry. Did you say "de-emphasizes"?

Senator MENENDEZ. That de-emphasizes.

Ms. MCWILLIAMS. I think we need to take a look at the role branches are playing in today's community, banking in general, and the digital framework for banks. But, in general, I believe that branches are important, still important, and in a number of low- and moderate-income communities. To the extent that consumers rely on those branches, more so than they rely on digital devices, I would certainly want to make sure that emphasis remains a part of this debate.

Mr. QUARLES. I think place is important with respect to banking and the implementation of the CRA. I come from a part of the country that is fairly rural, and the importance of branches in rural communities is something that I have a special interest in.

On the other hand, the financial system is evolving, and branches have a different role than they have had in the past, and so I do think we need to think creatively while not ignoring place as an issue with respect to——

Senator MENENDEZ. So are you both familiar with research that home and small business lending increases in low- and moderate-income neighborhoods with the presence of bank branches and decreases when branches close?

Mr. QUARLES. I think some of that research has been done by the Fed. I am familiar with it.

Senator MENENDEZ. You are familiar with it?

Mr. QUARLES. Yes.

Senator MENENDEZ. Are you familiar with it?

Ms. MCWILLIAMS. I have heard. I cannot tell you the paper that it came from.

Senator MENENDEZ. Well, I will look forward to sending it to you so that you can look at it because that is the fact.

Would you support a final rule that limits analysis of lending and investment activities in individual census tracts and instead relies heavily on a single ratio to calculate qualifying lending and investments? That is to both of you.

Mr. QUARLES. Can I start first?

Ms. MCWILLIAMS. Please.

Mr. QUARLES. My view of the regulatory process is that we benefit enormously from input. The Comptroller of the Currency has put out an ANPR that will give us a lot more information than we currently have. We're going to work jointly together on the basis of that information to put out an NPR. So I do not want to front-run that process by committing now to something that I may find on the basis of information that comes in from a variety of sources ought to be more nuanced.

Senator MENENDEZ. Well, how about you?

Ms. MCWILLIAMS. I would want the final rule to ensure that the original congressional intent behind the CRA is satisfied.

Senator MENENDEZ. Well, I appreciate that. Do you agree with the premise that the CRA is about measuring banks' contributions—lending, investment, and services—to local communities?

Mr. QUARLES. You can go first this time.

Ms. MCWILLIAMS. Thank you. Local communities, yes, that is a part of the CRA's intent. The banks are supposed to serve the communities in which they operate. And to the extent that those local communities are low- and moderate-income communities, they are supposed to service those communities as well. To the extent that they have a footprint that is not included necessarily in their local presence, low- and moderate-income communities, but in their general footprint there are such communities, they are supposed to service those.

Senator MENENDEZ. Well, here is my concern. If regulators no longer look at activities in individual low- and moderate-income communities or do so in a limited capacity and instead rely on the totality of a bank's actions, how is it that they will be able to monitor whether banks are meeting local credit needs, which vary from community to community? That is why the question that has been put out that suggesting that instead of looking at individual census tracts, that a single ratio to calculate qualifying lending and investments basically looking at the total of an action without looking at its disparate effects upon communities, that is at the heart of the CRA. That is at the heart of the CRA. And I would hope that after your review, you would make sure that what is at the heart of the CRA remains at the heart of the CRA.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman. Thank you to the witnesses.

Let me begin with Ms. McWilliams. You observed what I think has been a national embarrassment and a big economic opportunity cost when you referred to the decade or so during which we had fewer than a dozen *de novo* banks launched over an entire decade. That is just horrendous compared to what we used to do. So I do want to commend you for the attention you are putting on facilitating the application process.

As we all know, a *de novo* bank is not a systemic risk to the United States, any particular State, or typically the negative in which they are headquartered. The idea that the Federal Government has to burden folks who are attempting to launch such a venture and provide capital in their community is just—I am relieved to hear that it is a priority of yours, and I thank you for that.

Mr. Otting, I would like to direct this primarily to you, although it applies more broadly. I was pleased to see the September statement that you folks put out underscoring and confirming and clarifying that guidance is not the same thing as a rulemaking, that it is not binding. You know the history of our successful effort to get the GAO to confirm that the leverage lending rule really amounted to—guidance, I should say, really amounted to a rule. So I am pleased that our regulators have acknowledged that when you take the delegated authority that Congress has given, you actually have to follow the APA and then the CRA and abide by those measures.

My question for you, Mr. Otting, is: What are you doing to make sure that this important idea makes its way to the examiner level? Because I have hard from banks that feel as though this somehow has not filtered down to the guys who are actually walking in the front door of the bank and doing examinations.

Mr. OTTING. Thank you very much for the question. I will admit that I am a little baffled by this guidance issue. It is fairly clear to me what the word "guidance" means, and we would hope that in the OCC people will take that to heart and understand that definition.

The one area that I think over the years that has perhaps got us off the rails a little bit was on the leverage lending guidance. And so I think over the 10 months that I have been here, we have had a number of sessions with senior leaders, with Deputy Comptrollers, with examination staff. We have produced internal communication on this item. I am a little disappointed to hear that you have heard feedback that people are not recognizing guidance as guidance and that rules are rules. But I would hope that the next time we get together, the feedback that you receive would be completely the opposite. I think we have taken this issue on straightforward, and have had a lot of both written and verbal communication within the agency, all the way to the point that no regulatory or supervisory action can be based on guidance.

Senator TOOMEY. Thank you. I appreciate that and I encourage your continuing that.

Vice Chairman Quarles, I think it is almost a year now since you have been confirmed. You and I have had a number of conversations about the tailoring of the enhanced prudential standards. And I am encouraged once again in your testimony you point out the importance of that, the legitimacy of that. But I have to say I am frustrated because I just have not seen the progress that I thought we would have seen by now.

As you know, I am particularly concerned about the liquidity coverage ratio as it applies to banks that are just above the $250 billion threshold but clearly not similar to the giant money center banks. So I thought we would have seen something a long time ago, frankly, and I am wondering if you can give us any assurance that there is something coming soon in the general category of tailoring but also specifically with respect to the LCR.

Mr. QUARLES. Yes, Senator, that is a perfectly comment. I have been surprised as well at the time that it has taken to move forward on that topic. But as I indicated in my testimony, we do view that as a priority, and we will be addressing it promptly.

Senator TOOMEY. Any more color on the "promptly"?

Mr. QUARLES. One of the issues with respect to the timing, which I know one could take different views about, but we did want to wait until the legislative instructions with respect to tailoring were clear before we completed that task. And so we are viewing it as a whole, and so it has been affected by that. But we are no longer—we are now working hard on that as part of the overall tailoring package, and so it should proceed at the same pace.

Senator TOOMEY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Tester.

Senator TESTER. Thank you, Mr. Chairman and Ranking Member Brown, for holding this hearing. Thank you all for being here. I appreciate your testimony.

Mr. Quarles, one of the provisions that I spent a lot of time on in S. 2155 was one related to international insurance capital standards. The provision intends to bring more transparency to the international standard-setting process. So could you give me an update on where the Federal Reserve is in terms of setting up an advisory committee on international insurance?

Mr. QUARLES. Well, we are working to increase the transparency of that process, and I do not think that we have an advisory committee stood up, but that is part of what we will be—you know, that is part of what we will be working on and ensuring that we have full input into——

Senator TESTER. Can you give me any—is there a timeline on when that advisory committee would be set up?

Mr. QUARLES. I cannot today, Senator, but I will respond promptly to you.

Senator TESTER. Perfect.

Senator TESTER. Mr. Quarles, is it your belief that the international standard-setting organization such as the International Association of Insurance Supervisors are embracing more transparency in their negotiations?

Mr. QUARLES. I do think that they are, yes. The information that I have received both from the international standard-setting bodies themselves as well from our participants in them is that we are making progress on that front.

Senator TESTER. OK. Last year the Treasury Department recommended continued U.S. engagement in international forums to enable the promotion of U.S. industry competitiveness as international regulatory issues are debated and standards are crafted. Does the Federal Reserve support those priorities as part of Team USA's coordinated engagement in international forums? And by our participation, do you feel progress is being made in advancing the United States' interests?

Mr. QUARLES. Yes, I do think so. I think that both with respect to the insurance standard-setting bodies and with respect to the international financial bodies themselves, it is very much in our national interest to try to ensure that our views are made known, and they are being made known particularly with respect to insurance.

Senator TESTER. Well, thank you. I just want to say quickly for the record that I think S. 2155 has taken a big step forward in terms of transparency for international regulations, insurance regulations. And I know that there are some efforts in the House of Representatives to go far beyond what was recently signed into law with S. 2155. I believe those efforts are misguided and, quite frankly, counterproductive to the good work that this Committee has done. And I would just like to say to my colleagues in the Senate I would hope that we would give the provisions of S. 2155 a chance to play out before folks try to amend this section of the law.

With regard to Section 401, you have already talked about implementation of that, Mr. Quarles, with banks with less than $100 billion in assets. For the other institutions—and you said that you anticipated those would be out before the end of the year. I just want to clarify some stuff. S. 2155 directs the regulators to exempt all bank holding companies with less than $250 billion from enhanced prudential standards, that issues like CCAR and international holding companies are somehow changed by the statutory language of S. 2155.

So my question for you, Governor Quarles, is this: Can you elaborate if the Federal Reserve views S. 2155 as directing you to eliminate all prudential standards for banks with less than $250 billion or require you to change CCAR or IHC thresholds?

Mr. QUARLES. So I think it is clear that we have been instructed for banks in that category, $100 to $250 billion, to tailor our regulations.

Senator TESTER. Yes.

Mr. QUARLES. And I think that is a clear instruction, and we are taking that seriously.

Senator TESTER. In regard to tailoring, let us say you find a bank that is in that—let us say you find any bank, by the way, that has got a pretty nonrisky profile, we will call it, and you have changed the standards on them because you find that their portfolio is pretty reasonable and lacks risk, and they change it. Do you have the ability to bring them in regardless of the size?

Mr. QUARLES. Absolutely. The statute certainly does not change our ability to prudentially regulate. We will continue to be focused on capital and liquidity for institutions in that size and complexity range. The instruction is to tailor, but it is not to eliminate prudential regulation.

Senator TESTER. So would it be fair to say—and then I will quite, Mr. Chairman. Would it be fair to say that as you look to tailor regulations, you are going to base it on a risk profile, and if that risk profile changes, you will change the regulations to meet that risk?

Mr. QUARLES. Absolutely.

Senator TESTER. Thank you.

Chairman CRAPO. Thank you, Senator Tester.

Senator Shelby.

Senator SHELBY. Thank you.

Governor Quarles, are capital and liquidity two of the most important, maybe not all but most important things in the banking community?

Mr. QUARLES. They are the foundation, yes.

Senator SHELBY. They are the foundation of the whole thing, are they not?

Mr. QUARLES. Yes.

Senator SHELBY. I will throw this question out because it is what you do every day. How do you balance the risk in the banking community? Do you do it bank by bank? Do you do it small banks versus big banks, everything in what we will call "systemic risk" to our banking system, our economy, as to what will not, keeping in mind you want all banks, if they can be, to be healthy? How do you do that?

Mr. QUARLES. Well, as you note, we have to have a regulatory system that allows us to look both at the capital and liquidity position of individual institutions for their individual safety. And then we look at factors that affect the stability of the financial system, even apart from individual institution failure.

Senator SHELBY. I will ask this of the whole panel. How have and how will the agencies that you head up take cost-benefit analysis into account when implementing regulations? And how important is that?

Mr. QUARLES. I am happy to start——

Senator SHELBY. Go ahead.

Mr. QUARLES.——with the fact that I think that that is an extremely important factor in any regulatory process. Looking at the cost of regulation versus the benefit of regulation, doing that seriously and honestly is something that we as regulators are, A, required to do by the law, and it is also very appropriate for us to do.

Senator SHELBY. Ms. McWilliams?

Ms. MCWILLIAMS. I agree. Cost-benefit analysis is crucial for us to determine the outcome of the rulemaking process and to avoid unintended consequences that would in the end in some cases harm the very entities and consumers that we are trying to protect.

Senator SHELBY. Mr. McWatters?

Mr. MCWATTERS. Yes, Senator, we certainly pay attention to it. But in all candor, it is sometimes difficult to come up with a meaningful metric as to what is a cost and what is a benefit. It is back-of-the-envelope in many cases. It is a sincere, good-faith effort as to what are we really accomplishing here versus what it is going to cost. So it is a little more visceral than it is scientific, a little more art than science.

Senator SHELBY. Comptroller?

Mr. OTTING. Yes, Senator Shelby, we deploy a risk-based system, and accordingly with technology we can do more and provide more offsite-related analysis. We also spend a significant amount of our time doing outreach with CEOs and various executives of banks to gather data where they think there is an overabundance of both either interagency or within a particular agency of giving us feedback. And I think we have been able to take a lot of those things and try to become more efficient as we are implementing our regulatory oversight and authority.

Senator SHELBY. Mr. Quarles, I will start with you again. Is or will the methodology to do the analysis differ from the Fed, FDIC, Comptroller, credit union, or will it overlap? Will it be similar? I am sure there is no one standard.

Mr. QUARLES. Well, when we do a joint rulemaking, you know, we work together——

Senator SHELBY. Should you do a joint rulemaking dealing with cost-benefit analysis?

Mr. QUARLES. Well, I think the cost-benefit analysis that we undertake in connection with a joint rulemaking, we would coordinate on that as well. I think.

Ms. MCWILLIAMS. So, to continue, we would look at each other's entities. For us, it would be State-chartered banks that are not members of the Federal Reserve System and what the impact of the rule would be on those banks. We would certainly solicit comment on that as well. We would ask our economists and researchers to work collaboratively with the other agencies to estimate what the aggregate cost will be on the financial framework, and then we would come up with something good, hopefully, all together.

Mr. OTTING. I think that is a creative and innovative thought process to do joint rulemaking on that issue, and in our weekly general calls we will bring that up and have dialogue around that subject.

Senator SHELBY. I know my time is moving on here, but Senator Toomey got into the *de novo* bank applications. There are not many of them. You are doing some analysis, all of you looking at that. What is the cause of this? Why are there fewer *de novo* applications? What is the implication for the banking system and ultimately the entire economy? Is there a connection there, or is this an ongoing analysis? Ms. McWilliams?

Ms. MCWILLIAMS. I believe there is a connection there, and, frankly, we lost hundreds and thousands of banks in the last 10, 20, 30 years. In order for us to replenish the ranks of especially community banks, we need to encourage *de novo* applications. They work well for their communities. They serve their communities. Usually they start with a very small staff, with several millions dollars in capital. It is usually a local banking activity, and it happens in places where there is not a whole lot of competition for banking services. So they serve the communities that are otherwise a little bit neglected or not at the forefront of the larger banks' business models.

Senator SHELBY. My time is up. Thank you.

Chairman CRAPO. Thank you.

Senator Donnelly.

Senator DONNELLY. Thank you, Mr. Chairman. I want to thank all the witnesses for being here.

I am proud to have worked closely with you and Senators Heitkamp and Tester and Warner, among others, to craft this bipartisan legislation. This law provides much needed regulatory relief to the Main Street community banks and credit unions vital to economic growth in our communities, particularly in rural areas where families and farmers and small businesses often lack access to borrowing.

Today I want to focus on how this law benefits consumers across Indiana. Sections 301 and 302 of S. 2155 were partly inspired by the Equifax data breach, which compromised the personal information of more than 145 million Americans, including nearly 4 million Hoosiers. Sixty percent of Hoosiers were impacted, which is the highest percentage of any States, according to data from the Wall Street Journal. Americans deserve the ability to monitor and protect their credit files from criminals seeking to steal their identities.

With that goal in mind, I will highlight three important new provisions I helped author.

One, as of 10 days ago, every American can now freeze and unfreeze their credit files and set year-long fraud alerts, all free of charge.

Two, starting next year, active-duty servicemembers will receive free credit monitoring to make sure their credit files are kept safe while they keep us safe.

And, three, veterans will no longer be penalized by medical payment delays at the Department of Veterans Affairs and can more easily remove VA-related mistakes from their credit files.

Due to these three provisions, consumers and servicemembers and vets can now better protect their credit files and safeguard their personal information against fraud and identity theft.

The following questions will be for all four witnesses. Though the FTC and the CFPB are the agencies primarily focused on the provisions I highlighted, the Federal Reserve, OCC, FDIC, and NCUA are relevant as the primary regulators of financial institutions that report to and rely on credit files as part of the consumer lending process.

So, first, how do you recommend consumers best take control of their financial information and protect themselves from fraud of identity theft? Mr. Otting, we will start with you?

Mr. OTTING. Thank you very much. First of all, I commend you on your efforts. I think this information is important for consumers to be aware of and have access to. On the OCC website, we parallel some of the activities that you described, where consumers have an educational format, where they can identify ways they can reach their credit reports, what is available to them for free so they understand the rules and the regulations.

I do think it is important that consumers take advantage of some of the tools that are offered by financial institutions. Recently I lost my credit card for a day, and I was able to freeze my account, and then I found my card and I could reactivate it. Years ago that account would have been closed. They would have issued a new card, and I would have been without it for a week. So I think some of the provisions that we have recently put in under your leadership are going to make consumers more able to monitor risk and then be able to spot when there are activities associated with that.

Senator DONNELLY. Thank you.

Mr. Quarles?

Mr. QUARLES. Thank you. At the Federal Reserve, through the Federal Reserve banks, we have an active financial education process to make consumers aware of their rights under the new legislation. And we also will be doing research as to the effect of some of these changes going forward.

Senator DONNELLY. Chair McWilliams?

Ms. MCWILLIAMS. We have a very robust consumer education program at the FDIC, including the Money Smart publication that goes to the consumers. We have consumer newsletters. We have provided a newsletter on the credit freezes that are available by virtue of S. 2155, so I want to thank you for that. And, in general, we do extensive consumer outreach.

Senator DONNELLY. Thanks.

Mr. McWatters?

Mr. MCWATTERS. Thank you, Senator, for your leadership in this very, very important area. We have a separate website, *MyCreditUnion.gov,* that covers many of these items. It helps consumers understand what their identity is, how important their identity is, how to safeguard their identity, how to look at a statement from a financial institution, to determine whether statements are accurate, and if not, who to notify, and how to notify. So it is really the blocking and tackling, things that you may just know instinctively but that a lot of people do not actually know.

Senator DONNELLY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

Mr. Otting, can we agree that banks enjoy numerous advantages *vis-a-vis* nonbank competitors as a result of Government actions?

Mr. OTTING. Yes, we can.

Senator KENNEDY. For example, I could start a competitor to YouTube tomorrow, but if I want to start a bank, I have to get a charter, do I not?

Mr. OTTING. That is correct.

Senator KENNEDY. So that limits existing banks' competition. Can we agree on that?

Mr. OTTING. We can.

Senator KENNEDY. OK. Banks can lend nationwide, can they not?

Mr. OTTING. Depending upon their charter and where they are legally chartered to operate, that is correct.

Senator KENNEDY. Right, but Government has given them the privilege of lending nationwide—am I correct?—so long as they comply with the necessary rules.

Mr. OTTING. And depending on what charter they have, correct.

Senator KENNEDY. Right, OK. A nonbank like Prosper or Lending Club, they have to get a license from every single State, don't they?

Mr. OTTING. Yes, they do.

Senator KENNEDY. What about transferring money? Banks can transfer money across State lines, but nonbank competitors have to get State licenses, do they not?

Mr. OTTING. Well, are you saying where a bank has locations in multiple States?

Senator KENNEDY. Yes.

Mr. OTTING. Yes, they can.

Senator KENNEDY. OK.

Mr. OTTING. And nonbanks usually will use a financial institution to accomplish that.

Senator KENNEDY. How about Federal deposit insurance? Does that give a bank a competitive advantage over a nonbank competitor like a money market mutual fund?

Mr. OTTING. Up to a certain level it does, the maximums of the FDIC levels. It gives people confidence that the U.S. Government stands behind those deposits.

Senator KENNEDY. OK. In 2008 and 2009, the American taxpayer bailed out some of our larger financial institutions under TARP. You, of course, remember that.

Mr. OTTING. I do.

Senator KENNEDY. Do you think all those financial institutions would have survived had the American taxpayer not stepped up to the plate and bailed them out?

Mr. OTTING. I cannot speculate on that. I think it was very important in the eyes of Americans that the banking industry was stable.

Senator KENNEDY. Of course.

Mr. OTTING. And that there was capital there to ensure that those financial institutions would be available to support their needs.

Senator KENNEDY. Well, for example, under TARP and Federal loan guarantees, Citigroup got $475 billion from the American taxpayer. Bank of America got $336 billion in dollars and guarantees.

Without those guarantees and loans from the American taxpayer, would they have made it?

Mr. OTTING. I did not do that analysis. I am assuming—if you want me to offer a general opinion, I think it could have been questionable.

Senator KENNEDY. OK. Well, when a bank uses Government-provided market power to force social change, can we agree that that bank is effectively acting as a private regulator?

Mr. OTTING. Could you repeat that question for me? When a bank——

Senator KENNEDY. Yes, banks have competitive advantages as a result of Government.

Mr. OTTING. That is correct.

Senator KENNEDY. When they use that Government-provided market power to implement their version of appropriate social change, they are in effect acting as a private regulator, are they not?

Mr. OTTING. I do not know if I would say a private regulator. I think that they are deploying the management and the board's decision on markets that they wish to serve.

Senator KENNEDY. OK, or not serve.

Mr. OTTING. Or not serve.

Senator KENNEDY. All right. I am going to be introducing a bill called the "No Red and Blue Banks Act" that is going to block the GSA from awarding contracts to banks that discriminate against lawful companies based solely on social policy considerations. I would sure like you to take a close look at it.

Mr. OTTING. I would.

Senator KENNEDY. In the 30 seconds I have left, let me ask you this question: I just read an article where Bank of America was fined $30 million for manipulating a benchmark for interest rate products. They did it over 6 years to enhance—or to make money on their own derivatives positions. They were fined $30 million. Their total assets are $2.3 trillion. Do you think that is really going to stop them?

Mr. OTTING. A fine is one aspect to regulatory oversight. In addition to a fine, usually there are critical factors around consent orders and various policies that are required to be adapted by the financial institution. So I do not think a fine solely will dictate, you know, whether the bank will not be involved in that activity going forward.

Senator KENNEDY. If you did that, you would have U.S. Attorneys hanging all over your neck, wouldn't you?

Mr. OTTING. Probably.

Senator KENNEDY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

So for decades, banks refused to lend to low-income minority neighborhoods and in rural communities, and this prevented a lot of working families from getting a loan either to buy a home or to start a small business. So in the 1970s, Congress passed the Community Reinvestment Act, or CRA, to level the playing field and to require the banks to “meet the credit needs” of all the communities in which they operate.

So, Mr. Otting, your agency, the OCC, put out a proposal a few weeks ago to rewrite the CRA rules. Notably, the Fed and the FDIC did not join in that proposal, even though usually all three agencies work together on CRA.

Now, that was a pretty sharp sign that there are problems with your proposal, and as I dug into the details, I saw some of these problems. So here is one example.

Today banks get credit under CRA for all kinds of things—making mortgages, providing financial education—and the amount of CRA credit they receive depends on the impact of the actions they take.

Now, Mr. Otting, you suggest a new “transformational approach” that would count all these investments the same for CRA purposes. So a dollar to help a family buy a home is the same as a dollar to print a financial education pamphlet. Is that right?

Mr. OTTING. That is incorrect.

Senator WARREN. That is incorrect? So you do not stand behind the idea that you proposed?

Mr. OTTING. I do stand behind the ideas that I propose, but what we have offered in there is a concept. And recall this is an ANPR where we go out—it is a document to get feedback from people——

Senator WARREN. So you are backing off from what you put though in your document?

Mr. OTTING. No, I am not backing off. This is a document that we put out to receive feedback. We spent time with over 1,100 people before that document was produced. We gathered that feedback from civil rights groups, community organizations——

Senator WARREN. And so now you will be rewriting it?

Mr. OTTING. Well, just for clarification, an ANPR goes out, we gather questions, we expect to have somewhere between 5,000 and 10,000 feedback from that report to which then we will work with the other agencies——

Senator WARREN. So you are telling me you are not standing by what you wrote. All right.

Mr. OTTING. No.

Senator WARREN. The approach is designed——

Mr. OTTING. You know, if you do not understand the process of an ANPR——

Senator WARREN. I think I do understand——

Mr. OTTING.——I would be happy to explain it.

Senator WARREN. Please, please. I think actually I do understand.

Mr. OTTING. OK, good. Then I would be happy to have dialogue with you on that.

Senator WARREN. That is what we are doing right here. I am asking some questions, and I would like some answers. This approach is designed to allow banks to invest even less in underserved communities than they do——

Mr. OTTING. I disagree with that statement.

Senator WARREN. Yeah, I am sure you do. Forty-one years after the CRA was passed to promote service in low-income neighborhoods and rural areas, it was supposed to reduce redlining, but a new report shows that in 2018 it is harder to get a mortgage in 48 large U.S. cities if you are black. Adjusted for inflation, lending in rural communities is below 1996 levels. And yet 98 percent of banks pass CRA exams today, and you want to weaken those standards. Now, we——

Mr. OTTING. I do not want to weaken those standards. That is an inaccurate statement.

Senator WARREN. Look, all I can do is read the words that you have printed.

Mr. OTTING. Then we should spend time with you and clarify it.

Senator WARREN. Yeah, I am sure you should. We need to revise the CRA to make it stronger. Can you agree on that?

Mr. OTTING. We do agree with that.

Senator WARREN. All right. So you are going to try to make it stronger. You know, I have——

Mr. OTTING. We are going to make the measurement system clearer hopefully with my colleagues.

Senator WARREN. Yeah.

Mr. OTTING. We will identify what qualifies, because it is subjective and not accurate today.

Senator WARREN. Well, I have laid out in my housing bill last week concrete ways of doing that, of making the CRA stronger.

Mr. OTTING. I would enjoy speaking with you on that.

Senator WARREN. I am delighted to hear that. You know, but that really is the point here. This really is about families who cannot get access to credit. As Senator Kennedy just pointed out, the banks get an enormous advantage thanks to the Federal Government on lending, and one of the responsibilities in return for that is that they serve their communities. And when two other Federal agencies cannot agree with you the rules you are proposing do that, I think we have a serious problem.

In the time I have left, I just want to ask about one other thing, and that is another rollback of financial rules.

You know, in April, the Fed and the OCC proposed loosening the enhanced supplementary leverage ratio, a special capital requirement for the eight largest banks in this country. The FDIC did not join in the proposal, but that was before you got there. I want to ask you about this, Chairman McWilliams. I want to get your thoughts on it.

Two of your most recent predecessors as FDIC Chair, Marty Gruenberg and Sheila Bair, opposed weakening the leverage ratio. Director Gruenberg said in a speech last month the proposal would reduce this important capital requirement at these eight federally insured banks by at least $121 billion, which represents a roughly 20-percent decrease relative to today. Do you agree with Chairman Gruenberg?

Ms. MCWILLIAMS. I certainly appreciate his views on this proposal as well as I appreciate the views of all of our Board members. It is an open rulemaking. I was not privy to the process that went into consideration of the rulemaking, and I certainly would want to understand the logistics and the reasoning behind coming up with the proposal as it is.

Senator WARREN. All right. So this is an open question. I will quit because I recognize I am over time, but I just want to say again putting American taxpayers at risk again and weakening capital standards by $121 billion at a time when the banks are making record profits is insane. This is not what our banking regulators should be doing.

Thank you, Mr. Chairman. I apologize for going over.

Chairman CRAPO. Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman. Thank you to the panel for joining us this morning and sharing your expertise.

I am not opposed to regulation. I am opposed to regulation for regulation's sake, however. It was congressional intent in S. 2155 to move away from the $50 billion asset threshold not just for capital standards but for resolution planning, the LCR, and stress test frequency. Comptroller Otting's work on the recovery planning rule is a good model to follow. I ask you all, especially Vice Chair Quarles, to act with a sense of urgency when it comes to exercising your discretion with an eye to a sensible regulatory approach and continued economic growth.

I will also add that foreign banks are a welcome presence in our country. Seven percent of South Carolina's workforce are at foreign companies. That is about 130,000 workers working at 1,200 foreign firms. And who often banks those employers? Well, it is foreign banks. Michelin deals with BNP Paribas, a French bank for a French company. BMW is served solely by Commerzbank, a German bank for a German company. And the list, of course, goes on.

We should encourage FDI here at home and not vilify it. Please apply a tailored regulatory approach to these institutions when appropriate.

On a different note, South Carolina has suffered its third major storm in 4 years. The flood insurance take-up rate is too low in South Carolina. Out of about 1.5 million households, only about 204,000 policies exist. According to a recent Milliman study, 60 percent of those in Hurricane Matthew's path did not have flood insurance. It was 80 percent for Hurricane Harvey. The same study found that a private market could increase the take-up rate in both low- and high-risk areas, improving the resilience, rebuilding, and recovery process.

While there is nothing in Federal law that prohibits consumers from choosing a private flood insurance market, a robust private market still does not exist.

I will ask Mr. Otting and Ms. McWilliams: What is the timeline on issuing the final rule Congress asked for back in 2012? And are you deviating from the narrow and unworkable 2016 proposed rule?

Mr. OTTING. Would you like me to answer first?

Senator SCOTT. Sure.

Mr. OTTING. First of all, I do support the private insurance market, and you may or may not know that we have communicated that to the banks that we regulate. I think the point you made that, unfortunately, it is not a large enough market at this point to make it price competitive, we do support making the market larger by private insurance being able to enter into the market. We also collectively have had dialogue on this topic. We would hope that in early 2019 we can issue the rule. That I think can bring resolution to this issue. I look forward to having joint discussions with Jelena on the FDIC's perspective on this as we move forward.

Senator SCOTT. Thank you.

Ms. MCWILLIAMS. Likewise, we are looking to very promptly move—and I am sorry for the devastation in your State. I had an opportunity to be in North Carolina last week, and most of northern North Carolina was not affected. But I know some of the bankers from the southern parts could not make it for those reasons. We are looking to finalize a rule hopefully by as early as February of next year, and we have encouraged the banks to use private flood insurance in substitution of the Federal where possible or where available.

Senator SCOTT. All right. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman. Thank you to all of you for being here and for your public service.

I want to ask Mr. Otting a question first, and it is following up on a conversation we had last time I think that you were here. I asked you about OCC's CRA guidance, and I was concerned because the guidance limited the impact of discriminatory credit practices on a bank's CRA rating, and I thought we had a meeting on the minds because you said: "We should never allow any discrimination in any kind of lending activities to occur, and if it does, it should have an impact on their CRA rating." And you promised to relook at that. But now the OCC is still not going to downgrade a bank's CRA rating for discriminatory lending practices that fall outside of the bank's CRA lending activities.

I just want to register that I am confused. I thought we had a meeting of the minds. I am disappointed with what OCC does. I believe that you had the discretion to do what you did. I also believe that you had the discretion to not do what you did. I do not think the law required you to interpret your statutory mandate so narrowly.

I do not want to waste the rest of the 5 minutes on that, but I would like to follow up for the record and through my staff.

Senator SCHATZ. The second question is: Where are we with the 800,000 consumers who were ripped off by Wells Fargo by purchasing auto insurance that they did not need?

Mr. OTTING. Yes, first of all, thank you for the point on the 500–43. I do believe—and I will follow up with your staff and yourself personally, if you would like to have a dialogue on that. But I do think that we did bring clarification to that point.

On the issue of Wells Fargo Bank, I would say that we continue to work with the management and the board. We are not comfortable where we are with them. In April, you may recall that we issued a consent order that clearly spelled out all the actions that we expected from the bank. We continue to monitor that. I have high confidence in our 100 examiners that are onsite at Wells Fargo, have confidence in their process to monitor.

Senator SCHATZ. But if I am one of those 800,000 consumers, when can I expect to be made whole? When can I expect this to come to a resolution? Because I understand you are going through a process and kind of wrangling with their board of directors and working through your agency. But if I am one of those 800,000 people, I want to distill this into, well, when do I get my money back?

Mr. OTTING. I do not have the particular date in front of me because each of these supervisory activities are broken into timelines and activity. However, I will say it is not the wrangling with the board and the management and the OCC. It is accurately getting the data so you can determine the harm and the impact that needs to be——

Senator SCHATZ. Fair enough. And let me just kind of raise a second question as it relates to Wells Fargo. We know that this is not an isolated scandal as it relates to Wells Fargo. They wrongly charged consumers for extensions of mortgage rate locks. They charged monthly fees to consumers for add-on products that they do not understand. They wrongly repossessed the vehicles of hundreds of servicemembers. They are being investigated for pushing customers into high-fee investment products and churning accounts to increase fees and wrongly denied mortgage loan modifications for more than 600 customers and foreclosed wrongly on 400 customers.

The question I have is: Isn't this organization just too big? And I understand that you kind of analyze whether something is too big kind of in a strict statutory analysis, but you also analyze it in terms of your ability to supervise it. And if you look at the OCC, it has got, what—how many employees do you have?

Mr. OTTING. Four thousand.

Senator SCHATZ. Four thousands employees. Wells Fargo has 260,000. You have about $2.8 billion in revenue. They have $88 billion in revenue. And here is the kicker: Besides the systemic risk, besides the systematic kind of growth model where you have a multi-trillion-dollar bank who depends on these business units, regardless of the business opportunity, regardless of the size of the economy, the growth of the economy, they have to grow, they have to report growth up. And then they cannot supervise themselves. It is very clear that they cannot supervise themselves. It is also very clear that we cannot supervise them.

Then I ask the CEO about revoking their charter, and they say, "No, you should not revoke our charter because we provide products and services to one out of every three American households."

So how is that not them actually saying we are too big to be taken down?

Mr. OTTING. It is our viewpoint there are other large financial institutions that have proven to be able to be regulated and to serve their customers in a satisfactory manner, so size does not necessarily dictate inability to be——

Senator SCHATZ. But in this instance, it seems like their size is a problem. I get that there are other institutions that are not so egregiously harming customers and creating systemic risk. But this institution does seem beyond repair from the standpoint of the overall economy and also from the standpoint of how they systematically screw customers.

And so it does have something to do with size, because at some point, you know, I—excuse me, Chairman. I will just—with your indulgence. I understand kind of the analysis of whether something is a monopoly, you know, vertical versus horizontal integration. I get all of that. What I am asking is if at some point an institution is so big that you cannot manage it, that it cannot manage itself, and also that its political influence is so massive that we cannot wrangle it to the ground on behalf of the health of the economy or the health of individual household economics. And I want you to think about that, not as a sort of partisan talking point but the extent to which its size makes it almost impossible to supervise.

Thank you.

Chairman CRAPO. Senator Heitkamp.

Senator HEITKAMP. Just to follow on, we have heard many circumstances—in fact, one not partisan, but you cannot go after money laundering because the institution is too big. And if you attack them on money laundering, it might further rattle the credit markets. And so we hear this periodically, and this is a problem. And if you do not want action on not being too big to fail, then the regulation has to have some impact. But we keep hearing story after story, and there is not adequate explanation at this point. And so I think it is important that we follow up.

But I want to first off thank you all for moving forward with the community bank provisions on some of the simplifying the complex capital requirements rules under 201. I understand Chairman Crapo asked that question when I was at a different hearing, and I just want to thank you for moving forward with those provisions.

I think another provision that is important for local banks is Section 205, which eliminates paperwork for banks through an expanded short-form call report.

Can anyone give me an expected timeline for rules regarding that section?

Mr. OTTING. We are expecting either late October or early November to be able to have the NPR——

Senator HEITKAMP. So notice of proposed rulemaking the end of October?

Mr. OTTING. That is correct—end of October or early November.

Senator HEITKAMP. OK. We will watch for those.

I want to turn to appraisals because that was a big provision. I think a lot of people here have heard me say over and over again how difficult it is to get appraisals in rural communities, and this goes to you, Ms. McWilliams. Where are you at with setting out some guidelines or a process for appraisal waivers for residential property?

Ms. MCWILLIAMS. We are looking to issue something very soon, Senator, in the next month or so.

Senator HEITKAMP. Next month?

Ms. MCWILLIAMS. Yes. First of all, we need to comply with the law as promptly as we can. But, second of all, it is a huge issue for rural communities, and, frankly, the fact that sometimes they have to take months to approve transactions at a rural bank because of the lack of appraisers is not optimal.

Senator HEITKAMP. Yeah, we need to move forward. As people are looking at getting back into mortgage lending, that is a huge component.

On a related matter, it is my understanding that the State banking commissioner and the Governor submitted a request to the Appraisal Subcommittee to exercise its discretion to initiate a temporary waiver regarding preexisting regulatory authority. Again, there is some dispute within my community in North Dakota whether that appraisal waiver is needed. But one of the things I would say without looking at the merits of their request, I am interested in knowing how these requests are reviewed and why so few waivers have been granted under the Appraisal Subcommittee's existing discretionary authority.

Can you give me, Ms. McWilliams, an explanation of why these waiver requests have not been granted in the past and how the FDIC works with the Appraisal Subcommittee to ensure a fair, transparent, and timely process with input from everyone? And I think I will just tell you, there is some concern that it was just unilaterally denied and with no explanation for why that denial was issued.

Ms. MCWILLIAMS. I would certainly hope that they were not denied without an explanation. I can go back and make sure that that was not the case, or if it was the case, I will personally make a call. Basically the process works through the Appraisal Committee at the FFIEC. These requests for waivers would be sent through, and they have to satisfy a certain number of requirements in order for them to be approved. If the waiver request is too broad and it is, frankly, outside of the authorities of the FFIEC's Subcommittee to grant, it will not be granted. It is my understanding we are working with the entities in your State to make sure that we can proceed.

Senator HEITKAMP. Ms. McWilliams, based on their experience, I really would ask you to go back and take a look at may be broader than just this one request from North Dakota, but go back and take a look at kind of the response and the lack of what they believe was transparency and basically making short shrift of the arguments that they made. I think you want to take a broader look than just North Dakota. But please get back to us and hopefully get back to the banking commissioner in North Dakota. Thank you.

Ms. MCWILLIAMS. I will do that promptly. Thank you.

Chairman CRAPO. Thank you, Senator Heitkamp.

Senator Van Hollen.

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

Mr. Quarles, I had a question with respect to the lack of a real-time payment system in the United States. I wrote to the Fed last month and appreciate the letter I got back from the Chairman, because you have got lots of Americans who are living paycheck to paycheck, who send their check in, they think it is cashed, and they think they are getting credited for it, only to find out that they did not when they get overdraft fees. And we are talking, as you know, billions of dollars of overdraft fees for people who are, again, just trying to pay their bills. And that also leads some people to leave the banking system. They go to payday lenders and others.

A lot of other countries—on my list I have got the United Kingdom, Poland, Mexico, South Africa, Denmark, and others—have gone to a real-time payment system. Why are we not there yet? And when are we going to get there?

Mr. QUARLES. Well, Senator, working on the faster payment system has been a priority of the Fed, as you know, for some time. We have worked with the private sector on that topic to catalyze efforts to develop both the technology and the systems in order to move toward faster payment.

Senator VAN HOLLEN. If I could, again, I got your letter, I appreciate getting a letter back. My reading of it was a restatement of the problem, and, you know, we are working on it. As you said, you have been working on this for a while. It just seems to me in this era where you have got Venmo and PayPal and you have got the technology that allows people to make payments from their kitchens if they are on certain systems, that we as a country should be able to have 24/7 real-time payment systems.

And so my real question is: Why are we not there yet? Are there obstacles? You write in the letter that you do not have the authority to mandate it, but you have a lot of authorities. And so my question is: Why are we not using those authorities? My understanding was you may be coming out with something this quarter. We are in it now. Why are we not there yet? This is costing billions of dollars to people mostly who just are living paycheck to paycheck. I just do not understand why the United States cannot do what these other countries have done.

Mr. QUARLES. It is a fair question, Senator, but as you note, that is not something that we as the Federal Reserve can mandate. But we are using a lot of those powers that you have described, our convening power and our exhorting power, and I think effectively. It is not as though there has been no progress. There has been a lot of progress toward that, and I think that in the next short period you will see some further concrete steps that have been catalyzed by Federal Reserve action in the private sector that move us to a real-time payment system. I think that is an important goal for us.

Senator VAN HOLLEN. All right. I would like to follow up. It is just the pace of this change seems to be very sluggish, and in the meantime, a lot of people are paying a lot of unnecessary fees and a lot of people are collecting a lot of fees that they would not be able to collect absent the lack of a real-time payment system.

Mr. Otting, I would just like to follow up with you on your sort of investigation with respect to some of the Wells Fargo practices. Specifically, I think it was July of last year that we discovered that about 800,000 people who took out car loans were charged for auto insurance that they did not need. And, nationally, that pushed about 274,000 Wells Fargo customers in delinquency, resulted in 25,000 wrongful vehicle repossessions, including a harrowing story of a Marylander who went out to go to work one day and discovered his car was gone, thought it was stolen, called the police. It turns out it was the Wells Fargo folks repossessing the car, and they had sort of wrongfully sold him unnecessary insurance.

Now, I know that they sent you a report. My understanding is you rejected that report. Can you bring us up to date on what is going on and when Wells Fargo consumers can expect to be made whole?

Mr. OTTING. Thank you for the question. I cannot give specific examples because I do not have that information in front of me.

But I will say there are a host of activities that Wells Fargo is framing up, the harm that was applied to consumers. There are timelines for them to be able to complete that process.

You may have missed the earlier conversation where we talked a little bit about this, but I would say that we continue to not be comfortable with where they are. We have hundreds of examiners onsite following this process. We have high expectations for Wells Fargo to complete that process in a timely manner. And as you may recall, in the April consent order we put in very strong language that we expect compliance with those activities.

Senator VAN HOLLEN. Right. I know you were unsatisfied with the plan that they submitted recently. Is there any date where I can tell my consumers who have been wronged by these actions that they can expect to be made whole?

Mr. OTTING. We would be happy to follow up with the bank and then contact your office and be able to give them that date.

Senator VAN HOLLEN. All right. And I am not talking just about specific customers, although there are some of those, but I am talking about the people throughout the country.

Mr. OTTING. The whole project.

Senator VAN HOLLEN. Thank you. I appreciate that.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Van Hollen.

That concludes the questioning, but I would like to encourage each of you to quickly implement S. 2155 and significantly tailor regulations for banks with between $100 billion and $250 billion in total consolidated assets, with a particular emphasis on tailoring the stress testing regime.

In addition, an article in today's Wall Street Journal highlights the efforts underway at the Fed to revisit rules like the liquidity coverage ratio and advanced approaches rules to align the nature of our regulations with the nature of the firms being regulated. I commend those efforts and encourage the Fed to continue to move forward on those aggressively.

Finally, yesterday some of my colleagues and I urged the agencies responsible for implementing the Volcker Rule to build on the work they have already begun in their notice of proposed rulemaking. Among other things, the letter notes the absence of proposed reforms in the covered funds provisions. We encourage you to use your discretion to address the overly broad application of these provisions to venture capital, other long-term investments, and loan creation.

So, with those suggestions, I will now give the final instructions to our Senators as well as our witnesses.

For Senators wishing to submit questions for the record, those questions are due in 1 week, on Tuesday, October 9th. We ask the witnesses to please respond to these questions promptly.

Once again, I thank you all for not only your efforts in implementing S. 2155, but for being here today, and this hearing is adjourned.

[Whereupon, at 12:02 p.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today, we will hear from four agencies responsible for the supervision and regulation of banks or credit unions.

Each will provide an overview of its efforts, activities, objectives and plans to implement S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act.

Providing testimony will be Federal Reserve Vice Chairman for Supervision Randy Quarles; Federal Deposit Insurance Corporation Chair Jelena McWilliams; National Credit Union Administration Chairman Mark McWatters; and Comptroller of the Currency Joseph Otting.

Each of these agencies plays an integral role in implementing key provisions of this law.

As policymakers, it is our job to enact laws and regulations that not only ensure proper behavior and safety for our markets, but are also tailored appropriately.

Shortly after Dodd-Frank was signed into law, we began to see some of the unintended cumulative regulatory burden it had on certain financial institutions.

For years, I and many Members of the Committee, on both sides of the aisle, worked to find a solution to provide meaningful relief to small financial institutions, and we succeeded in crafting S. 2155.

We are now approaching 5 months since S. 2155 was signed into law by the President, having passed both the House and Senate with significant bipartisan support.

This law's primary purpose is to make targeted charges to simplify and improve the regulatory regime for community banks, credit unions, midsize banks and regional banks to promote economic growth.

It right-sizes regulations for financial institutions, making it easier for consumers to get mortgages and obtain credit while also increasing important consumer protections for veterans, senior citizens, victims of fraud, and those who fall on hard financial times.

For example, just over a week ago, the Federal Trade Commission and Bureau of Consumer Financial Protection announced as effective a provision of S. 2155 that provides consumers concerned about identity theft or data breaches the option to freeze and unfreeze their credit for free.

A New York Times article commenting on this provision noted that, "one helpful change . . . will allow consumers to 'freeze' their credit files at the three major credit reporting bureaus—without charge. Consumers can also 'thaw' their files, temporarily or permanently, without a fee."

Susan Grant, director of consumer protection and privacy at the Consumer Federation of America expressed support for these measures, calling them "a good thing."

Although agencies have started to consider this law in some of their statements and rulemakings, there is still a lot of work to do on the bill's implementation.

It is imperative that agencies carry out all of their responsibilities under this law expeditiously so that consumers, homeowners, veterans and small businesses can begin to fully experience its benefits.

In addition to timing, Members of this Committee are also deeply vested in the substance of agencies' specific actions to implement this law and other efforts by the regulators to provide regulatory relief.

In particular, agencies should: significantly tailor regulations for banks with between $100 billion and $250 billion in total consolidated assets, with a particular emphasis on tailoring the stress testing regime (it should be noted that the primary reason we gave the regulators time to implement this provision was to develop a streamlined stress-testing regime, and I encourage you to move quickly here); tailor the Liquidity Coverage Ratio for regional banks with more than $250 billion in total consolidated assets; reassess the advanced approaches thresholds; provide meaningful relief from the Volcker Rule for all institutions, as I said in a letter to the regulators yesterday; and examine whether the regulations that apply to the standalone U.S. operations of foreign banks should also be tailored at the same time and in a similar manner as U.S. banks.

S. 2155 raised the threshold for the application of enhanced prudential standards under Section 165 of the Dodd-Frank Act from $50 billion, and in some cases $10 billion, to $250 billion.

Regulators have applied the Section 165 asset thresholds in various rulemakings and guidance documents in the past.

For example, the Fed's Comprehensive Capital Analysis and Review requires bank holding companies with more than $50 billion in total assets to submit capital plans to the Fed on an annual basis.

In the final capital plan rule, the Fed notes that " . . . the asset threshold of $50 billion is consistent with the threshold established by Section 165 of the Dodd-Frank Act relating to enhanced prudential standards and prudential standards for certain bank holding companies."

The OCC recently raised the threshold for requiring recovery plans from $50 billion to $250 billion.

I encourage the regulators to revisit all regulation and guidance thresholds that were consistent with the outdated Section 165 threshold to an amount that reflects actual systemic risk.

Regulators have two options: use a systemic risk factors-based approach, or raise all thresholds to at least $250 billion in total assets to be consistent with S. 2155.

Many of this law's provisions require agency rulemakings.

In order to avoid unnecessary delays in implementation, agencies should promptly issue notice of proposed rulemakings for all relevant aspects of this law.

As S. 2155 is implemented, I suspect some of it may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking.

While I encourage the regulators to use notice and comment rulemaking generally, I recognize that sometimes policy must be communicated through more informal means.

The Congressional Review Act, however, requires agencies to submit, with certain minor exceptions, all rules to Congress for review.

By definition, a rule is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency."

That is a very broad definition.

In order to ensure that Congress can engage in its proper oversight role, as well as ensure that future Congresses do not overturn the agencies' policy statements related to implementation of S. 2155, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Our economy is finally getting back on track, and full implementation of S. 2155 will continue to drive growth and improve economic health to the benefit of families across America.

I look forward to hearing more from each of you on how your agencies have begun and will continue to implement the Economic Growth, Regulatory Relief and Consumer Protection Act.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

This hearing was originally scheduled for September 13—the same week 10 years ago that Lehman Brothers declared bankruptcy, paving the way for the worst economic crisis since the Great Depression.

We all know what happened next. The Bush administration put together an alphabet soup of programs to keep the financial sector afloat, but it wasn't enough. Ten years ago this week, taxpayers were forced to spend $700 billion to bail out Wall Street and save our economy from collapse. A New York Times headline from October 2, 2008—10 years ago today—described those chaotic early days of the collapse with the headline, "36 hours of Alarm and Action as Crisis Spiraled."

A decade after the most severe financial crisis since the Great Depression—today, we're discussing how the financial watchdogs will roll back rules put in place after that crisis.

These are the same agencies that ignored the buildup to the 2008 collapse, and in the case of the OCC, went to court to fight those who were trying to do something.

In some cases, they are now led by the very people that failed to prevent or profited from the crisis.

S. 2155 was described as an effort to reduce the burden of regulation on the Nation's smallest community banks and credit unions—something many of us agreed we could improve. But in reality, this bill is littered with concessions to the biggest banks and offers virtually nothing for American consumers.

And based on the questions and letters sent to officials by my Republican colleagues since passage of S. 2155, it seems they are most concerned about how the law will help the largest domestic and foreign banks—or "regional banks with an international parent," to use a new Republican euphemism for firms like Deutsche Bank.

These are the same banks that have been profitable every quarter since the second quarter of 2009. Last quarter profits at U.S. banks reached record levels—more than $60 billion dollars, a 25 percent jump from the year before. The five largest banks in this country recently announced more than $72 billion dollars in stock buybacks, a nearly 30 percent increase from the year before. How many workers got a 30 percent raise last year?

While the banks have recovered, many Americans haven't.

Nearly 10 million Americans lost their jobs during the crisis. The unemployment rate peaked at 11 percent in Ohio. More than a third of workers across the country were unemployed for 27 weeks or more.

Losses in household wealth and income were devastating to families during the crisis, and African Americans and Latino Americans suffered even worse losses.

Some want to argue that household wealth has recovered since the crisis, but these aggregate measures are misleading. Recent data from the Federal Reserve Board of Governors shows that the top 10 percent of households have seen big gains in household wealth, while the bottom 90 percent have experienced no gains.

The poverty rate rose 2.5 percentage points between 2007 and 2012, with 46.5 million people living in poverty by 2012.

More than 8 million children were affected by the foreclosure crisis by 2012. That includes 6 percent of children in Ohio. We all know the lasting impact of childhood displacement.

And some studies suggest a correlation between the Great Recession and the current opioid crisis.

In August, the Federal Reserve Bank of San Francisco released research that said the financial crisis, quote, "cost the average American $70,000 in lifetime income." The Federal Reserve Bank of Dallas estimated the loss was even higher. And numerous other studies estimate the impact of the crisis on the overall economy at over ten trillion dollars.

But here we are today, talking about how Washington can do more to help the Nation's banks.

We should be talking about how to increase wages, how to make housing more affordable and accessible, how to protect consumers, and how to build up capital at banks, which many academics and Fed researchers suggest is still too low, so that taxpayers and families won't be forced to bail out big banks again when the next crisis hits.

I don't think we'll hear about any of these issues from today's witnesses.

The collective amnesia in the Administration and Congress is astounding.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF JOSEPH M. OTTING

COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY *

OCTOBER 2, 2018

I. Introduction

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the invitation to appear before you today to discuss the Economic Growth, Regulatory Relief, and Consumer Protection Act (Economic Growth Act or Act). I am honored to join my colleagues from the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA).

The Economic Growth Act is a testament to the bipartisan work of this Committee, under the leadership of Chairman Crapo, to provide prudent burden relief for the small- and mid-size financial institutions that need it most. The Office of the Comptroller of the Currency (OCC) recognizes the importance of this effort and is committed to implementing the Act quickly so that the national banks and Federal savings associations (banks) we supervise can continue to create jobs and promote economic opportunity in a safe, sound, and fair manner. The work needed to write the implementing regulations called for by the statute is well underway. In the meantime, the OCC has joined the Board and the FDIC (collectively, the agencies) to clarify our intention to regulate and supervise financial institutions consistent with the outcomes that the Act requires.

* 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.

Before I turn to the specific progress the OCC has made to implement the Economic Growth Act, I would like to describe briefly the current condition of the Federal banking system. The OCC has supervisory responsibility for over 1,300 banks. Together, these banks hold $11.8 trillion in assets—roughly 67 percent of the commercial banking system. They service 33 percent of the country's first-lien residential mortgages and issue 66 percent of all credit card balances. The vast majority of these 1,300 banks are smaller banks, with less than $10 billion in assets. These numbers show the important role that OCC-supervised institutions have in the Nation's economy and how essential it is for these banks, especially community and mid-size banks, to operate efficiently and effectively and to offer the products and services that their customers and communities need.

The OCC works to promote a vibrant and diverse banking system that benefits consumers, communities, businesses, and the economy. We ensure that banks operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. The dedication and commitment of the OCC, and that of the other agencies, have contributed to the strength and resiliency of the U.S. banking system. The overall capital position and the credit quality at large and small banks have strengthened considerably in recent years, as has liquidity and profitability. This environment has contributed to banks' abilities to develop innovative approaches to delivering their products and services. I am optimistic about the direction of the country's economy, in no small part because of the regulators' work to support and enable a strong and resilient banking system.

I am well aware, however, that with opportunity comes risk. The OCC regulates banks to ensure that their boards of directors and management clearly understand and actively manage the risks they face. We are closely monitoring trends with respect to credit, interest rate, operational, and compliance risks, and we continue to share our insights and concerns with the banks we supervise. In addition, the OCC assesses new and emerging threats, including those related to cybersecurity. I believe that these efforts have made and will continue to make banks safer and stronger.

II. The Economic Growth Act

The strength and vitality of the Nation's financial system depend, in large part, on the ability of financial institutions, particularly community and mid-size banks, to operate efficiently, effectively, and without unnecessary regulatory burden. The Economic Growth Act is a bipartisan, commonsense law that will significantly reduce regulatory burden for small- and mid-size institutions while safeguarding the financial system and protecting consumers. The Act includes several features that will benefit community banks in particular and are consistent with my priorities as Comptroller, including reducing the number of banks subject to the Volcker Rule and providing a simpler capital regime for highly capitalized community banks. These and other provisions in the Act will help the Federal banking system continue to foster job creation and promote economic opportunity. Today, I will outline the steps the OCC has taken to ensure that the relief provided by the Economic Growth Act is realized as quickly as possible.

A. Interagency Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act[1]

Following passage of the Economic Growth Act and in response to questions from various stakeholders, the agencies issued an Interagency Statement to financial institutions to clarify how we would administer certain provisions of the Act. For example, a number of provisions of the Act were effective upon enactment or soon thereafter, but agency regulations had yet to be revised to reflect these changes in the law. In order to avoid confusion and the unnecessary use of institutions' compliance resources, the agencies issued the Interagency Statement to demonstrate our commitment to administering our regulations, during the interim period before we promulgate any necessary conforming regulations, in a manner consistent with the Act.

The Interagency Statement provides direction and sets the table for upcoming regulatory revisions in a number of areas. For example, the Economic Growth Act at section 401 raises the threshold at which bank holding companies (BHCs) and depository institutions are required to perform company-run stress tests from $10 billion to $250 billion. This change was effective immediately for BHCs with less than

[1] Joint Release, OCC NR 2018–69, *Agencies Issue Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act,* July 6, 2018 (Interagency Statement).

$100 billion in total consolidated assets but not for similarly sized depository institutions. In order to provide parity and avoid unnecessary burden, the Interagency Statement explains that the agencies will not require depository institutions with less than $100 billion in total consolidated assets to perform company-run stress tests during this interim period.

In addition, sections 203 and 204 of the Economic Growth Act make changes to the statutory provisions underlying the Volcker Rule, including reducing the number of institutions subject to its requirements. These changes provide regulatory relief to institutions that do not pose the types of risks the Volcker Rule was intended to limit. To address conflicts between the agencies' current Volcker Rule and these statutory changes, the Interagency Statement explains that the agencies will not enforce the Volcker Rule in a manner inconsistent with the Act.

B. Recently Completed Actions

I am happy to report that we have made steady and significant progress implementing the Act since the agencies issued the Interagency Statement in early July. As discussed below, we have completed several actions and are engaged with our fellow regulators to move quickly on the remaining rulemakings.

Thrift charter flexibility. On September 10, 2018, the OCC issued a notice of proposed rulemaking (NPR) to provide greater flexibility to Federal savings associations by implementing a new section of the Home Owners' Loan Act added by section 206 of the Economic Growth Act.[2] This proposal would establish streamlined standards and procedures under which a Federal savings association with total consolidated assets of $20 billion or less can elect to operate as a "covered savings association." A covered savings association would have the same rights and privileges and be subject to the same duties and restrictions as a similarly located national bank but would retain its charter and existing governance framework.

The Act, together with the OCC's rulemaking, will provide Federal savings associations with additional flexibility to adapt to evolving economic conditions and business environments and allow them to better serve the changing needs of their customers—without the burden and expense of changing charters. The public comment period on the NPR is open until November 19, 2018.

HVCRE. Section 214 of the Economic Growth Act provides that the agencies can require an institution to assign a heightened risk weight to a high volatility commercial real estate (HVCRE) exposure only if it meets the Act's new definition of an HVCRE acquisition, development, and construction loan. To address conflicts among this provision, existing rules, and relevant Consolidated Reports of Condition and Income (Call Report) instructions, the Interagency Statement provides that institutions can choose either to rely on the Act's definition when risk-weighting and reporting HVCRE exposures or to continue to risk-weight and report HVCRE exposures consistent with current Call Report instructions. On September 18, 2018, the agencies jointly issued an NPR to implement the statutory definition.[3] The public comment period is open until November 27, 2018.

Examination cycle. On August 23, 2018, the agencies jointly issued interim final rules implementing changes to their examination cycles.[4] Section 210 of the Act increases the asset threshold for certain well managed and well capitalized insured depository institutions that are eligible for an 18-month examination cycle from institutions under $1 billion in total assets to institutions under $3 billion. Under the interim final rules, the extended examination cycle is now available to a larger number of qualifying 1-and 2-rated institutions. This change, together with parallel changes to the onsite examination cycle for U.S. branches and agencies of foreign banks, will allow the agencies to better focus their supervisory resources on financial institutions that present capital, managerial, or other supervisory issues and thus enhance safety and soundness collectively for all financial institutions. The public comment period is open until October 29, 2018.

High quality liquid assets (HQLA). Section 403 of the Economic Growth Act directs the agencies to treat certain municipal obligations as HQLA for purposes of their regulations, including the liquidity coverage ratio (LCR). It further directs the agencies to amend their liquidity regulations to implement these changes within 90 days of enactment.

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[2] OCC NR 2018–95, *Office of the Comptroller of the Currency Invites Comment on Proposed Rule to Enhance Business Flexibility for Federal Savings Associations;* 83 Fed. Reg. 47101 (Sept. 18, 2018).

[3] Joint Release, OCC NR 2018–100, *Agencies Propose Rule Regarding the Treatment of High Volatility Commercial Real Estate;* 83 Fed. Reg. 48990 (Sept. 28, 2018).

[4] Joint Release, OCC NR 2018–82, *Agencies Issue Interim Final Rules Expanding Examination Cycles for Qualifying Small Banks and U.S. Branches and Agencies of Foreign Banks;* 83 Fed. Reg. 43961 (Aug. 29, 2018).

In anticipation of this rulemaking, the agencies announced in the Interagency Statement that they will not require an institution subject to the liquidity regulations to exclude from the definition of HQLA those municipal obligations they believe meet the statutory criteria for inclusion in HQLA. Subsequently, on August 22, 2018, the agencies jointly issued interim final rules to implement this statutory provision, under which covered institutions will have additional flexibility in meeting the LCR requirements.[5] The public comment period on this rulemaking is open until October 1, 2018.

C. Additional Actions Underway to Implement the Economic Growth Act

The agencies, working both jointly and independently, continue to move forward with the remaining steps to fully implement the Economic Growth Act. The OCC is participating actively in interagency consultations related to the rulemakings and other efforts underway by the Bureau of Consumer Financial Protection (BCFP) to implement the Act's changes to Federal consumer financial protection laws. We are reviewing several other provisions of the Economic Growth Act to determine whether further action is necessary. We are also participating in interagency discussions on a rulemaking to implement the exemption in section 103 from the appraisal requirements for certain rural real estate transactions. As described below, we are also working diligently to address changes to the regulatory capital regime and the preparation of Call Reports. I expect that we will take action on all remaining rulemakings by the end of the year.

Community bank leverage ratio. The agencies are working to implement section 201 of the Act, which addresses the complex and burdensome process—particularly for highly capitalized community and mid-size institutions—of calculating and reporting regulatory capital. In addition to providing much needed clarity regarding the capital treatment of HVCRE exposures (discussed above), the Act directs the agencies to draft regulations that allow certain institutions—those that exceed a "community bank leverage ratio" (tangible equity to average total consolidated assets of 8 percent to 10 percent) and engage only in traditional banking activities—to be deemed in compliance with current leverage and risk-based capital provisions.

Staffs of the agencies are meeting frequently to develop rules to implement this provision, which represents an important new direction in capital regulation. A number of complex issues remain outstanding, including how to harmonize this provision of the Act with statutory provisions unaffected by the Act, and the agencies are working to resolve these issues. I am confident that a thoughtful implementation of this provision will lead to a substantial reduction in regulatory burden for highly capitalized, qualifying institutions while ensuring that these institutions continue to maintain appropriate capital levels.

Asset threshold for short form Call Report. Section 205 of the Act provides for reduced reporting requirements on Call Reports for the first and third quarters for institutions with less than $5 billion in total consolidated assets. This change expands the number of community institutions that can benefit from the reduced burden associated with the short form Call Report, freeing up employees and other resources to serve customers and the operational needs of the institutions. The agencies are meeting regularly to discuss a framework to implement this change.

Periodic stress testing. In addition to the changes to the company-run stress testing thresholds discussed above, section 401 of the Act amends the required frequency of stress testing from annual to periodic and reduces the required number of scenarios from three to two. These agencies are working to implement all of these changes, which will reduce burden while maintaining this important supervisory tool. Stress testing serves a critical function for both regulators and financial institutions by ensuring that financial institutions consider potential economic events that could cause significant balance sheet disruptions and prepare to mitigate such disruptions if necessary.

Supplementary leverage ratio. Section 402 of the Act directs the agencies to revise the leverage ratio requirements applicable to the largest U.S. banking organizations engaged in custody, safekeeping, and asset servicing activities. The agencies are determining how best to implement these changes, particularly in the context of other, proposed changes to the leverage ratio calculations.

D. Additional Efforts to Promote Economic Growth and Job Creation

In parallel with our efforts to implement the Act, the OCC is considering additional ways that we can reduce unnecessary burden on the banks we supervise, an

[5] Joint Release, OCC NR 2018–81, *Agencies Issue Interim Final Rule Regarding the Treatment of Certain Municipal Securities as High-Quality Liquid Assets;* 83 Fed. Reg. 44451 (Aug. 31, 2018).

endeavor that we believe is consistent with the purpose of the Act and will fuel job creation and economic opportunity.

Additional capital framework changes. The OCC is meeting with the Board and the FDIC to consider other options for reducing the compliance burden associated with the capital framework, including the changes described in the October 27, 2017 joint NPR.[6] The NPR was issued in response to the agencies' commitment to Congress pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 to meaningfully reduce regulatory burden.[7] The proposed changes include allowing smaller, noncomplex institutions to apply a simplified regulatory capital treatment to mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions, and certain minority interests held by third parties. These changes would allow these institutions to more efficiently and effectively serve their customers.

Recovery planning. On September 19, 2018, the OCC issued an NPR to increase the threshold for the agency's enforceable guidelines establishing standards for recovery planning, which currently require a bank with average total consolidated assets of $50 billion or more to prepare a recovery plan.[8] The proposal would raise the threshold for banks subject to the guidelines to $250 billion or more, providing regulatory relief to the mid-size banks currently covered by the guidelines. The public comment period is open until November 5, 2018.

III. Other Agency Priorities

I would also like to take this opportunity to update the Committee on some of the other important work taking place at the OCC.

Community Reinvestment Act of 1977 (CRA). While the communities that banks serve will benefit greatly from the economic opportunities that the Act makes possible, such progress does not always require congressional action. One area in which the agencies can achieve additional reforms on their own is the modernization of the CRA regulatory framework. I have seen firsthand how CRA activities reinvigorate financially distressed areas through community development and reinvestment, but stakeholders from all perspectives acknowledge the limitations of the current framework. Despite the best of intentions, the CRA regulatory framework, which has been pieced together over the past 40-plus years, is outdated, ambiguous, overly complex, and unnecessarily burdensome. These problems hinder banks' ability to fulfill the statute's goals.

To continue the burden reduction and economic empowerment that Congress made possible with the Act and to address concerns about the CRA framework, on August 28, 2018, the OCC issued an Advance Notice of Proposed Rulemaking (ANPR) to solicit ideas to modernize the implementation of the CRA.[9] A modernized framework would strengthen the CRA by encouraging more lending, investment, and activity where it is needed most-fulfilling the ultimate purpose of the CRA. We can achieve these goals by providing greater clarity regarding CRA-qualifying activities; establishing clear and objective measures to assess CRA performance; rethinking the concept of the "communities" that banks serve in a more comprehensive manner; facilitating more consistent, timely, and transparent performance evaluations and CRA ratings; and encouraging increased community and economic development in low- and moderate-income areas. The public comment period on the ANPR is open until November 19, 2018. I look forward to reading the stakeholder comments we receive and working with my regulatory colleagues and other stakeholders as we move forward.

Innovation. At the end of July, the OCC announced that it will accept applications for special purpose national bank charters from financial technology (fintech) companies that are engaged in the business of banking but do not take deposits, provided they meet the requirements and standards for obtaining a charter.[10] This decision reflects the OCC's understanding that responsible innovation will enable banks to meet consumers', businesses', and communities' evolving needs; operate in a safe and sound manner; provide fair access to financial services; and treat customers fairly. Responsible innovation is important in order for banks to continue to promote economic opportunity and job creation going forward. Let me reiterate, however, that the OCC will supervise special purpose national banks like other similarly

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[6] 82 Fed. Reg. 49984.

[7] Federal Financial Institutions Examination Council, Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act (March 2017).

[8] 83 Fed. Reg. 47313.

[9] OCC NR 2018–87, *OCC Seeks Comments on Modernizing Community Reinvestment Act Regulations;* 83 Fed. Reg. 45053 (Sept. 5, 2018).

[10] OCC NR 2018–74, *OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies,* July 31, 2018.

situated national banks. They will be held to the same high standards applicable to any other national bank, including with respect to capital, liquidity, and financial inclusion commitments as appropriate.

The OCC's decision to consider applications for special purpose national bank charters followed extensive outreach by the OCC over a 2-year period. It also is consistent with bipartisan Government efforts at the Federal and State levels to promote economic opportunity and support innovation that can improve the provision of and access to financial services.

In addition, fintech companies that provide banking services in innovative ways deserve the opportunity to pursue that business on a national scale as federally chartered banks. Contrary to what some have suggested, I believe that a special purpose national bank charter supports and enhances the dual banking system. A Federal charter provides companies interested in banking with another choice, alongside others such as becoming a State bank, operating as a State-licensed financial service provider, or pursuing a partnership or business combination with an existing bank. Competition between these options yields a wider range of products and services available to consumers, lower regulatory costs, and more effective supervision.

Short-term, small-dollar lending. On May 23, 2018, the OCC issued a bulletin encouraging banks to offer responsible short-term, small-dollar installment loans to help meet the credit needs of consumers.[11] The bulletin reminds banks of the core lending principles for prudently managing the risks associated with this type of installment lending and is consistent with the OCC's support for responsible innovation by banks. Encouraging banks to offer these products will bring borrowers back into the regulated marketplace and will help improve their access to additional mainstream financial products, which will benefit these borrowers and the economy.

Bank Secrecy Act and Anti-money laundering (BSA/AML). The OCC has taken a leadership role in coordinating discussions among the FDIC, Board, NCUA, U.S. Department of Treasury (Treasury), and Financial Crimes Enforcement Network (FinCEN) to identify ways to improve the efficiency and effectiveness of BSA/AML regulations, supervision, and examinations. The financial institution regulators are working closely with Treasury and FinCEN to identify ways to enhance the risk-focused supervisory process while continuing to support law enforcement and reducing unnecessary burden currently associated with BSA/AML compliance. The agencies also encourage the use of innovative technologies and practices to assist financial institutions in achieving AML compliance. These proactive efforts toward BSA/AML reform are meant to yield efficiencies while improving the ability of the Federal banking system and law enforcement to safeguard the Nation's financial system from criminals and terrorists.

Guidance. Finally, in response to recent inquiries suggesting the agencies clarify the differences between supervisory guidance and laws and regulations, on September 11, 2018, the OCC, FDIC, Board, NCUA, and BCFP issued a statement to explain the role of supervisory guidance and to describe policies related to the agencies' approach to supervisory guidance.[12] This statement makes clear that guidance does not have the force and effect of law and that examiners may not criticize financial institutions for "violations" of guidance. At the OCC, we will reinforce this message by continuing to set clear expectations for how our examiners use guidance on examinations and the proper role that guidance plays in the supervisory process.

IV. Conclusion

I appreciate the opportunity to update the Committee on the OCC's work to implement the Economic Growth Act and to share with you the progress we have made in other areas. I believe that consumers, businesses, and communities alike will benefit from these efforts for many years to come. The OCC looks forward to keeping the Committee apprised of our work.

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[11] OCC Bulletin 2018–14, *Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending.*

[12] Joint Release, OCC NR 2018–97, *Agencies Issue Statement Reaffirming the Role of Supervisory Guidance.*

PREPARED STATEMENT OF RANDAL K. QUARLES

VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

OCTOBER 2, 2018

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate this opportunity to testify on the Federal Reserve's implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA or the Act). The Act calls on the Federal banking agencies to aid in promoting economic growth by further tailoring regulation to better reflect the character of the different banking firms that we supervise. While recognizing that the core objectives of the post-crisis regime—higher and better quality capital, stronger liquidity, and increased resolvability—have contributed to reducing the likelihood of another severe financial crisis, the Act also acknowledges that we should be seeking to improve the efficiency with which we achieve these objectives, and gives the Federal banking agencies the task of executing the thoughtful detail work necessary to enhance that efficiency.

Of course, detail work can be challenging to get right. The Federal Reserve Board (Board) strongly supports the principle underlying the Act of tailoring regulation to risk, and we have embedded this principle in several aspects of our regulatory and supervisory framework. It is, however, fair to say that until recently our tailoring of regulations has been principally calibrated according to the asset size of an institution. Yet, while a useful indicator, asset size should be only one among several relevant factors in a tailoring approach. We continue to evaluate additional criteria allowing for greater regulatory and supervisory differentiation across banks of varying sizes, and the Act reflects similar goals. The legislation recognizes that banks have a variety of risk profiles and business models, and I believe that our regulation and supervisory programs can be flexible enough to accommodate this variety.

The Federal Reserve's implementation of the Act's directives is underway. In my testimony today, I will describe progress we have made to date on tasks set out for the Federal Reserve in the Act. I will also highlight the work that will be our top priorities in the next few months: tailoring for firms with assets over $100 billion that are not global systemically important banks (G–SIBs) and developing a community bank leverage ratio.

Tailoring in Post-Crisis Supervision and Regulation

In building the post-crisis framework, the Board designed its supervision and regulation to take on increased stringency the larger a firm's size and systemic footprint. This can be seen in larger or more complex banks facing stricter requirements in various elements of the regulatory capital framework, including the application of the supplementary leverage ratio, as well as certain buffers and surcharges, among others. And it can be seen in the specific set of more stringent prudential and resolution-related requirements that the Board has imposed on G–SIBs. By implication, these and other enhanced standards and supervisory tools have not been applied to smaller and community banks, resulting in a tailored and more appropriate regulatory framework for these institutions.

We now have many years of experience with the body of post-crisis regulation, however, and it is clear that there is more that can and should be done to align the nature of our regulations with the nature of the firms being regulated. The Act provides for further tailoring of our banking rules while maintaining the Board's authority to promote financial stability and ensure the safety and soundness of supervised institutions.

Regulatory Relief for Community Banking Organizations

Among the Act's key provisions are targeted tailoring measures to reduce the regulatory burden on community banks. The Federal Reserve is making substantial progress to implement these provisions. To provide clarity to the public, the Board and the Federal banking agencies in July issued public statements on the regulations and associated reporting requirements that the Act immediately affected, indicating that we would give immediate effect to those provisions even before the formal regulatory changes were fully implemented.[1] And in August, the Board began

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[1] Board of Governors of the Federal Reserve System, "Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf;* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Interagency Statement regarding

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implementing the Act with several interim final rules, which I will describe in more detail.[2]

Small Bank Holding Company Policy Statement

The Act requires the Board to revise a part of its rules commonly known as the small bank holding company (BHC) policy statement.[3] The small BHC policy statement permits certain small BHCs to incur debt levels higher than would be permitted for larger holding companies and exempts those small BHCs from the Board's minimum capital requirements.[4] This element of the Board's rules aims to facilitate the transfer of ownership in small banks, which can require the use of acquisition debt, while maintaining bank safety and soundness. The Act directs the Board to raise the asset threshold from $1 billion to $3 billion for BHCs to qualify for the policy statement, thereby expanding the reach of this regulatory relief. The Board completed this task on August 28, through an interim final rule. The rule renders most BHCs and savings and loan holding companies with less than $3 billion in assets exempt from the Board's regulatory capital rules, and provides corresponding relief from comprehensive consolidated financial regulatory reports.[5]

Expanded Eligibility for the Extended Exam Cycle

The Act expands the eligibility for small firms to undergo 18-month examination cycles, rather than annual cycles. Previously, firms with less than $1 billion in total consolidated assets were eligible, but now firms with up to $3 billion in total consolidated assets are eligible.

On August 23, the Federal banking agencies adopted an interim final rule to implement these provisions and make parallel changes for U.S. branches and agencies of foreign banks.[6]

Community Bank Leverage Ratio

The Act gives the Federal banking agencies the task of developing a community bank leverage ratio applicable to certain depository institutions and depository institution holding companies with total consolidated assets of less than $10 billion. Implementation of this provision is a high priority for the Board and our fellow regulators, and we have developed a work program to issue a regulatory proposal on this matter in the very near future.

Regulatory Relief for Banks with Less Than $100 Billion in Assets

Relief from Enhanced Prudential Standards

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) originally mandated certain enhanced prudential standards for BHCs with greater than $50 billion in total consolidated assets as well as company-run stress tests for firms with greater than $10 billion in assets. The Act exempted BHCs under $100 billion in assets from these requirements immediately upon enactment. To put these provisions into immediate effect, the Board has already stated that it will not take action to require BHCs with less than $100 billion in assets to comply with requirements related to resolution planning, liquidity risk management, internal liquidity stress testing, the liquidity coverage ratio, debt-to-equity limits, and capital planning, even before formal revisions to the regulations that implement these requirements.[7] The Board has also stated that it will not collect supervisory

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the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf.*

[2] The Board found good cause for adopting the rules on an interim final basis, thereby implementing Congress's directives and reducing regulatory burden as soon as possible, providing further clarity to the public, and allowing affected financial institutions and agencies appropriate time to prepare for the changes. The Board invites comment on all aspects of the interim final rules.

[3] The small BHC policy statement also covers savings and loan holding companies. 12 CFR part 225, appendix C.

[4] Of course, the subsidiaries of these firms remain subject to minimum capital requirements.

[5] Board of Governors of the Federal Reserve System, "Federal Reserve Board issues interim final rule expanding the applicability of the Board's small bank holding company policy statement," August 28, 2018, available at: *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180828a.htm.*

[6] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies issue interim final rules expanding examination cycles for qualifying small banks and U.S. branches and agencies of foreign banks," joint news release, August 23, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180823a.htm.*

[7] "Statement regarding the impact of EGRRCPA," *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf.*

assessments for calendar years after 2017 for holding companies with assets under $100 billion.[8]

Relief from Stress Testing Requirements

The Act exempted BHCs under $100 billion in total assets from Dodd-Frank requirements for supervisory stress tests and company-run stress tests immediately upon enactment. As a result, the Board did not include the three affected BHCs with less than $100 billion in assets in the results of this year's Dodd-Frank supervisory stress tests and the related Comprehensive Capital Analysis and Review.[9] The Board has effectively eliminated application of Dodd-Frank company-run stress test requirements for BHCs and other financial companies regulated by the Board with less than $100 billion in total assets.[10]

Tailoring Regulations for Larger Banking Organizations

The Act directs the Board to further tailor its supervision and regulation of large BHCs with more than $100 billion in assets that do not qualify as G–SIBs. For firms with total assets in the range of $100 billion to $250 billion, the legislation gives us more flexibility to tailor or eliminate certain requirements that, under Dodd-Frank, were mandatory. The legislation directs us to consider factors other than size for differentiating our supervision and regulation. Moreover, for firms with more than $250 billion in total assets that are not G–SIBs, we are independently considering how these firms could be more efficiently regulated by applying more tailored standards.

BHCs with Assets between $100 Billion and $250 Billion

The Board has placed our highest priority on issuing a proposed rule on tailoring enhanced prudential standards for banking firms with assets between $100 billion and $250 billion. Our task is not merely to reform the current regulation of the particular institutions that are affected by the Act at this moment, but to develop a framework that will describe in a principled way when future institutions may expect enhanced regulation and why, using objective measures that account for the relative complexity and interconnectedness among large banks. Considering the greater economic impact of the failure of larger banks versus smaller banks, it seems appropriate that tailoring supervision and regulation of large banks should not ignore size, but consider it as one factor among others. Additional factors that capture, for instance, larger banks' complexity and interconnectedness may—together with size—better serve as a basis for tailoring supervision and regulation rather than size alone.

While the statute sets an 18-month deadline for this regulatory process, we expect to move much more quickly than this. Topics covered by such a proposal could include, among other things, capital and liquidity rules, and resolution planning requirements for the less complex and interconnected of these firms. The statute requires "periodic" supervisory stress testing by the Federal Reserve, which I believe recognizes the value of stress testing but requires a more tailored frequency and requires us to think more carefully about the burden of these tasks. This is consistent with the Federal Reserve's long standing expectations that all banking organizations, regardless of size, should employ internal risk-management practices that appropriately assess their capital needs and vulnerabilities under a range of reasonably anticipated stress scenarios.

BHCs with Assets of $250 Billion or More

Beyond thinking about how we will further tailor our regulation and supervisory programs for firms with assets between $100 billion and $250 billion, the Board is similarly reviewing our requirements for firms with more than $250 billion in total assets but below the G–SIB threshold. Through this review, the Board aims to ensure that our regulations continue to appropriately increase in stringency with the risk profiles of firms, consistent with the Act and the Board's extant focus on tai-

[8] "Statement regarding the impact of EGRRCPA," *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf.*

[9] Board of Governors of the Federal Reserve System, "Federal Reserve Board releases results of supervisory bank stress tests," news release, June 21, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180621a.htm.*

[10] The Board announced that it will take no action to require BHCs with less than $100 billion in assets to comply with company-run stress test requirements. The Board effectively exempted other financial companies regulated by the Board by extending their deadline for compliance with company-run stress test requirements until these firms would benefit from the statutory exemption under the Act, which took effect later than the exemption for BHCs with assets less than $100 billion. See the "Statement regarding the impact of EGRRCPA," *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf.*

loring. Currently, some aspects of our regulatory regime-liquidity regulation, for example—treat banks with more than $250 billion in assets with the same stringency as G–SIBs. I can see reason to apply a clear differentiation.

Foreign Banking Organizations

Under the Dodd-Frank Act, the application of enhanced prudential standards to foreign banks is determined based on total global consolidated assets. The Act raises the threshold for automatic application of enhanced prudential standards under section 165 of the Dodd-Frank Act from $50 billion in total global consolidated assets to $250 billion, but the Federal Reserve may continue to apply enhanced prudential standards to foreign banking organizations (FBOs) with total global consolidated assets between $100 billion and $250 billion. The Act does not require the Board to change the U.S. asset threshold for establishment of an intermediate holding company, which is currently at $50 billion in U.S. nonbranch assets.

FBOs with significant U.S. operations have total global consolidated assets well in excess of the new statutory thresholds. We are not including any changes to the FBO regulatory scheme for FBOs with more than $250 billion in global assets as part of our implementation of tailoring mandated by the Act. We continue, as we always have, to review our regulatory framework to improve the manner in which we deal with the particular risks of FBOs in light of the distinct characteristics of such institutions.

Additional Measures in EGRRCPA

The provisions I have highlighted focus on the Federal Reserve's tasks that the Board has completed or made a priority for the near term. Two additional measures for which the banking agencies have already issued rulemakings are the treatment of municipal securities in liquidity rules, and the capital treatment of high volatility commercial real estate exposures. Regarding the former, the Federal banking agencies completed this task on August 22 through an interim final rule that modified the agencies' liquidity coverage ratio rule to treat certain municipal obligations as high-quality liquid assets as required by the Act.[11] And on the latter, the Federal banking agencies released an Interagency Statement allowing depository institutions and their holding companies to report only commercial real estate loans that would remain subject to the higher capital requirements after implementation of the Act. The Board and the other Federal banking agencies then followed up this announcement with a notice of proposed rulemaking on September 18, that seeks comment on changes to our regulation that would implement this statutory amendment.[12]

Under the Act, there is additional important work to be done on various other regulatory relief and refinements, including the provision in the Act regarding a custodial bank including central bank deposits in the denominator of its supplementary leverage ratio. We remain focused on completing these tasks in a timely fashion, while maintaining our commitment to engaging with stakeholders and other interested parties. In the appendix to this testimony, I have set out these tasks and the Board's latest thinking and actions on these topics.

Conclusion

At this point in the aftermath of the financial crisis, we face an important opportunity to further tailor our supervision and regulation framework in a way that lets us be more risk-sensitive without sacrificing the increased post-crisis resiliency of the financial system. In implementing the Act, we should tailor regulation more broadly to take into account the business mix, complexity and interconnectedness, and risk profile of banking institutions. Implementing the Act is an important milestone in the Federal Reserve's continuing tailoring mandate. Thank you again for the opportunity to testify before you this morning, and I look forward to answering your questions.

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[11] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies issue interim final rule regarding the treatment of certain municipal securities as high-quality liquid assets," joint news release, August 22, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180822a.htm.*

[12] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies propose rule regarding the treatment of high volatility commercial real estate," Joint Press Release, September 18, 2018, available at: *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180918a.htm.*

Appendix to the Statement by Randal K. Quarles

In my testimony, I focused on progress we have made to date on tasks set out for the Federal Reserve in the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act) as well as certain near-term priorities. In this appendix, I set out additional provisions in the Act and some of the Board's key considerations as to implementation.

Short Form Call Reports

The Act prescribes a reduced reporting requirement for certain small depository institutions, specifically, a reduced reporting requirement every first and third quarter for qualifying depository institutions with total assets of less than $5 billion. The Board, in conjunction with the other Federal banking agencies, intends to provide relief in the short-term, with additional simplifying changes to follow at a later stage.

Volcker Rule Relief

The Act exempts from the Volcker rule certain banks based on enumerated criteria. The Act also revises the statutory provisions concerning the naming of covered funds. Both changes took effect when the Act was signed into law. In light of these provisions, the relevant agencies immediately announced that they would limit enforcement of the final regulation implementing the Volcker rule consistently with the amendments made by the Act.[13] The Board and the other agencies responsible for implementing the Volcker rule also intend to conform the implementing rule to these statutory amendments through a separate rulemaking process.

Other Measures Related to Capital and Liquidity

Other provisions in the Act concerning capital and liquidity rules include requirements to eliminate the "adverse" scenario in stress testing for BHCs with total assets of $250 billion or more and allow a custodial bank to exclude central bank deposits from the denominator of its supplementary leverage ratio. The Board continues to develop these refinements.

Additional Measures

The Act contains a number of other provisions that may require agency implementation either through a rulemaking or other action. The Board is required to tailor supervisory assessments for BHCs with total assets between $100 billion and $250 billion. The Board is required to modify its engagement in international insurance standard setting, including through the establishment of an Insurance Policy Advisory Committee and through certain reports and testimony to Congress. In addition, the Board intends to assist the Treasury Department in analyzing how Federal banking agencies are addressing material risks of cyber threats to U.S. financial institutions and capital markets. The Board continues to develop policies, rulemakings, and other relevant steps to address these provisions, in conjunction with the other Federal banking agencies and Treasury as appropriate. Moreover, we intend to be highly engaged in the public feedback process in implementing all of the improvements to regulation and policymaking arising from the Act.

PREPARED STATEMENT OF JELENA McWILLIAMS

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

OCTOBER 2, 2018

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify today on the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Act"), which was signed into law on May 24th. I want to congratulate Chairman Crapo and other Members of the Committee who worked hard to craft this strong, bipartisan legislation, and former Chairman Shelby for his prior work in the area. The Act includes a number of directives that will help reduce the regulatory burden on small banks, while preserving the ability of financial regulators to ensure the safety and soundness of banks and the banking system. The Act also makes significant progress in appropriately tailoring

[13] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg2018 0706a1.pdf*.

regulations to the size and risk profile of particular institutions, especially with respect to small banks.

When I testified during my confirmation hearing, I told you that one of my top priorities would be the health of the Nation's community banks and their ability to effectively serve their communities. Community banks play a pivotal role in their local economies, and our regulatory regime must do what it can to ensure their continued vitality. Implementation of the Act will play a key role in delivering on this priority.

My testimony will describe actions that the FDIC has taken or plans to take to implement the Act's reforms, along with a description of other initiatives and priorities aimed at rightsizing the regulatory requirements for community banks.

Implementation of the Act's Reforms

Interagency Statement

The FDIC has taken a number of actions to implement the Act. With respect to interagency provisions that were effective immediately upon enactment, on July 6, 2018, the FDIC, the Office of the Comptroller of the Currency (OCC), and the Federal Reserve Board (FRB) (collectively, the "agencies") issued a statement describing the positions the agencies would take to implement statutory changes while working to amend existing regulations. Simply put, the statement made clear that we will not enforce existing regulations in a manner inconsistent with the Act.

Among the issues addressed in the statement is the agencies' position on the company-run stress testing requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). For depository institutions with average total consolidated assets of $100 billion or less, the agencies extended the deadlines for such stress tests until November 25, 2019, thereby eliminating requirements related to the Dodd-Frank Act company-run stress testing. This action was taken to avoid unnecessary burden for depository institutions and to maintain consistency between bank holding companies and depository institutions.

The Interagency Statement also addressed a number of other issues, including resolution planning, the Volcker Rule, risk weighting of high volatility commercial real estate (HVCRE) exposures, the examination cycle for small banks, the treatment of municipal obligations under the liquidity coverage ratio (LCR), and an exemption from appraisal requirements for certain transactions.

Section 103: Appraisals for Residential Loans in Rural Areas

Section 103 of the Act became effective immediately upon enactment and exempts certain loans secured by real property from the agencies' appraisal requirements. The exemption applies to federally related transactions under $400,000 and secured by a lien on properties located in rural areas. The exemption does not apply if a Federal financial institution's regulatory agency requires an appraisal for safety and soundness purposes or if the loan is a "high-cost mortgage," as defined in the Truth in Lending Act. The agencies are currently working on changes to existing regulations.

Section 201: Small Bank Leverage Ratio

Section 201 of the Act directs the agencies, in consultation with applicable State bank supervisors, to develop a community bank leverage ratio of not less than 8 percent and not more than 10 percent. Under the law, community banks that exceed the community bank leverage ratio will be considered compliant with all other capital and leverage requirements. This will substantially simplify compliance with capital rules for qualifying banks. This community bank leverage ratio will only be available to certain banks with total consolidated assets of less than $10 billion. The agencies are working expeditiously to develop a proposed rule to implement this provision.

Section 202: Reciprocal Deposits

Section 202, which became effective upon enactment, provides that, under certain circumstances, reciprocal deposits will not be considered funds obtained, directly or indirectly, by or through a deposit broker under section 29 of the Federal Deposit Insurance Act.

Reciprocal deposits are defined as deposits that a bank receives through a deposit placement network with the same maturity (if any) and in the same aggregate amount as deposits the bank submitted for placement through the deposit placement network. The FDIC, working with the Federal Financial Institutions Examination Council (FFIEC) members, revised the Call Report Instructions to reflect the reporting change from brokered to nonbrokered treatment of specified reciprocal deposits for the June 30, 2018, Call Report. Additionally, on September 12, 2018, the

FDIC issued a Notice of Proposed Rulemaking (NPR) to conform its brokered deposit regulation to section 202.

Sections 203 and 204: Volcker Rule

Section 203 of the Act amends the definition of "banking entity" under section 13 of the Bank Holding Company Act to alter which institutions are subject to the requirements of the Volcker Rule. The term "banking entity" is defined under the Bank Holding Company Act to include an insured depository institution or a company that controls an insured depository institution. Following the passage of the Act, the term "insured depository institution" does not include an institution (A) that functions solely in a trust or fiduciary capacity (subject to certain conditions) or (B) that does not have and is not controlled by a company that has (i) more than $10 billion in total consolidated assets and (ii) total trading assets and trading liabilities that are more than 5 percent of total consolidated assets.

Section 204 revises the statutory provisions related to the naming of covered funds, effective on the date of enactment. This revision removes certain naming restrictions on covered funds in a manner than enables hedge funds or private equity funds to share the same name as a banking entity that is an investment adviser to the fund under certain conditions.

Section 205: Short Form Call Reports

Section 205 of the Act requires the banking agencies to issue regulations that allow for a reduced reporting requirement in the first and third quarter Call Reports for "covered depository institutions" that have less than $5 billion in total assets and satisfy other appropriate criteria established by the agencies. The agencies are developing a proposed rule to implement section 205 that we intend to issue for comment in the very near term.

The agencies' efforts to implement section 205 will build on the work already done by the FFIEC's Community Bank Call Report Burden-Reduction Initiative, which includes the introduction of a streamlined Call Report that, at present, is generally applicable to institutions with domestic offices only and total assets of less than $1 billion. The shorter Call Report reduced the length of the report for eligible small institutions from 85 to 61 pages, removed approximately 40 percent of the nearly 2,400 data items required, and reduced the reporting frequency for approximately 100 additional data items. In implementing section 205, in addition to raising the asset threshold and expanding the number of eligible institutions, the agencies are exploring ways to further streamline Call Reports.

Section 210: Examination Cycle

Section 210 of the Act raises the total asset threshold from $1 billion to $3 billion for well-capitalized insured depository institutions to be eligible for an 18-month examination cycle, setting a longer examination cycle for a larger number of "1-rated" institutions and authorizing the agencies to make corresponding changes for "2-rated" institutions. On August 23, 2018, the FDIC issued an IFR with the OCC and the FRB to conform existing rules and to make the corresponding change for 2-rated institutions. Under the IFR, up to 420 additional institutions will benefit from an 18-month examination cycle. Comments on the IFR were requested within 60 days of publication in the Federal Register.

Section 214: Revised Definition for HVCRE

Prior to the enactment of the Act, the regulatory capital treatment of HVCRE exposures was a concern for many institutions. Under the standardized approach, banks were required to assign a 150 percent risk-weight to any loans that met the definition of HVCRE. Section 214 provides that the agencies may only require a bank to assign a heightened risk weight to such an exposure if it is an "HVCRE ADC Loan," as defined in the statute. While banks are currently able to report their HVCRE exposures using this new definition, the FDIC must amend its capital rules to align with the definition provided in the Act. On September 12, 2018, the FDIC issued a Notice of Proposed Rulemaking (NPR) to conform its capital regulation to section 214.

Section 403: Municipal Obligations as High-Quality Liquid Assets (HQLA)

Section 403 of the Act requires the agencies to treat certain municipal obligations as HQLA for purposes of their final rules establishing the LCR and in other regulations incorporating the term HQLA. The section also requires the agencies to amend their liquidity regulations to implement these changes no later than 90 days after enactment. On August 22, 2018, the FDIC issued an IFR jointly with the OCC and the FRB that amends the agencies' LCR rule to treat liquid and readily marketable, investment grade municipal obligations as HQLA. Comments on the IFR were requested within 30 days of publication in the Federal Register.

Additional FDIC Initiatives

In addition to implementation of the Act, the FDIC is also looking at additional ways to improve the effectiveness and efficiency of its supervision and regulation and to enhance its processes and communications.

Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA)

EGRPRA requires the agencies to conduct a joint review of regulations every 10 years and consider whether any of those regulations are outdated or unnecessary. The most recent EGRPRA cycle resulted in a Joint Report to Congress, submitted by the banking agencies and the National Credit Union Administration (NCUA) in March 2017. Through this process, the agencies began to address issues related to regulatory burden, including reporting requirements, capital rules, and appraisal requirements. As a few examples stemming from the review, the agencies have implemented a short form call report, issued an NPR to simplify certain aspects of the regulatory capital rules, and raised the threshold for commercial real estate loans exempt from appraisal requirements.

Future Initiatives

Since becoming Chairman, I have focused on reviewing the FDIC's organization and processes, approach to supervision, and existing regulations and policies. The FDIC has commenced work on a number of new initiatives, and others will be introduced in the near future. A few of my initial priorities include improving (1) the transparency and accountability of the agency, (2) the examination process, and (3) the *de novo* application process.

Improving transparency at the FDIC will be a core component of my Chairmanship. Yesterday, the FDIC issued a request for comment on how the FDIC disseminates information to regulated institutions, and how to make these communications more effective, streamlined, and clear. Additionally, on September 10, 2018, the FDIC proposed to rescind more than 50 percent of the Financial Institution Letters (FILs) related to safety and soundness issues after determining they are outdated or that the information can be found elsewhere on the FDIC's website. We also plan to retire more than half of FILs related to consumer compliance as well. Overall, my goal is to make sure that supervisory guidance we provide is as clear and concise as possible, and that outdated or superseded supervisory communications are archived.

As the current Chair of the FFIEC, the FDIC is leading an Examination Modernization Project to minimize burden to banks where possible, principally by reevaluating traditional processes and making better use of technology. Additionally, the FDIC has undertaken separate internal projects to improve the effectiveness, efficiency, and quality of community bank safety and soundness processes. These projects are focused on improving the examination planning process and further risk-focusing or tailoring examinations to a bank's business model, complexity, and risk profile.

The FDIC is currently looking at how we can further improve the application process to encourage more *de novo* activity while ensuring that prospective banks are strong enough to survive, especially given industry consolidation over recent decades. Since January 2010, the number of insured depository institutions has declined by nearly 2,500, which includes mergers of non-affiliated banks (41 percent); consolidations within the same organization (27 percent); bank failures (15 percent); acquisitions of banks on the problem bank list (11 percent); and self-liquidations (6 percent). Meanwhile, during that same time period, only 11 new charters have been approved and opened, most in the past 15 months.[1] To ensure the long-term vibrancy of the banking industry, it is important to attract new startups and new capital. It is also important to clarify that the FDIC does not have a standard initial capital figure for *de novos,* but rather a prospective bank is expected to propose initial capital sufficient to support its business model.[2]

[1] This number does not include shelf charters (new banks formed to acquire a failed bank or another bank), conversions (which includes credit unions converting into banks, or new banks that are spin-offs of existing banks), or a new subsidiary by a banking organization that already has an affiliated bank.

[2] The FDIC's *Statement of Policy on Applications for Deposit Insurance* states that normally, the initial capital of a proposed depository institution should be sufficient to provide a Tier 1 capital to assets leverage ratio (as defined in the appropriate capital regulation of the institution's primary Federal regulator) of not less than 8.0 percent throughout the first 3 years of operation. In addition, the depository institution must maintain an adequate allowance for loan

The FDIC is also planning to address a number of additional regulatory priorities in the coming months, including revisiting those regulations that have not received recent or comprehensive public input. One example is a comprehensive look at the regulatory approach to brokered deposits and national rate caps, which will include seeking public comment later this year. The banking industry has undergone significant changes since these regulations were put into place, and we will consider the impact of changes in technology, business models, and products since the brokered deposit requirements were adopted.

Conclusion

Thank you again for the opportunity to appear before you today, and I look forward to your questions.

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and lease losses. Initial capital should normally be in excess of $2 million net of any preopening expenses that will be charged to the institution's capital after it commences business. Overall, the amount of capital will be dependent on the prospective bank's size and proposed business model—there is no standard dollar amount required.

National Credit Union Administration

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October 2, 2018

Congressional Testimony

J. Mark McWatters
Chairman
National Credit Union Administration

Senate Committee on Banking, Housing, and Urban Affairs

Hearing on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act

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Congressional Testimony

Chairman Crapo, Ranking Member Brown, and Members of the Committee, as Chairman of the National Credit Union Administration (NCUA) Board, I appreciate the invitation to testify today about the NCUA's implementation of S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[1]

The NCUA's mission is to "provide, through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit."[2] This system is vital to the American economy, touching more than one-third of all U.S. households.[3] In turn, the NCUA is charged with, and focused on, ensuring the safety and soundness of the National Credit Union Share Insurance Fund (Share Insurance Fund). The agency takes seriously its responsibilities for the regulation and supervision of approximately 5,480 federally insured credit unions with more than 114 million member-owners and more than $1.4 trillion in assets across all states and U.S. territories.[4] As an adjunct to that mission, the agency has developed initiatives to make it easier for credit unions to serve their members more effectively, including members of modest means and those in underserved areas.[5]

The first part of my testimony today focuses on the NCUA's implementation of the EGRRCPA. Next, I will discuss the NCUA Board's recent efforts to improve the efficiency and effectiveness of the agency and to reduce the regulatory, reporting, and examination burdens facing credit unions without sacrificing the safety and soundness of the credit union system and, in turn, the Share Insurance Fund. Finally, I will provide recommendations for potential legislative actions that would enhance how the NCUA carries out its safety and soundness mission and allow credit unions to serve their members and communities better, including those of modest means and the underserved.

I appreciate and recognize that changes to the Federal Credit Union Act made possible by this Committee and regulatory changes embraced by the NCUA are improving credit

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[1] Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), Pub. L. No. 115-174, 132 Stat. 1296 (2018) [hereinafter EGRRCPA].
[2] See NCUA Mission and Vision, https://www.ncua.gov/About/Pages/Mission-and-Vision.aspx.
[3] NCUA calculations using the Federal Reserve's *Survey of Consumer Finances, 2016*.
[4] Based on June 30, 2018 Call Report Data.
[5] *Serving the Underserved*, National Credit Union Administration, https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx. The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet "the credit and savings needs of consumers, especially persons of modest means." Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998).

unions' ability to serve their members. At the same time, technological and other advancements, including credit union relationships with fintechs and other third-party vendors, are changing the way financial services are provided. While these developments can help credit unions meet the needs of all segments of their membership and communities, they also mean that credit unions and the NCUA must evolve to remain effective in the changing financial services landscape.

Implementation of the EGRRCPA

The EGRRCPA includes a number of amendments that apply to credit unions and relieve regulatory burdens placed on them. My testimony will focus on select amendments that have a more substantial impact on the NCUA and credit unions. Specifically, I will address four amendments related to appraisals in rural areas, member business lending, budget transparency, and the Home Mortgage Disclosure Act that apply to federally insured credit unions and the NCUA.[6] Since passage of the EGRRCPA, the NCUA has begun to update its examiner guidance and examination procedures to reflect the statutory changes introduced. The agency will review credit union compliance with these changes, as warranted, as part of our risk-focused examination program. Additionally, the NCUA will work cooperatively with state supervisory authorities and the other federal regulators to implement these amendments.

Exemption from Appraisals in Rural Areas
Section 103 of the EGRRCPA amends the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to exempt from appraisal requirements certain federally related, rural real estate transactions valued below a specified limit if no state-certified or state-licensed appraiser is available.[7] Specifically, the EGRRCPA provides an exemption to the appraisal requirements for certain transactions with values of less than $400,000 involving real property or an interest in real property that is located in a rural area, as specified in Section 103 of the EGRRCPA. At its September 2018 Board meeting, the NCUA Board proposed an amended appraisals rule that incorporates the provisions of the EGRRCPA amendments and proposed additional changes to reduce regulatory burden and make compliance easier for regulated entities.

Member Business Lending (Loans for Non-primary Residences)
Prior to the passage of the EGRRCPA, the Federal Credit Union Act defined a member business loan in relevant part as any loan, line of credit, or letter of credit, the proceeds

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[6] The EGRRCPA contains other amendments, generally in the area of compliance and financial literacy, which apply to the NCUA and credit unions. The Consumer Compliance Task Force of the Federal Financial Institutions Examination Council has assembled a working group, in which the NCUA participates, to ensure a consistent and non-duplicative approach to implementation of these amendments.
[7] Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L No. 101-73, 103 Stat. 183 (1989).

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of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose, but does not include an extension of credit that is fully secured by a lien on a one-to-four-family dwelling that is the primary residence of a member.[8] Section 105 of the EGRRCPA removed from that definition the words ''that is the primary residence of a member,'' addressing a statutory disparity in the treatment of certain residential real estate loans made by credit unions and banks.

As a result, the revised member business loan definition now excludes all extensions of credit that are fully secured by a lien on a one-to-four-family dwelling regardless of the borrower's occupancy status. Because these loans are no longer considered member business loans, they do not count towards the aggregate member business loan cap imposed on most federally insured credit unions by the Federal Credit Union Act.[9] The amendment was effective upon the EGRRCPA's enactment. Less than one week later, the NCUA Board issued a final rule to incorporate the amendment into the NCUA's commercial and member business lending regulation.[10]

While this amendment is an important change and one I support, I would like to emphasize the NCUA's longstanding and continued support for additional legislative action to provide further relief in this area, including an additional exemption for loans to small businesses. Small businesses are a critical job-creating segment of the U.S. economy that, especially at start-up and in the early phases of their development, have difficulty obtaining affordable credit. I look forward to working with Congress and the credit union community to enhance credit unions' ability to serve small businesses.

Budget Transparency

Section 212 of the EGRRCPA amended the Federal Credit Union Act to require the NCUA to annually make publicly available and publish in the *Federal Register* a draft of the NCUA's detailed business-type budget. It also requires the NCUA to hold a public hearing, with public notice provided of the hearing, during which the public may submit comments on the draft budget. As discussed in greater detail below, I am pleased to report that the NCUA has been compliant with the spirit of the provisions in Section 212 of the EGRRCPA for the last two years.

Throughout my tenure on the NCUA Board, including as Chairman, I have worked to increase transparency and accountability throughout all agency levels. One of my first initiatives was to increase transparency around the NCUA's budgetary process. The NCUA Board is mindful that the finite resources of federal and state-chartered credit unions and their member-owners finance the agency's budget. Consequently, we should only allocate these funds following thoughtful consideration on the expenditure

[8] 12 U.S.C. 1757a(c)(1).
[9] 12 U.S.C. 1757a(a).
[10] 83 FR 25881 (June 5, 2018).

and whether it can be undertaken in the most efficient, effective, transparent, and fully accountable manner. Through a bipartisan effort, we restarted public budget hearings and posted a significant level of budget detail in respect of the last two budget cycles.[11] Last month, we released a proposed staff budget for 2019–2020 and its supporting documents and published the draft budget in the *Federal Register*. A public budget briefing is planned for October 17, 2018.

Home Mortgage Disclosure Act (HMDA)

Section 104 of the EGRRCPA provides partial exemptions for some insured credit unions from certain HMDA requirements. The partial exemptions are generally available for: closed-end mortgage loans, if the credit union originated fewer than 500 closed-end mortgage loans in each of the two preceding calendar years; and open-end lines of credit, if the credit union originated fewer than 500 open-end lines of credit in each of the two preceding calendar years.

In May, the NCUA sent a notice to all field staff notifying them of the change and instructing them to use the amended thresholds when reviewing HMDA compliance. The agency is also in the process of updating its examiner guidance and examination tools for reviewing HMDA compliance at credit unions.

The NCUA's Efforts to Improve its Efficiency and Reduce Regulatory and Examination Burden

The NCUA's primary mission is to protect the safety and soundness of the credit union system and the Share Insurance Fund. As an adjunct to that mission, the agency has developed initiatives to facilitate credit unions more effectively serving their members and communities, including the underserved and those of modest means.

It is essential the NCUA Board develops a regulatory environment that meets our safety and soundness mission, but does not inhibit flexibility and innovation within the credit union system and allows credit unions to continue to serve all of their members. As the financial services landscape evolves, the NCUA must evolve with it to promote continued financial stability within the credit union system. In so doing, it is imperative the agency continues to fulfill its mission in a fully transparent, accountable, and efficient manner. In my view, the NCUA Board is obligated to consider the compliance burdens and the costs our institutions shoulder on a day-to-day basis. As a result, we must reduce, streamline, or eliminate outdated or overly burdensome regulations where possible, so credit unions can simultaneously stay competitive in the changing environment and continue to provide financial services to their members and communities.

[11] See NCUA Budget and Supplementary Materials, https://www.ncua.gov/About/Pages/budget-strategic-planning/supplementary-materials.aspx.

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Over the last two years, the NCUA has undertaken initiatives to improve the efficiency and effectiveness of our operations. Through consistent bipartisan collaboration, the NCUA Board has revised the agency's regulations to relieve regulatory, reporting, and examination burdens on federally insured credit unions, which we believe enables them to continue to provide competitive financial services to all of their members. I wish to thank my Democratic colleague, Rick Metsger, for diligently working with me in a collegial and collaborative manner for over 28 months to accomplish our shared regulatory agenda.

Initiatives Aimed at Decreasing Regulatory Burdens

Since I became Chairman in 2017, I tasked the agency with reviewing and modernizing its rules to create a transparent and fully accountable regulatory framework that acknowledges the need for flexibility, creates new avenues for growth, and strengthens the system's resiliency, while simultaneously reducing the regulatory burden where prudent and appropriate.

Consistent with the spirit of President Trump's regulatory reform agenda and Executive Order 13777, the NCUA established a Regulatory Reform Task Force to oversee the implementation of the agency's own regulatory reform agenda. Although the NCUA, as an independent agency, is not required to comply with Executive Order 13777, the agency chose to comply with its spirit by undertaking a comprehensive review of all of the NCUA's regulations. The Regulatory Reform Task Force published the NCUA's first report for public comment in August 2017.[12] This reform agenda proposed a four-year, three-tiered regulatory relief plan with approximately 40 regulatory relief recommendations.

Since the report's publication, the NCUA has completed nine of the initial regulatory relief recommendations and proposed rules or commenced action on five others. Specifically, the NCUA issued final regulations or took other final actions designed to:

- Provide additional flexibility to corporate credit unions' capital standards;[13]
- Improve the NCUA's emergency merger process;[14]
- Recognize that federal credit unions may securitize the loans they make;[15]

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[12] 82 FR 39702 (Aug. 22, 2017), available at https://www.ncua.gov/About/Pages/board-actions/comments/Documents/regulatory-review-notice-2017.pdf.
[13] 82 FR 55497 (Nov. 22, 2017).
[14] 82 FR 60283 (Dec. 20, 2017).
[15] Asset Securitization Authority, NCUA OGC Op. Ltr. 17-0670 (June 21, 2017), available at https://www.ncua.gov/regulation-supervision/Pages/rules/legal-opinions/2017/asset-securitization-authority.pdf; and 82 FR 29699 (June 30, 2017).

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- Improve the NCUA's appeals process for examination determinations to ensure due process and fairness;[16]
- Improve and centralize the NCUA's appeals procedures in one section of the NCUA's regulations;[17]
- Provide greater transparency regarding the calculation of each eligible financial institution's pro rata share of a declared equity distribution from the Share Insurance Fund;[18]
- Decrease the burden and improve the efficiency of the NCUA's capital planning and stress testing rules;[19]
- Decrease burden and add flexibility to the NCUA's advertising requirements;[20] and
- Add flexibility to the NCUA's field-of-membership processes.[21]

Additionally, the NCUA proposed or sought advanced comment on amendments that would provide regulatory relief by:

- Improving the NCUA's regulations governing federal credit union bylaws;[22]
- Making clarifying and technical changes to improve the user-friendliness of the NCUA's loan maturities requirements;[23]
- Clarifying the NCUA's limits on loans to a single borrower or group of associated borrowers;[24]
- Proposing a delay in the effective date of the NCUA's risk-based capital rule and a decrease in the number of credit unions covered by the rule;[25] and
- Improving the NCUA's appraisals regulation to reduce burden and make compliance easier.

The NCUA plans to publish its second Regulatory Reform Task Force report in the coming months. This report will provide an updated blueprint for the agency's regulatory reform agenda and a formal means of measuring the agency's regulatory relief efforts moving forward.

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[16] 82 FR 50270 (Oct. 30, 2017).
[17] 82 FR 50288 (Oct. 30, 2017).
[18] 83 FR 7954 (Feb. 23, 2018).
[19] 83 FR 17901 (Apr. 25, 2018).
[20] 83 FR 17910 (Apr. 25, 2018).
[21] 83 FR 30289 (June 28, 2018).
[22] 83 FR 12283 (Mar. 21, 2018).
[23] 83 FR 39622 (Aug. 10, 2018).
[24] *Id.*
[25] 83 FR 38997 (Aug. 8, 2018).

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Finally, the NCUA will continue its annual regulatory review to provide stakeholders with a means of providing feedback on the regulatory burden they face. As part of this process, the agency reviews and solicits public comment on one-third of the agency's regulations each year. Agency staff then provides the NCUA Board with regulatory recommendations, based in part on the comments received. The NCUA will open the comment period for the first one-third of its regulations in January 2019.

Capital

Given the critical importance of capital to the safety and soundness and viability of any financial institution, I would like to highlight the NCUA's recent actions in this area. I believe that, while we should, of course, thoughtfully consider the lessons learned from the recent financial crisis, it is incumbent on regulators to focus on the changing financial landscape and adopt targeted regulations to address the actual risks presented. Accordingly, the NCUA Board recently finalized or proposed a number of amendments to the agency's capital rules to be commensurate with the safety and soundness risks currently present in the credit union system.

- *Risk-based Capital* — In August 2018, the NCUA issued a proposed rule to delay the effective date of the NCUA's 2015 final risk-based capital rule for one year, from January 1, 2019 to January 1, 2020.[26] The proposal also amended the definition of a ''complex'' credit union for risk-based capital purposes adopted in the 2015 final rule by increasing the threshold level from $100 million to $500 million. These proposed changes would provide covered credit unions with additional time to prepare for the rule's implementation, and exempt an additional 1,026 credit unions from the rule without, as described in detail in the proposed rule, subjecting the Share Insurance Fund to undue risk. Under the proposal, the NCUA's current prompt corrective action requirements remain in effect during the implementation period.

- *Capital Planning and Stress Testing* — In April 2018, the NCUA issued a final rule amending its regulations regarding capital planning and stress testing for federally insured credit unions with $10 billion or more in assets.[27] The final rule also made the NCUA's requirements more efficient by authorizing covered credit unions to conduct their own stress tests in accordance with the NCUA's requirements. The change reflects the NCUA's experience in implementing the previous rule's requirements, while also taking into consideration the systemic risk that covered credit unions pose to the Share Insurance Fund. Both the capital planning and stress testing requirements in this rule were tiered to reflect

[26] 83 FR 38997 (Aug. 8, 2018).
[27] 83 FR 17901 (Apr. 25, 2018).

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credit unions' size, complexity, and financial condition. As a result, certain covered credit unions will have their regulatory burden reduced.

- *Corporate Credit Union Capital Standards* — When the NCUA Board last made comprehensive revisions to its rules governing corporate credit unions in 2010, it focused on stabilizing the corporate system and improving their ability to function and provide services to natural-person credit unions. Since then, the corporate system contracted and consolidated, with assets declining from approximately $81.7 billion prior to 2010 to approximately $24.9 billion in 2017. During that same period, the number of corporates declined from 26 to 11. Given these developments, the Board determined it was appropriate to revisit the capital standards for corporate credit unions in 2017. The resulting final rule primarily clarified the capital requirements for corporate credit unions and expanded what constitutes Tier 1 capital.[28]

- *Alternative Forms of Capital* — Under the Federal Credit Union Act, only low-income credit unions are able to accept secondary capital (a form of alternative capital).[29] However, since joining the NCUA Board, one of my goals has been to increase credit union access to capital, provided the form of such capital is consistent with the system of cooperative credit. In January 2017, the NCUA Board issued an advance notice of proposed rulemaking on potential changes to the rules governing alternative forms of capital that credit unions could use to meet their risk-based net worth requirements. The notice asked stakeholders for their views on a range of topics, including any regulatory changes that would be necessary to facilitate greater use of alternative capital, potential tax implications related to issuing alternative capital, particularly for state-chartered credit unions, and the impact of alternative capital on the mutual ownership structure of credit unions, among others. After evaluating the comments received on that proposal, the NCUA included alternative capital as part of its regulatory reform agenda.

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[28] 82 FR 55497 (Nov. 22, 2017).

[29] Alternative capital includes two different categories: secondary capital and supplemental capital. Secondary capital is currently permissible under the Federal Credit Union Act only for low-income designated credit unions to issue and to be counted toward both the net worth ratio and the risk-based net worth requirement of NCUA's prompt corrective action standards. The Board is considering changes to the secondary capital regulation for low-income designated credit unions. There are no other forms of alternative capital currently authorized. However, the Board is also considering whether or not to authorize credit unions to issue supplemental capital instruments that would only count towards the risk-based net worth requirement.

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Additional Flexibility in Credit Union Lending

Over the last two years, the NCUA Board has, through consistent bipartisan collaboration and effort, adopted regulatory changes to provide federal credit unions with increased flexibility in their lending activities. These changes are intended not only to reduce regulatory burden, but also to allow credit unions to offer lending products that serve the credit needs of their members and communities better, including those of modest means and the underserved.[30]

- *Payday Alternative Loan Program* — To provide credit union members with a safe and less expensive alternative to high-cost, traditional payday loans, the NCUA's regulations permit federal credit unions to offer small-dollar loans called payday alternative loans (PALs).[31] As of the end of 2017, 524 federal credit unions reported that they made PALs loans during the year. These credit unions reported making 191,216 loans amounting to $132.8 million in PALs during the year. In comparison, in 2012, 476 federal credit unions reported that they made 115,809 loans amounting to $72.6 million of lending during the year.[32]

  Strong and consistent demand continues for short-term, small dollar loans, and credit unions can present consumers with a viable alternative to predatory lenders. In June, the NCUA Board proposed amendments to the NCUA's PALs regulation to provide federal credit unions with an additional payday alternative loan option.[33] The new proposed payday alternative loan option (PALs II) would not replace the current payday alternative loan program (PALs I), but would serve as an additional market-based alternative. The proposed PALs II option has features to enable federal credit unions to meet the needs of certain borrowers not met by the current program and encourage additional federal credit unions to offer PALs.

  The NCUA Board also sought public comment on a possible third option (PALs III), asking, in particular, for feedback on interest rates, maximum loan amounts, loan terms, and application fees. To gain additional industry insight into this program, I recently met with representatives of the Pew Charitable Trusts and the Center for Responsible Lending. They offered sharply differing analyses, both from each other and from the NCUA, of our programs and their views on

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[30] The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet "the credit and savings needs of consumers, especially persons of modest means." Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998). Also, see *Serving the Underserved,* National Credit Union Administration, https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx.

[31] 12 CFR 701.21(c)(7)(iii).

[32] 83 FR 25583 (June 4, 2018).

[33] *Id.*

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the optimal structure for small dollar lending programs that offer robust consumer protection while permitting lenders to earn a reasonable risk-adjusted rate of return.

- *Maturity Limits* — The Federal Credit Union Act places a general 15-year maturity limit on loans made by federal credit unions.[34] In August, the NCUA Board issued a proposed rule designed to improve the clarity and user-friendliness of the NCUA's regulations implementing the current maturity limits.[35] The NCUA Board also solicited advanced comment on how it could, in instances when the Federal Credit Union Act authorizes the NCUA Board to deviate from the statutory maturity limits, provide additional flexibility with respect to those limits. The NCUA recognizes that any such additional flexibility will enable federal credit unions to provide lending products that serve the credit needs of their members and their communities better.

- *Maximum Loan Rate Ceiling* — The Federal Credit Union Act caps the interest rate on federal credit union loans at 15 percent. However, the NCUA Board has discretion to raise that limit for 18-month periods, "after consultation with the appropriate committees of the Congress, the Department of Treasury, and the [f]ederal financial institution regulatory agencies, … if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth."[36] Since 1987, the NCUA Board has maintained an interest rate cap at 18 percent for virtually all federal credit union lending.[37]

  The NCUA is developing an advanced notice of proposed rulemaking to further explore and solicit public input on alternatives to the current fixed, temporary rate ceiling. Possible alternatives include a higher, variable, or tiered interest-rate ceiling. The agency believes that any interest rate ceiling must protect consumers and help federal credit unions fulfill the needs of their members and communities, especially those of modest means and the underserved. At the same time, such a ceiling should allow federal credit unions to provide competitive products and cannot pose undue risk to the Share Insurance Fund.

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[34] 12 U.S.C. 1757(5).
[35] 83 FR 39622 (Aug. 10, 2018).
[36] 12 U.S.C. 1757(5)(A)(vi)(1).
[37] Since 1987, the only exception to the 18 percent interest rate cap for federal credit union lending is the current PALs program. That program has an interest rate cap of 1000 basis points above the then-current interest rate cap established by the NCUA Board.

Initiatives Aimed at Increasing Agency Efficiency and Reducing Examination and Reporting Burdens

The NCUA is improving the regulatory environment for credit unions without sacrificing our safety and soundness mission. Upon becoming Chairman in 2017, I commissioned a full review of the NCUA's operations and staffing needs. This review resulted in a plan that reduces the agency's regional structure from five to three regional offices, an 80 percent reduction in the agency's leased space, and reorganizes several central office functions to reduce costs and increase efficiencies. While the majority of the reorganization has been completed, the final phase of the regional consolidation will occur in January 2019.

As part of the agency's broader reform plan, we also undertook a number of initiatives to increase the efficiency in our examination, data collection, and reporting efforts. Specifically, I call your attention to the following programs:

Exam Flexibility Initiative[38]

This initiative provides greater examination efficiency and flexibility for credit unions and the agency, and improves coordination with state supervisors. Because of this initiative, the NCUA adjusted the frequency of examinations based on a credit union's size, complexity, operating condition, and, in the case of state-chartered credit unions, the frequency of state examinations. This initiative resulted in meaningful regulatory relief for the vast majority of credit unions, led to greater coordination between federal and state regulators, and allowed the NCUA to focus more efforts on troubled credit unions, with the anticipated benefit of addressing some problems earlier when they are easier and less costly to resolve.

The Enterprise Solution Modernization Program[39]

This multi-year program modernizes the NCUA's technology infrastructure to create an integrated examination and data environment, and further enhances the agency's cybersecurity posture. It incorporates emerging technology solutions that support the NCUA's examination, data collection, and reporting efforts to improve key, integrated business processes and meet applicable security protocols. The program will improve the examination process and ease burdens on credit unions and staff by reducing the amount of examination and supervision time spent onsite in credit unions. The NCUA expects an improved user experience and increased efficiencies when the new systems are in place.

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[38] See NCUA Exam Flexibility Initiative, https://www.ncua.gov/About/Pages/open-government/exam-flexibility-initiative.aspx.

[39] See NCUA Enterprise Solution Modernization (ESM) Program, https://www.ncua.gov/About/Pages/open-government/enterprise-solution-modernization-program.aspx.

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The Call Report Modernization Project[40]
This project complements the Enterprise Solution Modernization Program and involves a comprehensive review of Call Report and Credit Union Profile data content.[41] The NCUA developed a prototype Call Report and Profile that eliminated outdated fields, and simplified the reporting process without sacrificing important information necessary for proper supervision and data analyses. In order to ensure a transparent and collaborative process the agency solicited public comment on the prototype. The NCUA estimates the proposed changes will reduce the number of account codes collected from credit unions. If the proposal is adopted, the agency will revise and improve its Call Report schedules and instructions to make it easier for credit unions to complete this critical regulatory filing.

Initiatives Aimed at Increasing Agency Effectiveness in Maintaining Safety and Soundness of the Credit Union System and the Share Insurance Fund
The NCUA has undertaken a variety of initiatives to improve the agency's effectiveness in fulfilling our core mission: protecting the safety and soundness of the credit union system and the Share Insurance Fund. These initiatives complement the NCUA Board's efforts to reduce regulatory, examination, and reporting burdens for federally insured credit unions.

Improved Risk Identification Techniques
The NCUA is developing new and advanced risk identification and monitoring capabilities and techniques. These new data and analytical techniques will facilitate more data-driven supervision and enable the agency to better identify and address risk outliers. Additionally, the NCUA incorporated advances in identifying credit unions with an elevated risk of fraud. This further supports the objective to spend less time onsite at credit unions and leverage technology to maximize efficiency.

Increased Use of Specialists
With the increasing complexity of the financial services landscape, the NCUA has expanded its use of specialists within its examination ranks. We added additional disciplines and subject matter experts to our examination teams to address a broader range of financial products, services, and risks effectively.

Expanded Examiner Training and Guidance
The NCUA recognizes the importance of identifying undue risk exposures timely and relies on both specialized staff and techniques to do so. The agency updated its subject

[40] See NCUA Call Report Modernization, https://www.ncua.gov/About/Pages/open-government/call-report-modernization.aspx.
[41] The NCUA uses the Call Report and Profile to collect financial and nonfinancial information from federally insured credit unions. The resulting data are integral to risk supervision at institution and industry levels, which is central to safeguarding the integrity of the National Credit Union Share Insurance Fund.

matter examiner training to ensure specialists maintain current knowledge sets and are consistent in the analysis of risk and determination of safety and soundness concerns. The NCUA has also conducted a comprehensive update to its core examiner training. Additionally, the NCUA's *Examiner's Guide* is undergoing an extensive update to expand and clarify risk management expectations for the growing range of financial services credit unions engage in.

Enhanced Examination Quality Control

The NCUA is improving its quality control program to strengthen the examination and supervision process. These improvements will increase our consistency when assessing risk. It will also enable the agency to better identify and address safety and soundness issues.

Recommendations for Legislative Action

While the NCUA Board can provide federally insured credit unions with meaningful regulatory relief, congressional action is required to provide additional flexibility in some areas. Today, I would like to highlight four areas where congressional action can provide new avenues for credit union growth, without sacrificing the safety and soundness of the credit union system. These include modifying the Federal Credit Union Act's provisions related to field of membership, granting the NCUA vendor authority, authorizing alternative forms of capital, and giving the NCUA Board broader authority to establish a maximum loan rate ceiling for federal credit unions.

Field of Membership

The Federal Credit Union Act currently permits only federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership.[42] Modification to the Federal Credit Union Act to permit all types of federally chartered credit unions to add underserved areas to their fields of membership would allow such institutions to offer financial services to those with no or limited access to federally insured financial institutions.

Specifically, we suggest Congress allow all federal charter types, not just multi-common bond charters, to add a local community, neighborhood, or rural district that is an investment area or underserved, as determined by the NCUA Board, if the credit union establishes and maintains an office or facility. Allowing federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could enable more credit unions to participate in programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of affordable

[42] 12 U.S.C. 1759(c)(2)

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financial services in distressed areas. The language of H.R. 4665, the Financial Services for the Underserved Act, accomplishes this objective.

We also suggest several other statutory reforms to the Federal Credit Union Act's field-of-membership provisions. Specifically, we urge Congress to consider allowing federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, we recommend that Congress simplify or remove the "facilities" test for determining if an area is underserved.[43]

We also request that Congress consider eliminating the Federal Credit Union Act's requirement that a multiple common-bond credit union be within "reasonable proximity" of the location of a group to provide services to members of that group.[44] Further, we ask Congress to consider granting explicit authority for web-based communities as a basis for a credit union charter. This authority would better recognize the ways in which people share common bonds today.

Finally, we encourage Congress to consider providing greater flexibility for low-income individuals to join federal credit unions, furthering the credit union mission of meeting "the credit and savings needs of consumers, especially persons of modest means."[45] Specifically, we suggest that Congress revise the Federal Credit Union Act to allow the NCUA to permit federal credit unions to add anyone residing in a census tract where current projections indicate he or she qualifies as low-income.

Vendor Authority

The NCUA requests that the Committee consider legislation to provide the agency with examination and enforcement authority over certain third-party vendors — including credit union service organizations (CUSOs). As fintech options increase both in importance and use in credit unions, this request becomes even more crucial to the NCUA's defense against cybersecurity risks in the credit union system.

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

[44] See 12 USC 1759(f)(1).

[45] The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet "the credit and savings needs of consumers, especially persons of modest means." Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998); see also *Serving the Underserved*, National Credit Union Administration, https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx.

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Financial technological innovation is poised to transform the financial services industry by increasing efficiency and convenience, and by providing new and innovative solutions to consumers and businesses. Fintech is revolutionizing financial services, but it also is requiring traditional financial service providers to adapt and embrace new methods, technological innovation, and new technology partners in order to remain competitive in the marketplace.

The rapid movement toward digital financial transactions and services benefits smaller financial institutions like credit unions by improving service to consumers and small businesses and reducing costs. However, fintech also increases potential systemic cybersecurity risks across the financial services landscape. The credit union system is particularly at risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose. Specifically, in order to manage the systemic risk that fintech poses to the credit union system appropriately, the NCUA needs vendor authority comparable to the authority provided to our Federal Financial Institutions Examination Council counterparts.

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission and cannot enforce any necessary corrective actions or share the results of a voluntary review with customer credit unions of the third-party vendor. To underscore the seriousness of this situation, nearly all of the core technology service providers that serve credit unions exclusively declined a voluntary review by the NCUA in recent years. Even though CUSOs are required to give the NCUA access to their books and records, without enforcement authority, they are free to reject the NCUA's recommendations to implement the appropriate corrective actions that would mitigate identified risks. This lack of vendor authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators, a situation noted as a concern by both the Government Accountability Office and the Financial Stability Oversight Council.[46]

For example, the Government Accountability Office has noted that the NCUA has a limited ability to assess and mitigate the risks third-party vendors, including CUSOs, pose for credit unions and ultimately the Share Insurance Fund. In a 2015 report on cyber threats to banks, the Government Accountability Office said that:

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[46] GAO, Electronic Banking: Enhancing Oversight of Internet Banking Activities, GAO/GGD-99-91 (Washington, D.C.: July 6, 1999). Also, see GAO-04-91 and See U.S. Gov't. Accountability Office, GAO-15-509, Cybersecurity: Bank and Other Depository Regulators Need Better Data and Analytics and Depository Institutions Want More Usable Threat Information 32 (2015), available at https://www.gao.gov/assets/680/671105.pdf.

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> We have long supported granting NCUA such authority. In a July 1999 report, we found that joint regulatory examinations of third-party service providers might increase the economy and efficiency of federal oversight of Internet banking activities. At the time, NCUA's temporary authority to examine third-party providers was set to expire in December 2001. We suggested that Congress consider extending NCUA's temporary examination authority beyond 2001. [[47]] The authority was not extended. In an October 2003 report, we found that NCUA had adopted a risk focused examination program but faced challenges in implementing it, partly because NCUA lacked authority to examine third-party service providers, on which credit unions increasingly relied to provide services. [[48]] We asked that Congress consider granting NCUA legislative authority to examine third-party service providers that provide services to credit unions and are not examined through the other federal banking agencies. This matter was never implemented. [[49]] We maintain that NCUA would benefit from this authority. The services of the third-party providers are integral to the operations of many credit unions, and deficiencies in providers' operations quickly could become deficiencies that produce financial and other harm at credit unions. In its response to our 2003 report, NCUA also stated that because many third-party service providers service numerous credit unions, a failure of a provider posed systemic risk issues. In its 2015 annual report, FSOC calls for granting NCUA examination and enforcement authority over third-party service providers in an effort to close what FSOC describes as a significant regulatory gap. We agree with this assessment. Without authority to examine third-party service providers, NCUA risks not being able to effectively monitor the safety and soundness of regulated credit unions.[50]

Today, the top five technology service providers serve more than half of all credit unions, representing 92 percent of the credit union system's assets. Data from the fourth quarter of 2017 show that credit unions using the services of a CUSO accounted for $1.375 trillion in assets or 99.7 percent of the system's assets. This figure is up from 88 percent of assets at year-end 2014, and it does not include third-party vendors that are not CUSOs. A failure of even one of these vendors represents significant potential risk to the Share Insurance Fund and the potential for losses from these

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[47] GAO, Electronic Banking: Enhancing Oversight of Internet Banking Activities, GAO/GGD-99-91 (Washington, D.C.: July 6, 1999).
[48] See GAO-04-91.
[49] [GAO] closed this matter as not implemented in July 2008.
[50] See U.S. Gov't. Accountability Office, GAO-15-509, Cybersecurity: Bank and Other Depository Regulators Need Better Data and Analytics and Depository Institutions Want More Usable Threat Information 32 (2015), available at https://www.gao.gov/assets/680/671105.pdf.

organizations are not hypothetical. Continued consolidation in the number of service providers and credit unions only heightens this risk. Without vendor authority, the NCUA cannot accurately assess the actual risks present in the credit union system, and determine if current CUSO or third party vendor risk-mitigation strategies are adequate to protect the system from a systemic risk. This leaves thousands of credit unions, billions in assets, and millions of credit union members potentially exposed.

Some parties have cited potential budget increases as justification for opposing the NCUA's vendor review authority. However, since 2008, CUSOs have caused more than $500 million in losses to federally insured credit unions, and they have contributed to the failure of 11 credit unions. The agency believes that any budget increase resulting from granting vendor review authority pales in comparison to losses sustained without it. In addition, more than half of the NCUA's institutions hold less than $33 million in assets and average approximately three to four full time employees per institution. These institutions are heavily dependent on third-party outsourced services and do not possess the resources to independently perform full due diligence on all of their critical services providers. The NCUA can add value to the industry through organized and professional oversight of key critical service providers and effectively reduce the administrative and regulatory burden for these small institutions.
If granted this authority, I assure the Committee that any costs associated with the new authority would be transparently accounted for in the NCUA's public budget documents. Instead of regularly examining every third party, the NCUA would focus on examining those vendors with red flags or those that pose the greatest risk to the credit union system. When the agency identifies material or widespread safety and soundness issues, we would have the authority to mitigate the risk and reduce losses to the Share Insurance Fund.

This authority would actually provide a small measure of regulatory relief for credit unions, especially smaller ones. The ability to address weaknesses at the source — the service provider — could easily save the NCUA and credit unions time and valuable resources by eliminating the need to mitigate the same issue at hundreds of credit unions. In other words, credit unions will no longer be stuck in the middle of trying to resolve problems between their vendors and their regulator and insurer. Further, the NCUA could remove current regulations requiring credit unions to maintain and modify contracts with CUSOs to govern certain aspects of these operations, helping to provide additional measures of regulatory relief to credit unions.

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Alternative Forms of Capital
As previously discussed in this testimony, under the Federal Credit Union Act, only low-income credit unions are able to include secondary capital (a form of alternative capital) in the calculation of their statutory net worth ratio.[51] However, since joining the NCUA Board, one of my goals has been to increase credit union access to capital, provided the form of such capital is consistent with the system of cooperative credit.

In January 2017, the NCUA Board issued an advance notice of proposed rulemaking on potential changes to the rules governing alternative forms of capital that credit unions could use to meet their risk-based net worth requirements. The notice asked stakeholders for their views on a range of topics, including any regulatory changes that would be necessary to facilitate the greater use of alternative capital, potential tax implications related to issuing alternative capital, particularly for state-chartered credit unions, and the impact of alternative capital on the mutual ownership structure of credit unions, among others. After evaluating the comments received on that proposal, the NCUA included alternative capital as part of its regulatory reform agenda.

While this proposal is an important step in the NCUA Board's development of market-based rules that will allow credit unions to count supplemental capital for purposes of risk-based capital, only Congress can authorize alternative forms of capital that would count towards the statutory net worth ratio of a credit union without a low-income designation.

The need for this action is demonstrated with a real example. I recently met with a group interested in forming a credit union with a proposed field of membership consisting of the members of an overwhelmingly African American religious denomination. The credit union would not qualify as low-income and, accordingly, would not have access to supplemental capital for the statutory net worth ratio or, under present NCUA regulation, the risk-based capital ratio. The group was adamant in their desire to form a not-for-profit cooperative and had no interest in a shareholder model. Unfortunately, without congressional action in this area, the group is unlikely to be able to form a viable cooperative.

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[51] Alternative capital includes two different categories: secondary capital and supplemental capital. Secondary capital is currently permissible under the Federal Credit Union Act only for low-income designated credit unions to issue and to be counted toward both the net worth ratio and the risk-based net worth requirement of NCUA's prompt corrective action standards. The Board is considering changes to the secondary capital regulation for low-income designated credit unions. There are no other forms of alternative capital currently authorized. However, the Board is also considering whether to authorize credit unions to issue supplemental capital instruments that would only count towards the risk-based net worth requirement.

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Loan Rate Ceiling
Finally, congressional action to give the NCUA Board broader authority to establish a maximum loan rate ceiling for federal credit unions based on financial criteria and for periods as the NCUA Board may determine would dramatically simplify the administration of interest rate changes and make it much easier for credit unions to comply. Providing the NCUA with this authority would allow the agency to provide much more flexibility to credit unions, while simultaneously protecting consumers and the credit union system. It would also allow the NCUA flexibility to establish loan rate ceilings that permit and encourage credit unions to continue to offer products with rates that appeal to and help those of modest means and the underserved as interest rates change.

Conclusion
In closing, I thank the Committee for the opportunity to provide the NCUA's perspectives on the EGRRCPA and detail the steps the agency has taken to implement its relevant provisions. As always, the NCUA stands ready to work with members of this Committee and with Congress on these legislative recommendations and other proposals that further the agency's safety and soundness mission, and ensure consumers have greater access to affordable financial services.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN CRAPO FROM JOSEPH M. OTTING

Some provisions of S. 2155 may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking. The Congressional Review Act requires agencies to submit, with certain minor exceptions, all rules to Congress for review. Under the Congressional Review Act, a rule, by definition, is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." This definition is very broad. In order to ensure Congress can engage in its proper oversight role, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Q.1. Can you commit to following the law by submitting all rulemakings and guidance documents to Congress as required by the Congressional Review Act?

A.1. The OCC will continue to comply with the Congressional Review Act, which requires Federal agencies to submit rules to Congress.

Q.2. On July 6, 2018, the Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency issued an Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act.[1] It is my understanding that the Interagency Statement would qualify as a rule under the Congressional Review Act.

Have the agencies submitted the Interagency Statement to Congress as required by the Congressional Review Act?

Q.3. If not, can you commit to submitting the Interagency Statement to Congress?

A.2.–A.3. The July 9, 2018, Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) announced the Federal banking agencies' intentions regarding EGRRCPA implementation and described certain interim positions the agencies would take during implementation of EGRRCPA. The OCC will submit any rules it issues to implement EGRRCPA to Congress, as required by the Congressional Review Act.

Q.4. Section 165 of Dodd-Frank established a $50 billion, and in some cases a $10 billion, threshold in total consolidated assets for the application of enhanced prudential standards. Such thresholds have been applied in rulemakings and guidance documents

[1] See *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg201807061.pdf.*

consistent with Dodd-Frank's requirements. As an example in 2012, regulators issued jointly supervisory guidance on company-run stress testing for banks with more than $10 billion in assets. The regulators have also applied numerous other standards using either the $10 billion or $50 billion asset threshold to be consistent with Section 165 of Dodd-Frank. For example, banks with $50 billion or more in total assets have historically been subject to CCAR, a supervisory test not required by statute.

Can you commit to reviewing all rules and guidance documents referencing thresholds consistent with Section 165 of Dodd-Frank, and revise such thresholds to be consistent with S. 2155?

A.4. The OCC has already started reviewing those rules and guidance documents referencing thresholds consistent with section 165 of the Dodd-Frank Act in light of the provisions of S. 2155.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JOSEPH M. OTTING

Q.1.a. Regarding section 206 of S. 2155, has the OCC estimated how many institutions may elect to operate as "covered savings associations"?

A.1.a. As of June 30, 2018, there were 320 Federal savings associations. All but five are under $20 billion in assets and would be eligible to elect to operate as covered savings associations under the proposed rule.

Q.1.b. How many institutions do you believe will have to divest, conform, or discontinue nonconforming subsidiaries, assets, and activities not permitted by national banks?

A.1.b. Any institution that makes an election to operate as a covered savings association will have to divest, conform, or discontinue subsidiaries, assets and activities not permitted for national banks. Given the differences in authorities applicable to national banks and Federal savings associations, the OCC's proposal poses questions about the details of divestiture and/or conformance of activities that are not permitted for national banks. The estimated population of Federal savings associations that hold subsidiaries, assets, or activities not permitted for a national bank that will have to divest them will depend on the requirements of the final rule and the importance of the activities, investments, or subsidiaries to the operations of the Federal savings association and the communities served. As drafted, the proposed rule would require any Federal savings association that makes the election to divest, conform, or discontinue holding the subsidiary or the asset or engaging in the activity, within a specified period.

Q.1.c. For those institutions that elect to become "covered savings associations," how will their examination and supervision differ from national banks and savings associations?

A.1.c. The examination and supervision of a Federal savings association that elects to become a covered savings association will not differ from other national banks or Federal savings associations. The majority of OCC examiners are commissioned to examine both national banks and Federal savings associations. The OCC will continue to use a risk-based examination philosophy that allows examiners to tailor the scope of their supervision to the strategic plan, risk profile, and complexity of the bank they are examining regardless of charter.

Q.2. Does the OCC plan on taking enforcement action against Wells Fargo related to the bank's "calculation errors" during the years 2010 to 2015 that led the bank to deny or not offer loan modifications to 625 homeowners, which led to 400 wrongful foreclosures?

A.2. The OCC cannot comment on supervisory activities underway and whether they may lead to enforcement actions. We generally evaluate the underlying issues or weaknesses that cause errors and determine the severity of deficient practices, including violations of law. The nature, extent, and severity of the bank's deficiencies, the board and management's ability and willingness to correct deficiencies within an appropriate timeframe and potential adverse impact to bank customers are some of the key factors considered when determining the appropriate supervisory response.

Q.3. When does the OCC expect Wells Fargo to conclude with the borrower remediation related to the applicable of unauthorized collateral protection insurance?

A.3. While the OCC cannot comment on our review of a specific remediation plan, we expect the bank's process for compensating harmed borrowers to identify the full population of customers that may have been harmed and to thoroughly analyze how such customers were harmed. The analysis, approval of the remediation plan, customer contact, and completion of remediation is sometimes a lengthy process as it may involve not only customers but also contact with and action by customer legal representatives, credit reporting agencies, insurance companies or other external parties.

Q.4. The Federal financial agencies often take intermediate steps to address problems in the financial institutions they regulate before formal enforcement actions are taken. For example, we know that the OCC had taken supervisory actions related to concerns about Wells Fargo's sales practices before the 2016 enforcement action.

Please describe the process for how your agency determines what type of supervisory action to take when it finds a problem at a financial institution it regulates, how it expects the financial institution to address the problem, how much time a financial institution is given to address the problem, how the agency follows up with the financial institution on the problem, and how the agency makes a determination that a problem has not been addressed and warrants escalated action.

A.4. The OCC supervisory process is transparently described in the Comptroller's Handbook, and supplemented by the OCC Enforcement Policies and Procedures Manual, available on *OCC.gov*. The Handbook details supervisory procedures and authority provided in statute and regulation that the agency follows to examine regulated institutions and require corrective action when necessary. The Handbook includes procedures related to safety and soundness, as well as compliance. Supervisory action may range from supervisory conversations, documented exam findings, and matters requiring attention to formal enforcement action such as:

- Cease & Desist Orders (C&D): Banking organizations subject to cease and desist orders are required to take actions or follow proscriptions in the orders, which may include comprehensive corrective changes to bank procedures, practices, and controls as well as providing remediation to individuals harmed by the deficiencies identified in the order. 12 U.S.C. § 1818(b).
- Civil Money Penalty Orders (BCMP): Banking organizations subject to civil money penalties must pay fines. 12 U.S.C. § 1818(i)(2).
- Formal Agreements (FA): Banking organizations that are subject to formal agreements agree to take actions or follow proscriptions in the written agreement. 12 U.S.C. § 1818(b).
- Notices Filed (NFB): Banking organizations against whom an "OCC Complaint" (in the form of a Notice of Charges and/or Notice of Civil Money Penalty Assessment) is filed have an opportunity to litigate the matter before an Administrative Law Judge. 12 U.S.C. § 1818(b) (Notice of Charges) and 12 U.S.C. 1818(i) (Notice of Civil Money Penalty Assessment).
- Prompt Corrective Action Directives (PCAD): Banking organizations that are subject to prompt corrective action directives are required to take actions or to follow proscriptions that are required or imposed by the OCC, under section 38 of the FDI Act. 12 U.S.C. § 1831.
- Safety & Soundness Orders (SASO): Banking organizations that are subject to safety and soundness orders are required to take actions or to follow proscriptions that are imposed by the OCC under section 39 of the FDI Act. 12 U.S.C. § 1831p–l.
- Securities Enforcement Actions (SEB): Banking organizations that are engaged in securities activities, such as municipal securities dealers, Government securities dealers, or transfer agents, can be subject to various OCC sanctions, including censures, suspensions, bars and/or restitution, pursuant to the Federal securities laws.

Specific corrective actions and the time required to implement those corrective actions vary according to the facts and circumstance of a particular matter. Examiners monitor corrective actions. Orders remain in force until the OCC confirms that the institution has fulfilled the terms of a particular order.

When circumstances warrant, the OCC shares documents and information obtained through its supervisory and investigative processes with criminal law enforcement. When the OCC identifies evidence of a likely criminal violation of law, it will refer such matters to the Department of Justice.

Q.5. As you know, financial institution misconduct often continues for many years, and it raises concerns that the current supervisory process is ineffective in addressing problems. Given that the details about supervisory actions including "matters requiring attention" or "MRAs" are considered confidential supervisory information, please provide the Committee for each year starting in 2005 the aggregate number of outstanding MRAs from the OCC for the U.S.

G–SIBs and the aggregate number of MRAs that were satisfactorily addressed and are no longer outstanding.

A.5. The number of MRAs identified and satisfactorily addressed varies over time and by institution. The life-cycle of an MRA will depend on the magnitude of the issue and the ability of management to develop and implement sustainable corrective actions. MRAs identified in the G–SIBs supervised by OCC are a subset of the MRAs published in the OCC's *Semi-Annual Risk Perspective* for all OCC banks. They are similar, in terms of trends over time in numbers and characteristics, to the top three MRA concern risk areas for all large banks—operational, compliance, and credit risk.

RESPONSE TO WRITTEN QUESTION OF SENATOR HELLER FROM JOSEPH M. OTTING

Your agencies have been working on regulations to implement the Biggert-Waters Flood Insurance Reform Act of 2012 for the last 6 years. The rule regarding acceptance of private flood insurance has been proposed in draft form , the last time on January 6, 2017. Nearly all comments submitted on the two drafts expressed serious concerns over the proposals, and the unintended consequences that would result.

Q.1. What steps are each of your agencies taking to address the concerns expressed during the comment period?

A.1. The OCC is aware of the serious concerns raised by commenters on the proposals issued by the agencies to implement the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012. The OCC, along with the other agencies, is working to address these concerns in the final rule. The OCC expects the agencies to finalize the rule in early 2019.

RESPONSE TO WRITTEN QUESTION OF SENATOR REED FROM JOSEPH M. OTTING

There have been reports of fake or phony comments that have been filed with Federal agencies as part of the Federal rulemaking process.

Q.1. Considering that the OCC recently published an Advance Notice of Proposed Rulemaking (ANPR) seeking comments on potential changes to the Community Reinvestment Act (CRA), how will you ensure that all fake and phony comments will not be included as part of this CRA ANPR or any other rulemaking by the OCC?

A.1. The ANPR is an information gathering process. All relevant and germane information regarding the operation and improvement of the regulations implementing the Community Reinvestment Act are welcome. The OCC expects a robust comment period and looks forward to reviewing all of the comments.

The OCC will review the content of each comment closely. Anonymous comments are accepted and the content of the letter is the focus of all submissions. Many groups conduct letter-writing campaigns using form letters and stock information. There is high potential for stock information and data to be inaccurate, misrepresented, or presented out of context. In such cases, the letters do not inform the agency's decision-making process in a meaningful way. Likewise, a large volume of identical form letters present very little additional information to inform a rulemaking process. Such identical letters are grouped and analyzed as a common comment. In analyzing submitted comments, the OCC employs subject matter experts in policy, law, and economics to review claims presented in the letters.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JOSEPH M. OTTING

Sales practices

The Wells Fargo fraudulent account scandal exposed how abusive sales practices and incentive compensation place consumers at risk of harm. In the 2 years since the first Wells Fargo scandal, we've watched as bank executives blamed low-paid employees for sales practices gone wrong, but in reality, these scandals reflect a failure of risk management and bank culture that comes from the top. A new report by the National Employment Law Project found that 90 percent of bank employees surveyed stated that failure to meet sales quotas still results in bullying, disciplinary action or possible termination.

Q.1. Are your agencies incorporating reviews of sales practices and compensation programs into your supervision?

A.1. For the banks subject to the sales practices horizontal review, OCC supervisory offices have informed bankers we are continuing to conduct supervisory activities related to sales practices on an institution-specific basis, including follow up on the corrective actions implemented to address any Matters Requiring Attention (MRAs) identified during the review. This ongoing monitoring and follow up is being conducted as part of our regular oversight and supervision of these institutions. For other institutions, the OCC has made examiners aware of the risks and characteristics identified during the horizontal review and will apply that insight when they determine if the risk profile of a particular bank warrants further review or action.

Examiners will consider the banks sales culture, the composition of products and services, the nature of incentive compensation programs, the presence of sales goals or quotas, and other relevant bank-specific considerations.

Q.2. If so, does that include any input or feedback from frontline employees?

A.2. We incorporate such information when reviewing a bank's policies, procedures, and controls, and its risk governance framework over sales practices, incentive compensation, and employee conduct. Examiners also assess any testing conducted by bank risk management, the results of any surveys, mystery shopping conducted by bank risk management, internal and external audit functions, and consultant evaluations commissioned by bank management. In instances where serious deficiencies are noted, either through OCC supervisory work or the banks' testing, examiners consider more in-depth analysis that could include additional supervisory action as well as potentially requiring third-party interviews or surveys of frontline employees.

Q.3. If not, how are you monitoring possible misconduct related to sales practices?

A.3. Please refer to our responses to the previous two questions.

Bank of America

Q.4. Last week, I sent a letter to the CEO of Bank of America regarding recent customer reports that the bank has asked existing account holders for their citizenship status, and in some cases the bank has frozen accounts when customers fail to respond. Have any of your agencies directed or suggested to banks under your supervision to ask existing account holders for their citizenship status? Please provide any information about whether any institutions may have been asked or encouraged to collect citizenship information on existing customers.

A.4. There is no statutory requirement administered by the OCC for an individual to be a U.S. citizen to open or maintain an account with a national bank or Federal savings associations, and the OCC has issued no new guidance on this subject directing banks to query account holders for their citizenship status. Banks are required by law, however, to document the identification of their customers. For certain customers, acceptable forms of identification include Government-issued documents evidencing nationality or residence, and these documentation standards differ for U.S. persons and non-U.S. persons.

Forced-place Insurance

Q.5. Last month, there was a report[1] that the OCC rejected Wells Fargo's remediation plan to pay back more than 600,000 drivers who were charged for auto insurance they never signed up for. The process has been going on for more than a year, but the bank can't seem to get it right.

What problems did you see with the remediation plan, and why did you reject it?

A.5. While the OCC cannot comment on our review of a specific remediation plan, the agency typically reviews such plans to ensure they are complete, appropriate, achievable, and remedy consumer harm. Accordingly, there are many reasons why the OCC may reject a plan including flaws with a bank's methodology, timeframes or determination of harm, concerns about the methodology to remedy consumer harm, or other reasons.

Q.6. Would the OCC support handing over the remediation to a neutral third party so that we can make sure harmed consumers are finally repaid?

A.6. When appropriate, the OCC has required an institution to employ a third party to provide restitution to harmed consumers.

[1] *https://www.reuters.com/article/us-wells-fargo-insurance-exclusive/exclusive-us-regulators-reject-wells-fargos-plan-to-repay-customers-sources-idUSKCN1LR2LG.*

GAP Insurance

Q.7. What is the OCC doing to ensure Wells Fargo refunds customers who were overcharged for guaranteed asset protection (GAP) insurance?

A.7. OCC examiners are actively engaged with bank management and its directors regarding the bank's plans to remedy harmed customers to ensure plans are complete, appropriate, and achievable.

Bank of America

Q.8. Have there been any recent supervisory or enforcement actions that might have caused Bank of America to focus on the citizenship status of its existing account holders?

A.8. No. The OCC has not issued any actions to direct or suggest that Bank of America ask account holders for their citizenship status.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JOSEPH M. OTTING

Thank you for your commitment to finalizing a rule on private flood insurance. As Congress clarified in its passage of the Biggert-Waters Flood Insurance Reform Act of 2012, consumers should have choices when it comes to obtaining flood insurance. While there is nothing in Federal Law prohibiting homeowners from purchasing private flood insurance, there is regulatory uncertainty about what policies banks can accept for mandatory purchase requirements. The lack of a finalized rule on the topic for over 6 years has exacerbated this uncertainty. The November 2016 proposed rule is too narrow and raises obstacles to the participation of private flood insurers in the market, which runs directly counter to congressional intent. The prompt finalization of a rule adopting an identical approach to the Flood Insurance Market Parity and Modernization Act would address these concerns.

If further delay would be necessary for the OCC and its peers to adopt the rule jointly, I urge the OCC to separately consider interim guidance or other approaches to promptly resolve the regulatory ambiguities that impede mandatory and discretionary acceptance of private flood insurance by banks.

Please answer the following with specificity:

Q.1. Will you commit to looking at the Flood Insurance Market Parity and Modernization Act as a model for a final rule on private flood insurance?

A.1. The final rule must reflect the existing statutory framework governing flood insurance. The OCC continues to monitor congressional efforts to modify the Biggert-Waters Act, and staff is available to provide technical assistance, as requested.

Q.2. Will you commit to coordinating the finalization of the rule with those who have an expertise in insurance regulation, such as the National Association of Insurance Commissioners and representatives from the insurance industry?

A.2. The agencies received comment letters from the NAIC and others with expertise on the insurance industry in response to two proposals to implement the private flood insurance provisions of the Biggert-Waters Act. Please be assured that we are taking these comments into consideration in drafting the final rule.

Q.3. Can you provide a timeline for finalization of the rule?

A.3. The OCC is expecting to finalize the rule in early 2019.

Q.4. There is growing concern that the upcoming transition to the Current Expected Credit Loss accounting standard beginning in 2020 will adversely impact banks' ability or inclination to make certain types of loans, including many forms of consumer credit that are essential for a healthy economy—mortgages, auto loans, and student loans.

I believe that the OCC, in conjunction with the Federal Reserve, SEC, and FASB, should act quickly to reevaluate this standard and assess its impact on financial institutions, consumers, and the overall health and stability of the financial sector. The analysis should account for how CECL may precipitate a change in regulatory capital requirements and pay special attention to the interaction between regulatory capital and the impact of increased loan loss reserve requirements.

Please answer the following with specificity:

Does the OCC believe that the economic impacts of CECL have been adequately studied to date?

A.4. The Financial Accounting Standards Board (FASB), the independent body that sets accounting standards, followed a lengthy process to solicit public comment and analysis on the accounting change. The OCC supports an independent accounting standard-setting process. The OCC, along with the other agencies, proposed a regulatory capital transition rule that provides institutions the option to phase-in any day-one regulatory capital effects of CECL over three years. This transition period allows the agencies to further monitor and study the impact of the accounting standard before the full effect on regulatory capital is recognized.

Q.5. Would you support measures to delay implementation of CECL pending completion of a thorough quantitative impact study?

A.5. The OCC supports the continued study of CECL and is actively engaged with the other banking agencies to better understand its effect on regulatory capital. The agency supports a move to an expected credit loss methodology, as it improves the timely recognition of credit losses, which itself is foundational to our mission of ensuring national banks and Federal savings associations operate in a safe and sound manner.

RESPONSE TO WRITTEN QUESTION OF SENATOR COTTON FROM JOSEPH M. OTTING

AR Banks Wish They Could Service More of Their Customers' Mortgages—This is About Mortgage Sentencing Rights (MSR)

One thing I hear from AR banks is that after they make a mortgage loan, they like keeping the mortgage servicing rights (MSR) even if they wind up selling the mortgage itself. Both current regulations, like the Basel III rules, make this difficult. These small lenders prefer to keep a relationship with their mortgage customers, which includes handling any issues with their mortgage. For these often-rural small banks, service is a competitive advantage for them over the big banks. So, as you might imagine, it's tough having to tell your longtime customer that she has to call some 1–800 number for questions about her mortgage.

Q.1. Last year, good news appeared on the way when regulators issued proposed rule that allowed for banks to keep a greater portion of their mortgage servicing rights, but it seems the rule got put on the backburner during the S. 2155 debate. So, can I tell my constituents that help is on the way and you plan to finalize the capital relief provisions soon? Any color on how soon?

A.1. Currently, the Federal banking agencies are focusing on implementing burden relief related to regulatory capital revisions included in S. 2155, but we continue to consider the comments on the simplification NPR, including the proposed simplifications to the treatment of mortgage servicing assets (MSAs). The agencies have provided banking organizations some relief from the more onerous standards of the regulatory capital rule, including the limitations on MSAs, through the November 21, 2017, final rule that froze the 2017 transitions (82 FR 55309). This freeze remains in effect until the agencies take further action on this issue.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR ROUNDS FROM JOSEPH M. OTTING

The OCC recently issued a notice of proposed rulemaking on the recovery plans for national banks. In that proposal, the OCC increased the asset threshold for filers from $50 billion in assets to $250 billion in assets citing S. 2155 as the motivation for this change. While several of my colleagues on the Committee agree that the change in thresholds to $250 billion in S. 2155 is beneficial, we also agree that operational risk should be a driving factor when regulating institutions above $250 billion.

Q.1. What was the OCC's motivation for this change in its rulemaking on recovery plans? Would you be open to considering operational risk as a determining factor for requiring recovery plans for institutions with more than $250 billion in assets and to tailoring regulations accordingly?

A.1. The OCC issued this proposal because raising the threshold for the recovery planning guidelines (Guidelines) allows us to better focus on those institutions that present greater systemic risk to the banking system. These larger, more complex, and potentially more interconnected bunks present the types of risks that could benefit most from having the types of governance and planning processes that identify and assist in responding to significant stress events.

With respect to whether operational risk could be used as basis to further reduce the number of banks subject to the Guidelines, we welcome all comments on the proposal and will consider any received before issuing the final Guidelines.

Q.2. Based on a straightforward reading of Section 206 of S. 2155, trust-only thrifts that make an election to operate as a national bank pursuant to Section 206 should be subject to the same requirements and enjoy the same benefits as trust-only national banks.

When you finalize the rule implementing this section, will you follow the straightforward reading of the law and treat the small number of trust-only thrifts that don't take deposits or make loans the same as their national peers who aren't required to have deposit insurance or comply with the Qualified Thrift Lending requirement?

A.2. The OCC has issued a proposed rule outlining a process for Federal savings associations to elect to operate as covered savings associations with the rights, duties, and requirements set forth in the statute. The OCC has not prejudged any of the issues raised by the proposed rule and is very interested in understanding how the issues raised by the proposal may affect Federal savings associations with different business models. We are committed to carefully reviewing all comments received on this matter as we develop a final rule.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM JOSEPH M. OTTING

Under the agencies' proposal to simplify and tailor the regulations implementing the Volcker Rule, the proposed "accounting prong" would cover all purchases or sales of financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards, which would subject a significantly higher number of financial activities to the rule.

Q.1. Given the agencies' policy goals of simplification and tailoring, how do you intend to revise the proposal to remain faithful to these goals?

A.1. The Volcker agencies are currently exploring the scope of the proprietary trading regulatory framework, by proposing to simplify and clarify the definition of "trading account" in a manner consistent with section 13 of the Bank Holding Company Act (known as the Volcker Rule). The recent Notice of Proposed Rulemaking (NPR) included a robust request for comment on the proposed accounting prong, including questions as to whether it is over- or under-inclusive, and questions about available alternatives. I look forward to exploring these issues further with my counterparts at the other agencies.

Q.2. The proposed amendments to the Volcker Rule would also introduce new metrics that could result in a nearly 50 percent increase in metrics reporting. How do you intend to revise the proposal to ensure that covered institutions are not subject to additional compliance burdens?

A.2. In the recent NPR, the Volcker agencies proposed to eliminate some current categories of metrics, and to replace other categories with simplified reporting of position data. The agencies also proposed a new electronic reporting format and proposed to collect a certain amount of descriptive information from each banking entity. The agencies requested comment whether these changes would materially reduce compliance costs, and whether any of the changes would have the opposite effect of increasing costs. The agencies will evaluate these considerations in deciding how to proceed with metrics revisions in the final rule.

Q.3. Recently the "Interagency Statement Clarifying the Role of Supervisory Guidance" was issued. I think this directive is a very important step in ensuring that the regulation and supervision of financial institutions is conducted pursuant to legal standards. Each of you is the leader of an organization that has thousands of employees and examiners and are responsible for its implementation.

How are you making sure examiners on the ground are following this statement?

A.3. In advance of the Interagency Statement, the OCC reminded examiners of the role of supervisory guidance, reiterating the important distinction between statutes and regulations that can be enforced according to their terms and supervisory guidance, which does not impose legally binding constraints but rather outlines safe and sound banking or risk management principles. The principles on the use of guidance outlined in the Interagency Statement are incorporated into OCC training classes. We have discussed the use of supervisory guidance on all-hands calls with our examiners, and recently reiterated supervisory guidance's role to OCC managers.

Q.4. Have you considered a formal rulemaking so that staff take this important statement seriously?

A.4. Supervisory guidance clarifies the OCC's expectations and promotes transparency and consistency in its supervisory approach across banks. The principle outlined in the Interagency Statement, that supervisory guidance does not have the force and effect of law, is consistent with the OCC's use of supervisory guidance. As described above, the OCC has taken multiple actions to remind our examiners of the important distinctions between statutes/regulations and supervisory guidance. We do not believe that a rulemaking is necessary.

Q.5. How will you independently verify that this statement is followed (audits, surveys from supervised entities, other independent verification)?

A.5. The OCC maintains processes for reviewing written communications before they are sent to banks. This process includes checking for consistency with OCC policies. The OCC also has quality assurance programs that assess adherence to internal processes, policies, and procedures. In addition, the OCC's Ombudsman's Office oversees the administration of the Bank Appeals Program, in which bankers may appeal an agency decision, including if they think supervisory guidance was used incorrectly in forming material supervisory determinations and other conclusions in the report of examination.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM JOSEPH M. OTTING

Wells Fargo Plans To Compensate Wrongs Auto Loan Borrowers

Comptroller Otting, we know that Wells Fargo pushed as many as 600,000 of its auto loan customers into unnecessary auto insurance. As part of its settlement for its numerous frauds, Wells Fargo is required to provide financial compensation to borrowers who faced wrongful fees, damaged credit, and vehicle repossession. I understand that a Wells Fargo compensation plan was rejected by the OCC last month. I understand that Wells doesn't expect to finish contacting all defrauded customers until the end of 2019—more than 18 months after they got caught (consent order was issued by the CFPB/OCC in April 2018).

Q.1. Why is it taking so long to compensate harmed borrowers?

A.1. While the OCC cannot comment on our review of a specific remediation plan, we expect the bank's process for compensating harmed borrowers to identify the full population of customers that may have been harmed and to thoroughly analyze how such customers were harmed. The analysis, approval of the remediation plan, customer contact, and completion of remediation is sometimes a lengthy process as it may involve not only customers, but also contact with and action by customer legal representatives, credit reporting agencies, insurance companies, or other external parties.

Q.2. The OCC has been closely monitoring Wells Fargo since at least September 2016, when the previous fake account scandal was uncovered. And yet the bank continues its misconduct and can't seem to make it right. What assurances can you provide to the Committee that Wells Fargo won't submit yet another insufficient plan that delays relief?

A.2. While the OCC cannot comment on our review of a specific remediation plan, examiners typically provide detailed feedback to bank management on deficiencies that must be addressed in order for the OCC to approve a plan to remedy consumer harm.

Section 104, Home Mortgage Disclosure Act (HMDA)

I was the Attorney General of Nevada during the financial crisis and saw first-hand how big banks targeted vulnerable people and communities of color. This is exactly why it was so important that the CFPB required more data collection and more oversight over lending activities. The law signed by President Trump earlier this year eliminated some of the data we need to preserve this progress. Despite the loss of public HMDA data, each of your agencies still has a requirement to ensure that Latinos, African Americans, women, and other people are not rejected for loans due to their gender or ethnicity.

Q.3. How many lenders supervised by your agency will not publicly report the additional data that was to be required this year? This data includes loan characteristics like credit score, fees, points, and interest rates.

A.3. Based on data reported in 2017, approximately 80 percent of OCC regulated banks will be eligible for the partial exemption (552 of 683) to report additional HMDA data. However, while the majority of bank HMDA reporters will qualify for the exemption to report the additional data, the OCC will collect the full expanded data set for the remaining national banks and Federal thrifts that do not qualify for the exemption, and those nonqualifying institutions make an estimated 95 percent of all closed-end mortgage loan originations by national banks and Federal thrifts. For those institutions that are exempt from the expanded data set, the bank regulators will still receive information added by the BFCP's 2015 HMDA rule, to report additional data about age, ethnicity, and certain other information.

Q.4. Would it have been easier to spot fair lending violations with transparent data reporting, rather than relying on your bank examiners to go bank by bank, loan by loan to root out discrimination?

A.4. The OCC can and will continue to effectively use HMDA data to identify fair lending risk in the banks we supervise. HMDA data is used to identify areas for further investigation or examination work, which can include loan file reviews and access to all information reported in the expanded data fields.

Q.5. Without the expanded HMDA data reporting slated to begin this year, what information will your agency's examiners have to trigger a review of potential discrimination?

A.5. The OCC does not believe the exemption for banks making fewer than 500 closed-end mortgage loans per year to provide expanded HMDA data will adversely affect our ability to identify potential discrimination. The agency can and will continue to effectively use HMDA reporting to screen the banks we supervise for fair lending violations.

Community Reinvestment Act

We have a massive affordable rental housing crisis in Nevada: 119,854 families pay more than half their income for rent. One of the few resources we have is the Low Income Housing Tax Credit. The new tax law is already making it harder to finance low-income housing because the cost of the credit has fallen.

Q.6. Will you commit to ensure that any changes you consider to the Community Reinvestment Act make Federal tools like the Low Income Housing Tax Credit and New Market Tax Credit work better in communities?

A.6. Yes. The OCC's Advance Notice of Proposed Rulemaking (ANPR) on CRA is seeking input concerning whether a bank should be able to include in its CRA evaluation additional areas tied to the bank's business operations beyond its banking footprint (or broader Statewide or regional area). This is one approach, and we are inviting comments on other approaches that could promote the effectiveness of the CRA and related programs. Under such an approach, banks could include these additional areas in their assessment areas, enabling consideration of CRA activities conducted within these areas. Such an approach could address concerns that the current CRA assessment areas can restrict bank lending or investment in areas of need, by expanding the circumstances in which banks receive CRA consideration of CRA qualifying activities conducted within these areas. Providing consideration for activities conducted in targeted areas or areas that have been largely excluded from consideration, such as remote rural populations or Indian Country, for example, could help promote services and activities in those areas as well. It may also accommodate banks that either operate with no physical branches or banks with services that reach far beyond the geographic location of their physical branches. By expanding the geographies where banks could undertake community development activities, banks would be provided greater opportunities to invest in Low Income Housing Tax Credits and New Markets Tax Credits in areas of need.

Q.7. Nonbanks provide more than half of all mortgages in this country. Six of the 10 largest mortgage lenders are not banks. Do you think nonbank mortgage lenders should be covered by the Community Reinvestment Act?

A.7. Expanding the CRA to apply to nonbank mortgage lenders would require a legislative change. We encourage Congress to explore expanding the coverage of the CRA to entities to which it currently does not apply, including nonbank mortgage lenders and credit unions.

Q.8. For generations, lenders understood that they should require property taxes and homeowners insurance be placed in escrow, so that those obligations are always paid on time. But in the run-up to the foreclosure crisis, lenders cut corners so that they could misrepresent monthly payments to homeowners and put them into obligations they couldn't afford. How will your agencies monitor the implementation of the escrow exemption? Will your examiners monitor foreclosure activities resulting from unpaid property taxes and/or property insurance?

A.8. Section 108 of the EGRRCPA directs the BCFP to provide, by regulation, the added escrow exemption for certain mortgage loans. The OCC looks forward to working with the BCFP as it initiates rulemaking in this area. Upon the BCFP's implementation of the rulemaking for this escrow exemption, the OCC is committed to working with the BCFP and the other FFIEC-member agencies in updating interagency examination procedures to ensure a consistent examination approach across each agency.

The OCC continuously monitors lending performance, including residential lending performance, across all OCC-supervised institutions so it can identify and respond to trends and emerging risks, such as those that may be the cause of any future increases in mortgage foreclosure activities.

Q.9. How will you communicate any findings or concerns from the elimination of the escrow requirement to us in Congress?

A.9. The OCC provides the BCFP with annual reporting of Regulation Z violations of law cited. This annual reporting would include any violations related to Regulation Z escrow requirements. The BCFP includes this OCC-reported data in its periodic reporting to Congress. Additionally, the OCC routinely publishes information regarding emerging risks and industry trends via its website, *www.occ.gov*. Specific to residential mortgages, the OCC issues a quarterly summary report of the previous quarter's first-lien mortgage performance (including foreclosures). The most recent quarterly report was issued September 21, 2018, and can be found on our website.

Anti-Money Laundering/Bank Secrecy Act

Q.10. On page 12, you note innovative technologies and practices that the OCC is exploring to assist financial institutions better achieve Anti-Money Laundering compliance. Please describe those.

A.10. The OCC encourages banks to explore technology solutions that allow them to both maintain their risk focus and gain process and system efficiencies. Artificial intelligence and machine learning are among the technologies that may offer banks opportunities to potentially enhance the ability of transaction monitoring systems to identify suspicious activity, while reducing the number of false positive alerts and investigations. Other techniques, such as natural language processing may facilitate the automation of manual processes, thus improving the efficiency and effectiveness with which banks are able to measure and mitigate risk.

RESPONSES TO WRITTEN QUESTIONS OF SENATORS WARNER, COTTON, TILLIS, AND JONES FROM JOSEPH M. OTTING

Comptroller Otting has testified before that "the process for complying with current BSA/AML laws and regulations has become inefficient and costly." In talking with banks/credit unions it is clear that they do not object to the principle of complying with AML regulations, it is that they feel that much of the time, effort, and money spent on compliance is ineffective, and therefore, a waste of time. Banks/credit unions fill out forms invented in the 1970s and have little insight into whether it is doing any good. And we've heard from banks/credit unions that they believe AML examinations are done without respect to the riskiness of the institution or its activities.

Q.1. What improvements can be made so we have a cheaper & faster system that is better at catching criminals?

A.1. Many banks use automated suspicious activity monitoring systems. We can improve the BSA/AML regime by ensuring BSA/AML systems and tools are appropriately developed, implemented, tuned, and validated to address the unique risk profile of each bank. Banks would benefit greatly from additional insight and feedback from the law enforcement community regarding the value of BSA reports. Banks could use this type of feedback to tune AML system rules and parameters to hone in on specific transaction types or patterns, customer segments, and geographies to target money laundering typologies and illicit financiers. We also support responsible innovation, including industry efforts to improve AML systems through the use of advanced technology and analytics designed to enhance system efficiency and effectiveness. Improving AML system efficiency and effectiveness may yield better quality suspicious activity reporting that could enhance law enforcement efforts.

Q.2. Is there a place in a new AML regime for new technology, like artificial intelligence or machine learning?

A.2. Absolutely. There is significant potential for responsible technological innovation, including artificial intelligence and machine learning, to provide banks opportunities to better manage their costs and increase the ability of their transaction monitoring systems to identify suspicious activity, while reducing the number of false positive alerts and investigations. We have also seen innovation used in customer risk identification and risk scoring, as well as the development and use of Know Your Customer (KYC)/Customer Due Diligence (CDD) utilities. We encourage banks to explore technology that allows them to maintain their risk focus and at the same time gain process and system efficiencies.

Q.3. What do you, as a regulator, think that it means to have a risk-based AML program?

A.3. The OCC expects a bank to have a BSA/AML compliance program commensurate with its BSA/AML risk profile identified by its risk assessment. Bank management should understand the bank's BSA/AML risk exposure and develop appropriate policies, procedures, and processes to monitor and control identified BSA/AML risks. Independent testing should review the bank's risk assessment for reasonableness, and management should consider the staffing resources and level of training needed to promote adherence with its policies, procedures and processes. For those banks that assume a higher-risk BSA/AML profile, bank management should provide a more robust BSA/AML compliance program that specifically monitors and controls the higher risks that bank management and its board have accepted.

Q.4. How do you implement the risk-based AML program requirement through examinations?

A.4. As mentioned above, examiners assess the adequacy of each bank's BSA/AML program, relative to the risk profile of the bank, by evaluating the implementation and effectiveness of the bank's policies, procedures, systems and controls. The OCC expects banks to have an effective BSA/AML program consisting of a system of internal controls, independent testing, a BSA officer, and training.

Examiners use the examination procedures contained within the FFIEC BSA/AML Examination Manual to evaluate the adequacy and effectiveness of banks' BSA/AML Program. Examiners are required to complete the core examination overview and procedures as well as any additional core or expanded procedures based on risk. Examiners determine whether banks have a satisfactory framework commensurate with the level of BSA/AML-related risks, to identify, measure, monitor and manage those risks. A bank's BSA/AML risk assessment framework and system should identify the risk within its banking operations (products, services, customers, transactions, and geographies) and incorporate these risks into the BSA/AML compliance program, including the suspicious activity monitoring program.

The OCC's BSA/AML examination process follows a risk-based approach and, at a high level, consists of scoping, fieldwork, developing and vetting findings and conclusions, and reporting. The FFIEC BSA/AML Examination Manual provides for risk-based transaction testing, to evaluate the adequacy of the bank's compliance with regulatory requirements, determine the effectiveness of its policies, procedures, and processes, and evaluate suspicious activity monitoring systems. The scope and method of this testing is not prescriptive and is risk-based. One tool the OCC developed to help assess BSA/AML risk in community banks is the Money Laundering Risk (MLR) system; an annual data collection, review and assessment process that allows the OCC to identify potentially higher-risk areas within the community bank population.

Examiners use the information collected through this tool to determine the bank's overall risk activities and to appropriately scope and plan bank examinations.

Q.5. How often does your agency meet with FinCEN and with the DOJ/FBI to discuss the usefulness of suspicious activity reports that are being filed?

A.5. There is currently a working group comprised of FinCEN and the Federal banking agencies that meets weekly to discuss BSA reforms. This working group is coordinating with FinCEN on various initiatives including to evaluate the usefulness of SARs filed. With regard to law enforcement discussions, the OCC is involved in discussions with law enforcement on the usefulness of SARs through the Bank Secrecy Act Advisory Group (BSAAG) process. The BSAAG is an advisory group, chaired by FinCEN and comprised of the Federal and State regulators, law enforcement, financial institutions and trade associations that provides a forum to discuss issues involving the BSA. The BSAAG holds plenary meetings twice a year, and working groups meet more regularly. A specific BSAAG working group formed in 2017, the SAR Metrics Working Group, is currently evaluating the value of SAR filings based upon data compiled by FinCEN. There is a second working group, the Structuring SAR Working Group, also formed in 2017, that is evaluating the value of structuring SARs and possible ways to improve the effectiveness of these filings. The OCC and law enforcement both participate in these working groups.

Q.6. When a bank/credit union files a SAR, or a regulator is examining a financial institution, how much feedback is there across the system about whether or not the SARs they filed were found to be useful, informative, or effective?

A.6. Currently there is no formal system that provides regular feedback to financial institutions on the SARs they filed. However, when examiners review a bank's suspicious activity monitoring system, they test for the content and timing of SARs filed and provide feedback on policies, procedures and practices. Also, FinCEN presents annual Law Enforcement Awards. FinCEN initiated this awards program to recognize significant criminal investigations in which information reported under the BSA was critical to law enforcement cases. Through this program, a wide variety of Federal and State law enforcement agencies nominate significant cases that utilized BSA reporting to investigate and prosecute a broad spectrum of criminal activity.

Q.7. What are the legal hurdles that prevent more effective and more regular feedback within the Federal Government and between the Federal Government and financial institutions?

A.7. Depending on the context of the proposed feedback to be shared among Federal Government agencies or between the Federal Government and banks, different legal considerations would apply. For example, financial privacy considerations are a significant legal issue that impacts feedback within the Federal Government. Certain Federal statutes that safeguard customer privacy impose limits on the sharing of information. Furthermore, section 314(b) of the USA PATRIOT Act, provides a safe harbor from liability from sharing and effectively preempts other Federal and State laws, however, the information that can be shared under section 314(b) is information regarding individuals, entities, and organizations engaged in or reasonably suspected based on credible evidence of engaging in terrorist acts or money laundering activities. The OCC has recommended expanding the safe harbor in Section 314(b) to also include mortgage fraud, cyber fraud and other financial crimes to make it more flexible and enable more sharing of information.

Privacy statutes that may have an impact in feedback between the Government and financial institutions, and between financial institutions, are listed below:

Right to Financial Privacy Act (RFPA)—The RFPA was enacted to provide the financial records of financial institution customers a reasonable amount of privacy from Government scrutiny. The Act establishes specific procedures that Government authorities must follow when requesting a customer's financial records from a bank or other financial institution. The Act also imposes duties and limitations on financial institutions prior to the release of information sought by Government agencies.

Title V of Gramm-Leach-Bliley Act (GLBA) and Regulation P—The GLBA and its implementing regulations, Regulation P, establish a general rule that a financial institution may not disclose any nonpublic personal information about a consumer to any nonaffiliated third party unless the financial institution first provides the consumer with a notice that describes the disclosure (as well as other aspects of its privacy policies and practices) and a reasonable opportunity to opt out of the disclosure, and the consumer does not opt out. There are two specific exceptions specific to BSA and may be applicable to the AML Utility: (i) to the extent specifically permitted or required under other provisions of law and in accordance with the Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 *et seq.*) to law enforcement agencies, self-regulatory organizations, or for an investigation on a matter related to public safety and (ii) to protect against or prevent actual or potential fraud, unauthorized transactions, claims or other liability.

Electronic Fund Transfer Act (EFTA)—The EFTA and its implementing regulations, require that banks make certain disclosures at the time a consumer contracts for an electronic fund transfer service or before the first electronic fund transfer is made involving the consumer's account. For example, the financial institution must disclose the circumstances under which, in the ordinary course of business, the financial institution may provide information concerning the consumer's account to third parties, whether or not the third party is affiliated with the bank. This disclosure must encompass any information that may be provided concerning the account (not just information relating to the electronic fund transfers themselves). The EFTA requirements apply to "accounts," which include demand deposit, savings deposit, and other consumer asset accounts.

State Privacy Laws—A number of States have enacted privacy laws that specifically relate to the disclosure of consumer financial information, as well as laws that more generally target unfair and deceptive acts and practices. The GLBA maintains that State laws that afford greater protection for consumer privacy than that provided by the GLBA are not preempted by Title V of the GLBA. The FCRA, however, provides that State laws that prohibit or impose requirements on the exchange of information among affiliates are preempted unless enacted after January 1, 2004.

Q.8. Will you pledge to institutionalize feedback mechanisms wherein banks/credit unions both get and can give feedback on how to constantly improve the process?

A.8. The OCC will continue to work with FinCEN and law enforcement to improve two-way feedback on the value and construct of SAR reporting. We will work to make this issue a priority for discussion in the BSAAG as well as in other forums, including the FFIEC BSA working group.

Q.9. We hear from banks that they feel pressured to file SARs even when they believe the underlying transaction or activity does not rise to a level of suspiciousness that merits a filing. They say they do this because they are afraid of being second-guessed by examiners after the fact, and because there is no Government penalty for over-filing SARs—only a penalty for not filing a SAR. The filing of unnecessary SARs, however, results in unnecessary expense.

What can be done to realign incentives so that banks/credit unions don't feel pressured to file SARs that they don't feel reflects activity warranting a filing?

A.9. Banks are only required to file SARs whenever a bank detects any known or suspected Federal criminal violation, or pattern of criminal violations, committed or attempted against the bank involving a transaction or transactions conducted through the bank, in any amount involving insider abuse, aggregating $5,000 or more where a suspect can be identified, and aggregating $25,000 or more when a suspect cannot be identified. OCC examiners are trained on the proper application of our SAR regulation (12 CFR 21.11), and a bank's suspicious activity monitoring program is evaluated in the context of the overall efficacy of the BSA/AML Program. Our examiners' evaluation of the overall effectiveness of the program does not require the filing of a specified number of SARs, and we do not hold bankers to SAR filing number benchmarks or other metrics. We also advise and train our examination staff that they should not cite SAR filing violations for difference of opinion or judgement between the examiner and the bank, provided there is no evidence of bad faith or lax judgment. Examination staffs have access to legal, policy, and supervision experts as they develop examination conclusions. All potential BSA Program-related violations are formally vetted through senior management committees before finalizing to ensure consistency across the OCC.

Q.10. Banks/credit unions commonly use "rules-based" software to screen transactions and alert AML compliance teams to suspicious activities. While these rules-based systems can be effective, they might not be the most effective tool available given advances in data science and machine learning, and further, that there may be opportunities for criminals to manipulate these rules-based systems.

We have heard concerns that many criminals have access to the exact same products that are used by financial institutions—is this true?

A.10. We do not have any evidence that supports that criminals have access to AML products used by financial institutions.

Q.11. If criminals have access to similar products, or can easily come to understand the rules-based system, how easy is it to manipulate these detection systems?

A.11. As stated in our response above, we do not have any evidence that criminals have access to AML products used by financial institutions. Any potential manipulation would generally be in the form of structuring transactions to avoid detection, which would be difficult since banks are expected to customize AML monitoring systems in a manner commensurate with their unique risk profile. Thus, vendor settings in AML systems generally are modified as banks customize transaction monitoring settings.

Q.12. If there was a proven model of using a "learning," algorithmic system to flag potentially suspicious transactions, would this be an improvement on the current system? What are the hurdles to financial institutions adopting such systems?

A.12. Advanced AML systems may assist a bank in gaining efficiencies in suspicious activity monitoring by reducing the number of false positives requiring review as well as providing enhanced capabilities for identifying risk through anomaly detection. There are a number of hurdles to successfully implement advanced AML systems including those using machine learning. Some of these hurdles include the absence of sufficient data to fully "train" these systems, data integrity and inconsistent data formatting issues resulting from multiple platforms and other system issues, lack of reliable information on SAR productivity, and the cost of acquiring and properly implementing and validating such systems.

Q.13. In what ways is a bank's/credit union's "safety and soundness" implicated by its AML system?

A.13. The OCC considers BSA/AML examination findings in a safety and soundness context when assigning the management component rating of the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). Serious deficiencies in a bank's BSA/AML compliance create a presumption that the bank's management component rating will be adversely affected because its risk management practices are less than satisfactory. Please refer to OCC Bulletin 2012–30—Consideration of Findings in Uniform Rating and Risk Assessment Systems.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN CRAPO FROM RANDAL K. QUARLES

Q.1. Some provisions of S. 2155 may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking. The Congressional Review Act requires agencies to submit, with certain minor exceptions, all rules to Congress for review. Under the Congressional Review Act, a rule, by definition, is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." This definition is very broad. In order to ensure Congress can engage in its proper oversight role, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Can you commit to following the law by submitting all rulemakings and guidance documents to Congress as required by the Congressional Review Act?

A.1. The Federal Reserve Board (Board) submits rules to Congress in accordance with the Congressional Review Act. As you know, the Board, along with other Federal financial agencies, recently issued an Interagency Statement clarifying the role of supervisory guidance. The statement explains that, unlike a law or regulation, supervisory guidance does not have the force and effect of law and that the agencies should not and will not take enforcement actions based on supervisory guidance. The Board will continue its practice of submitting all binding rules to Congress as required under the Congressional Review Act and will be clear internally and externally that our guidance documents are not binding rules.

Q.2. On July 6, 2018, the Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency issued an Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act.[1] It is my understanding that the Interagency Statement would qualify as a rule under the Congressional Review Act.

Have the agencies submitted the Interagency Statement to Congress as required by the Congressional Review Act? If not, can you commit to submitting the Interagency Statement to Congress?

A.2. The July 6, 2018, Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) did not modify any existing rule of the Board. Rather, the Interagency Statement indicated that the Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) would not enforce certain regulations that were affected by EGRRCPA. As noted above, the Board will continue its practice of submitting all binding rules to Congress as required under the Congressional Review Act.

Q.3. Section 165 of Dodd-Frank established a $50 billion, and in some cases a $10 billion, threshold in total consolidated assets for the application of enhanced prudential standards. Such thresholds

[1] See *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf.*

have been applied in rulemakings and guidance documents consistent with Dodd-Frank's requirements. As an example in 2012, regulators issued jointly supervisory guidance on company-run stress testing for banks with more than $10 billion in assets. The regulators have also applied numerous other standards using either the $10 billion or $50 billion asset threshold to be consistent with Section 165 of Dodd-Frank. For example, banks with $50 billion or more in total assets have historically been subject to CCAR, a supervisory test not required by statute.

Can you commit to reviewing all rules and guidance documents referencing thresholds consistent with Section 165 of Dodd-Frank, and revise such thresholds to be consistent with S. 2155?

A.3. On October 31, 2018, the Board issued two notices of proposed rulemaking, one together with the OCC and the FDIC, seeking comment on a framework for determining the prudential standards that apply to large U.S. banking organizations, based on the risk profiles of these firms. The proposals account for changes made by section 401 of EGRRCPA regarding enhanced prudential standards for these firms. As you suggest in this question, the Board also is evaluating changes to the prudential standards applicable to other large banking organizations, including rules that rely on a $50 billion total consolidated asset threshold but that were not affected by EGRRCPA. In addition, the Board is reviewing all guidance documents related to the statutory changes made by EGRRCPA.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM RANDAL K. QUARLES

Q.1. While S. 2155 does not require the Fed to change the domestic asset threshold for the establishment of an intermediate holding company for a foreign banking organization, does the Fed have any plans to alter the current $50 billion U.S. nonbranch asset threshold?

A.1. As you note in this question, S. 2155 does not require the Federal Reserve Board (Board) to change the U.S. asset threshold for the establishment of an intermediate holding company (IHC), which is currently at $50 billion in U.S. nonbranch assets. Foreign banking organizations are subject to Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) based on total global consolidated assets. In applying section 165 to foreign banks, the Board previously has tailored the enhanced prudential standards based, in part, on the size and nature of a foreign bank's activities in the United States. The IHC requirement and $50 billion U.S. nonbranch asset IHC threshold are examples of tailored standards based on the size and nature of a foreign bank's activities in the United States. Consistent with section 165, as amended by the Economic Growth, Regulatory Reform, and Consumer Protection Act (EGRRCPA), and the Board's longstanding policy objectives, the Board's enhanced prudential standards generally treat the U.S. operations of a foreign banking organization similarly to a domestic banking organization of the same size and business model. As a general matter, the Board routinely evaluates whether changes to certain standards would be appropriate, and the Board anticipates that it will continue this practice, taking into account the structures through which foreign banking organizations operate in the United States.

Q.2. Recently, former Fed Chair Yellen said in an interview that "regulators should sound the alarm," with regard to risks posed by leveraged corporate lending.[1] Chair Yellen noted that regulators "should make it clear to the public and the Congress there are things they are concerned about and they don't have the tools to fix it."[2]

Do you agree with this statement from Chair Yellen on the risks posed by growing leverage in corporate lending?

A.2. We continue to monitor and assess leveraged loan risk closely in the banks we supervise. The Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (the Agencies) believe that supervised banks can continue to participate in leveraged lending activities and provide credit to this market segment, provided such activities, as with all lending activities, are conducted in a prudent manner, consistent with safety and soundness standards.

Even when the direct risks posed to the banking sector are limited—principally because most leveraged loans originated by banks are promptly sold to other investors—indirect risks could arise if banks were separately exposed to those purchasers. The principal purchasers of leveraged loans from banks are collateralized loan obligation (CLO) vehicles, which are usually structured to reduce their susceptibility to runs by ensuring that the duration of their liabilities exceeds those of their assets. We monitor banks' exposures to such structures and take appropriate supervisory steps to reduce the risk that such exposures could rise to a level that might undermine confidence in a bank if the value of that bank's CLO holdings were to decline precipitously. At the same time, the Financial Stability Board under my chairmanship has begun analyzing the global distribution of exposure to CLOs, to understand whether such risks are arising elsewhere in the financial system.

Q.3.a. When Chairman Powell was a Fed Governor in 2015, he noted that the Fed's leveraged lending guidance from 2013 would "stand in the way of a return to pre-crisis conditions."[3]

Do you agree? If so, why has the Fed lessened the supervisory consequences for banks not in conformance with that guidance?

A.3.a. The Agencies issued the 2013 Interagency Leveraged Lending Guidance (2013 Guidance)[4] to provide banks with principles that are particularly relevant when we evaluate leveraged loan risk management and prudent underwriting. As discussed in the 2013 Guidance, and consistent with banks' obligations to operate in a safe and sound manner,[5] the Agencies continue to believe that

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[1] *https://www.bloomberg.com/news/articles/2018-09-27/wall-street-s-riskiest-loans-flash-dangers-as-watchdogs-muzzled?srnd=premium.*

[2] *Id.*

[3] *https://www.federalreserve.gov/newsevents/speech/powell20150218a.htm.*

[4] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, "Interagency Guidance on Leveraged Lending," March 21, 2013, *https://www.federalreserve.gov/supervisionreg/srletters/sr1303a1.pdf.*

[5] Section 39 of the Federal Deposit Insurance Act (12 U.S.C. 1831 p–1) requires each of the Agencies to prescribe bank standards relating to internal controls, information systems, and internal audit systems; loan documentation; credit underwriting; interest rate exposure; asset

banks engaged in leveraged lending activities should have underwriting standards that reflect the bank's risk appetite, and that consider covenant protections for expected financial performance, reporting requirements, and compliance monitoring. When assessing banks' practices, examiners focus on any weaknesses that could affect safety and soundness, taking into account each bank's individual circumstances.

As supervisory guidance, the 2013 Guidance does not have the force and effect of law, and the Agencies do not take enforcement actions based on supervisory guidance. Examiners may refer to the principles outlined in the 2013 Guidance when they assess any impact on safety and soundness posed by leveraged lending activities. If a bank has deficient practices relating to safety and soundness, the Agencies may take supervisory or enforcement actions, as appropriate, so that the institution addresses those deficiencies.

Q.3.b. How is the Fed protecting the banking sector from the risks of leveraged corporate lending? As a member of the Financial Stability Oversight Council, what is the Fed doing to protect against emerging risks among nonbank lenders?

A.3.b. The Agencies expect supervised banks to have prudent credit underwriting practices and commensurate risk management processes, as well as appropriate controls, transparency, and communication to senior management and the board of directors about leveraged lending risks. Deficient policies, procedures, or practices that relate to safety and soundness may result in supervisory actions.

In addition, the Agencies will continue to perform semi-annual interagency Shared National Credit (SNC) reviews. For some time, SNC reviews have been heavily weighted toward leveraged loans, and results are used by examiners when assessing credit quality and risk management practices at individual banks.

The Agencies also evaluate the results of various stress tests performed by the banks we supervise. Leveraged loans are one of several asset classes stressed under different scenarios to assess whether capital levels are appropriate. Examiners will take supervisory action if adverse findings are revealed.

The Financial Stability Oversight Council (FSOC) is able to analyze financial stability issues it may identify, as appropriate, including any related to leveraged lending markets. The FSOC has noted leveraged lending in some of its previous annual reports, including the most recent report.

Q.4. Fed officials, including yourself, have said the economy is performing robustly—for example, banks are more profitable than ever. Wall Street Reform required that bank capital requirements should increase in "times of economic expansion," but Chairman Powell has said now is not the time to activate the countercyclical capital buffer.

If not now, then when? Would increasing the capital buffer now give the Fed more room to lower it in the future, and soften the impact of the next downturn?

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growth; compensation, fees, and benefits; and such other operational and managerial standards as it determines to be appropriate.

A.4. The countercyclical capital buffer (CCyB) is designed to increase the resilience of large banking organizations when there is an elevated risk of above-normal losses. The Federal Reserve finalized its policy statement on the CCyB in 2016, which spelled out a comprehensive framework for setting its level. The framework centers on the Board's assessment of the overall vulnerability of the financial system. It incorporates the Board's judgment of not only asset valuations and risk appetite, but also the level of three other key financial vulnerabilities that tend to vary with the economic cycle—financial leverage, nonfinancial leverage, and maturity and liquidity transformation—and how all four of those vulnerabilities interact.

Within that framework, asset valuations continue to be elevated, despite recent declines in the forward price-to-earnings ratio of equities and the prices of corporate bonds. In the private nonfinancial sector, borrowing among highly levered and lower-rated businesses remains elevated, although the ratio of household debt to disposable income continues to be moderate.

However, the financial system is substantially stronger than at similar points in previous cycles. Bank capital ratios and liquidity buffers are now substantially higher than they were a decade ago. The stress tests ensure that the largest banks can continue to support economic activity even in the face of a severe recession—importantly, one characterized by extreme declines in asset prices. Following our scenario design framework for the stress tests, the scenarios used this year were the most severe since the start of the CCAR program in 2011, reflecting the framework's countercyclical elements. Outside the banking system, financial leverage does not appear to have risen to elevated levels, and the risks associated with maturity transformation by money market mutual funds are much reduced from the levels seen a decade ago.

Thus, I believe that the financial system is quite resilient, with the institutions at the core of the system well capitalized and less risky. Central clearing of derivatives limits the amount of contagion from the distress of an institution.

The CCyB is an important mechanism to build resilience among the largest banks should it become appropriate to do so, and we are carefully assessing relevant developments. If asset valuation pressures were to continue to build, especially if they were accompanied by increased leverage or increased maturity and liquidity transformation, activation of the CCyB could promote additional resilience among the largest U.S. banks, and then its later reduction during a downturn could support lending in that period.

Q.5. Some of the sponsors of S. 2155 and Chairman Powell have said that they do not intend for S. 2155 to benefit large foreign banks operating in the United States. But you've given speeches saying that the Fed should take a look at reducing the regulatory burden on these banks, saying that the Fed should "reconsider its calibration" of foreign bank rules.

As you run to head the Financial Stability Board—a crucial position leading international bank regulators—don't you think it's important for the United States to offer a united perspective that we must maintain the post-crisis regulatory framework for all large banks?

A.5. Post-financial crisis reforms have resulted in substantial gains in the resiliency of banking organizations and the financial system as a whole. We undoubtedly have a stronger and more resilient financial system due in significant part to the gains from those core reforms.

In undertaking a review of the post-crisis body of regulations, however, in addition to ensuring that we are satisfied with the effectiveness of these regulations, we have an opportunity to evaluate whether we can improve the efficiency, transparency, and simplicity of regulation. If we can achieve the same outcome with more efficient regulations, that is a benefit for the entire financial system.

The Board recognizes the important role that foreign banking organizations play in the U.S. financial sector and remains committed to the principles of national treatment and equality of competitive opportunity between the U.S. operations of foreign banking organizations and U.S. banking organizations. Consistent with section 165 of the Dodd-Frank Act, as amended by EGRRCPA, and the Board's longstanding policy objectives, the Board's enhanced prudential standards generally treat the U.S. operations of a foreign banking organization similarly to a domestic banking organization of the same size and business model. As a general matter, the Board anticipates that it would continue this practice, while taking into account the structures through which foreign banking organizations operate in the United States.

Q.6. At the hearing, you noted in response to a question regarding the G–SIB surcharge that the Fed will reconsider it, in part, "to insure that we have a level playing field internationally not as a way of trying to seek a benefit for our firms, but because when you have an international system that has an unlevel playing field, over time pathologies will develop as activity moves to different areas of that global system not on the basis of—or driven by incentives other than purely economic incentives—incentives by the cost of capital." Currently, the G–SIB surcharge in the United States is higher than the surcharge mandated by the Basel Committee on Banking Supervision.

Has this, to date, caused any pathologies to develop or caused activity to move out of U.S. banks and to other banks in the global system?

A.6. The Board's capital rules have been designed to significantly reduce the likelihood and severity of future financial crises by reducing both the probability of failure of a large banking organization and the consequences of such a failure were it to occur. Thus, the capital surcharge applied to U.S. global systemically important banking organizations (G–SIBs) was calibrated so that each G–SIB would hold enough capital to lower its probability of failure so that the expected impact of its failure would be approximately equal to that of a non-G–SIB. In particular, the Board's "method 2" G–SIB surcharge methodology takes into account the risks of short-term wholesale funding, and results in a higher surcharge than the international surcharge methodology designed by the Basel Committee on Banking Supervision (BCBS). Reliance on short-term wholesale funding is indicative of interconnectedness and makes firms vulnerable to large-scale funding runs.

The Board has noted unintended consequences related to the leverage ratio requirements applied to U.S. G–SIBs, which may encourage them to reduce their activity in certain low-risk, but capital intensive, activities. For example, the Board is aware that the enhanced supplementary leverage ratio standards for U.S. G–SIBs may increase the costs for low-risk and low-margin activities, such as custodial services. In direct response to the regulatory requirements, certain U.S. G–SIBs indicate that they have pursued a strategy of restricting the availability of their custodial services and passing along higher costs to customers.

The bulk of post-crisis regulation largely complete, with the important exception of the U.S. implementation of the recently concluded BCBS agreement on bank capital standards. It is therefore a natural and appropriate time to step back and assess those efforts. The Board is conducting a comprehensive review of the regulations in the core areas of post-crisis reform, including capital, stress testing, liquidity, and resolution. The objective of this review is to consider the effect of those regulatory frameworks on the resiliency of the financial system, including improvements in the resolvability of banking organizations, and on credit availability and economic growth.

In general, I believe overall loss-absorbing capacity for our largest banking organizations is at about the right level. Critical elements of our capital structure for these organizations include stress testing, the stress capital buffer, and the enhanced supplementary ratio. Work is underway to finalize the calibration of these fundamental building blocks, all of which form part of the system in which the G–SIB surcharge has an effect.

Q.7. Former Fed Governor Tarullo recently stated, "there is still some legitimate question among people as to whether if one of [the largest U.S. banks] got into significant trouble—and if one does the others will probably be at least under some stress—whether there still wouldn't be a view that they are too big to fail and that the Government should take extraordinary measures."[1]

Do you agree with this statement?

A.7. U.S. regulators have made a great deal of progress in our work to address the too-big-to-fail phenomenon. Notably, the statutory framework established by Congress and the efforts of financial regulators have made the largest banking firms more resilient and have significantly improved their resolvability. In particular, for the largest, most systemically important forms, the Federal Reserve has increased the quantity and quality of capital that they maintain, have established capital surcharges that are scaled to each firm's systemic risk footprint, have required hem to have more stable liquidity risk profiles, and have required them to carry long-term debt that can be converted to equity as part of a resolution.

In this regard, I believe it is much more likely that the failure of one of our most systemically important financial institutions could be resolved without critically undermining the financial stability of the United States. Moreover, more of the losses from such

[1] *https://www.politico.com/story/2018/09/26/wall-street-too-big-to-fail-podcast-842587.*

a failure would fall on the firm's shareholders and bondholders, not the Deposit Insurance Fund or taxpayers. Investors have recognized this progress as well. For example, the major rating agencies have removed the ratings benefit associated with the perceived Government support that they once ascribed to the largest bank holding companies. That said, financial institutions and markets are always evolving, and therefore it is important to remain vigilant regarding changing systemic risks.

Q.8. The Federal financial agencies often take intermediate steps to address problems in the financial institutions they regulate before formal enforcement actions are taken. For example, we know that the OCC had taken supervisory actions related to concerns about Wells Fargo's sales practices before the 2016 enforcement action.

Please describe the process for how your agency determines what type of supervisory action to take when it finds a problem at a financial institution it regulates, how it expects the financial institution to address the problem, how much time a financial institution is given to address the problem, how the agency follows up with the financial institution on the problem, and how the agency makes a determination that a problem has not been addressed and warrants escalated action.

A.8. The Federal Reserve's supervisory program is designed to focus on both individual firms and portfolio-wide risks in order to mitigate threats to a firm's safety and soundness and financial stability. Supervisors engage in continuous monitoring of firms and routinely meet with the firm's staff to discuss the operations of the firm, new issues, and remediation plans for previously identified weaknesses. Supervisors also conduct horizontal and firm specific examinations. The type of supervisory action taken is based on individual facts and circumstances and depends upon the number of violations, materiality to the safety and soundness of the firm, repeat nature of the deficiencies, and the ability of current management to connect the issues.

Prior to a formal enforcement action, supervisors have a range of tools available to address identified problems at a firm. Informal enforcement actions that may be taken include issuing supervisory findings or entering into a memorandum of understanding. Supervisors consider the type of action to take based upon the severity, complexity, and impact of the weaknesses identified. A frequently used method is to issue supervisory findings to a firm after an examination. These include recommendations for follow-up action on the part of the organization's management. These "matters requiring attention" (MRA) call for action to address weaknesses in processes or controls that could lead to deterioration in a banking organization's soundness, may result in harm to consumers, or could lead to noncompliance with laws and regulations. When weaknesses are acute or protracted, Federal Reserve examiners may recommend that management take action more quickly by issuing a "matter requiring immediate attention" (MRIA). A high volume of these may prompt an examiner to assign a less than satisfactory annual composite rating to a holding company.

Supervisory actions generally require that the institution submit a remediation plan that details how it expects to remediate issues identified by supervisors. Once a remediation plan is submitted, the Federal Reserve will notify the firm if the remediation plan is approved or whether changes are needed. Once agreement is reached on a remediation plan, the firm will implement the plan in accordance with designated timelines. Generally, after the firm believes that remediation is complete, the firm's internal audit function will validate implementation of the remediation plan. After internal audit validation, examiners also will confirm that implementation of remediation actions has taken place. If supervisors believe that a firm is not adequately addressing noted deficiencies, then the matter may be escalated and stronger supervisory actions imposed. These actions may include formal enforcement actions and, in some cases, fines. Occasionally, if the deficiencies result in the firm being in an unsafe or unsound condition or there is a violation of law or regulation, a formal or informal enforcement action may be pursued in the absence of previously communicated MRAs or MRIAs.

Q.9. As you know, financial institution misconduct often continues for many years, and it raises concerns that the current supervisory process is ineffective in addressing problems.

Given that the details about supervisory actions including "matters requiring attention" or "MRAs" are considered confidential supervisory information, please provide the Committee for each year starting in 2005 the aggregate number of outstanding MRAs from the Fed for the U.S. GIBs, and the aggregate number of MRAs that were satisfactorily addressed and are no longer outstanding.

A.9. On November 9, 2018, the Board released a *Supervision and Regulation Report* that provides data related to outstanding and addressed supervisory findings, including MRAs and MRIAs, since 2013.[2]

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM RANDAL K. QUARLES

Q.1. As I stated during the hearing, I greatly appreciated the recent Interagency Statement Clarifying the Role of Supervisory Guidance.

Q.1.a. Could you describe what, if any, additional steps you have taken to ensure that the content of the statement is understood and observed by your examination staff?

A.1.a. We have taken a number of steps to reaffirm the role of supervisory guidance in our communications to examiners and to supervised institutions. First, on October 4, 2018, we conducted an internal, mandatory training session for all our supervisory staff to reinforce the distinctions between laws and regulations versus guidance and to clarify the use of guidance in the supervisory process. Second, we are helping examiners with outreach to supervised institutions in answering questions about the policy statement.

[2] The *Supervision and Regulation Report* uses data since 2013 given systems availability. In addition, data after this date is most relevant for large financial institutions, given the changes in the supervisory program following the crisis. See SR letter 12–17/CA letter 12–14.

Third, we are reviewing the templates examiners use when they refer to supervisory guidance in their communications with supervised institutions. Fourth, we will continue to review supervisory findings to confirm that our examiners are referring to guidance appropriately. Finally, we regularly solicit the views of the forms we supervise on our supervisory process to include their views on our use of guidance in supervisory communications.

Q.1.b. Additionally, have past supervisory actions been reviewed to confirm that they are consistent with the statement? If so, have any problems been identified?

A.1.b. In connection with our ongoing scrutiny of supervisory practices, of which our clarification of the role of supervisory guidance forms a part, we look at existing supervisory actions to ensure that they are in line with developments in policy. At this point we have not found many instances where guidance has been used inappropriately in light of our clarifying statement, but in cases where we do discover that a reference to guidance in a supervisory action is inconsistent with our policy, we will address the error promptly.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM RANDAL K. QUARLES

Q.1. Your agencies have been working on regulations to implement the Biggert-Waters Flood Insurance Reform Act of 2012 for the last 6 years. The rule regarding acceptance of private flood insurance has been proposed in draft form twice, the last time on January 6, 2017. Nearly all comments submitted on the two drafts expressed serious concerns over the proposals, and the unintended consequences that would result.

What steps are each of your agencies taking to address the concerns expressed during the comment period?

A.1. As you are aware, the National Flood Insurance Act (NFIA) makes the purchase of flood insurance mandatory in connection with loans made by a federally regulated lending institution, including a State member bank, and secured by improved real estate or mobile homes in an area designated by Federal Emergency Management Agency (FEMA) as a Special Flood Hazard Area (SFHA). Currently, most of the flood insurance policies purchased to comply with NFIA are issued under FEMA's National Flood Insurance Program (NFIP).

The Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Farm Credit Administration (FCA), and the National Credit Union Administration (NCUA) (the Agencies), which are responsible for writing Federal flood insurance rules, issued proposed rules in October 2013 and in November 2016 to implement the private flood insurance provisions of the Biggert-Waters Act (Act), but have not issued a final rule. The proposals incorporated the mandatory acceptance of private flood insurance policies that meet the criteria identified in the Act and clarified the applicable legal standards related to private flood insurance. Based on feedback from commenters, the Agencies re-proposed a rule in November 2016 that included "discretionary private flood insurance" criteria, which would permit lenders to accept private flood insurance that met some, but not all, of the criteria provided for by the Act to satisfy the statutory mandatory purchase requirement.

The comment period on the November 2016 proposal closed on January 6, 2017. Agency staff have carefully analyzed the written comments received in connection with both proposals and have also conducted further outreach with stakeholders to further understand concerns raised in the comments. Agency staff are working to publish a final rule in early 2019, balancing commenters' concerns with the requirements of the statute and principles of safety and soundness and consumer protection.

Q.2. By law the Federal Reserve and Treasury Department are supposed to submit a report and testify to Congress on efforts to increase transparency at the International Association of Insurance Supervisors within 180 days.

Can you give an update on the progress of this mandated report and other requirements outlined in Section 212 of Public Law 115–174?

A.2. As a member of the International Association of Insurance Supervisors (IAIS), the Federal Reserve continues to work collaboratively in partnership with the National Association of Insurance Commissioners (NAIC) and the Federal Insurance Office (FIO), and remains committed to pursuing an engaged dialogue to achieve outcomes that are appropriate for the United States.

The Federal Reserve supports transparency in the development of international insurance standards at the IAIS. With regard to the report on the efforts of the Board and U.S. Treasury to increase transparency at IAIS meetings, we remain committed to producing this report, and expect to do so in a timely manner. The other reports required of the Board under Section 211 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)—namely, the annual report "with respect to global insurance regulatory or supervisory forums" and a joint report with the FIO required "before supporting or consenting to the adoption of any final international insurance capital standard"—also remain high priorities for timely and accurate completion in accordance with EGRRCPA.

Also, with regard to the EGRRCPA, we appreciate the opportunity to develop and engage with an Insurance Policy Advisory Committee on international capital standards and other issues, which we believe will be helpful in providing relevant information to both the domestic and international policy process. We are in the process of setting up that committee, in accordance with relevant Federal laws.

It is important to recall that the IAIS has no ability to impose requirements on any national jurisdiction, and any standards developed through this forum is not self-executing or binding upon the United States unless adopted by the appropriate U.S. lawmakers or regulators in accordance with applicable domestic laws and rulemaking procedures.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM RANDAL K. QUARLES

Q.1. There is growing concern that the upcoming transition to the Current Expected Credit Loss accounting standard beginning in 2020 will adversely impact banks' ability or inclination to make certain types of loans, including many forms of consumer credit that are essential for a healthy economy—mortgages, auto loans, and student loans. I believe that the Federal Reserve, in conjunction with the OCC, SEC, and FASB, should act quickly to reevaluate this standard and assess its impact on financial institutions, consumers, and the overall health and stability of the financial sector. The analysis should account for how CECL may precipitate a change in regulatory capital requirements and pay special attention to the interaction between regulatory capital and the impact of increased loan loss reserve requirements.

Please answer the following with specificity:

Q.1.a. Does the Federal Reserve believe that the economic impacts of CECL have been adequately studied to date?

A.1.a. The Financial Accounting Standards Board (FASB) is an independent, private sector organization that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow Generally Accepted Accounting Principles (GAAP). Prior to finalizing the current expected credit loss (CECL) accounting standard, the FASB followed its established due process, which included cost-benefit analysis and extensive outreach with all stakeholders, including users, preparers, auditors and regulators. Economists, institutions and independent organizations have produced impact analyses of CECL. To address concerns about the potential initial impact stemming from CECL implementation, the Federal banking agencies have finalized a rule that provides a 3-year phase-in of CECL's day-one impact on regulatory capital. This will allow additional time to study the measure's effects as the agencies continue to monitor the impact of CECL adoption.

Q.1.b. Would you support measures to delay implementation of CECL pending completion of a thorough quantitative impact study?

A.1.b. Our supervised institutions are required by statute to apply GAAP as established by the FASB. We support an independent accounting standard-setting process, and as such, we defer to the FASB on the implementation timeline for financial reporting purposes. However, as mentioned in the response to question 1(a), the Federal banking agencies have finalized a rule that provides a 3-year phase-in of the effect on regulatory capital. This will allow additional time to study the measure's effects as the agencies continue to monitor the impact of CECL adoption.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM RANDAL K. QUARLES

Sales practices

Q.1. The Wells Fargo fraudulent account scandal exposed how abusive sales practices and incentive compensation place consumers at risk of harm. In the 2 years since the first Wells Fargo scandal, we've watched as bank executives blamed low-paid employees for sales practices gone wrong, but in reality, these scandals reflect a failure of risk management and bank culture that comes from the top. A new report by the National Employment Law Project found that 90 percent of bank employees surveyed stated that failure to meet sales quotas still results in bullying, disciplinary action or possible termination.

Are your agencies incorporating reviews of sales practices and compensation programs into your supervision? If so, does that include any input or feedback from frontline employees? If not, how are you monitoring possible misconduct related to sales practices?

A.1. One of the Federal Reserve's fundamental goals is to promote a financial system that is strong, resilient and able to serve a healthy and growing economy. We work to ensure the safety and soundness of the firms we supervise, as well as their compliance with applicable consumer protection laws, so that such firms may, even when faced with stressful financial conditions, continue serving consumers, businesses, and communities.

The Federal Reserve applies high standards for risk management, internal controls, and consumer protection to organizations under its responsibility. To that end, we review compliance risk management and board oversight of bank holding companies and State member banks. We are focused on the compliance environment with respect to sales practices, and seek to ensure that internal controls, senior management oversight, and involvement of the board of directors are appropriately tailored to limit these risks according to each firm and the banking system as a whole.

Recently, the Federal Reserve assessed our existing guidance related to sales practices, incentive compensation, and fraud, and we determined that the existing guidance is sufficient to cover supervisory expectations for large and regional banks.[1] In addition, the Federal Reserve coordinated with other financial regulatory agencies to conduct a review of sales practices, incentive compensation, and fraud at some of the largest banking organizations under our supervision, which included reviewing audit reports related to sales practices, both internal and external as applicable, as well as interviews conducted with frontline employees.

The Federal Reserve's review noted that some banks needed to strengthen policies and procedures, management information systems reporting to all levels of management, and training. More specifically, a few banks had inadequate programs for oversight escalation and investigations of unethical behavior, and complaints were not always adequately captured for resolution. Any matters detected at these banks are being reviewed through active continuous monitoring or through specific follow-up examinations being conducted by the Federal Reserve.

[1] Supervision and Regulation (SR) Letter 12–17/CA 12–14, Consolidated Supervision Framework for Large Financial Institutions (Dec. 17, 2012); Interagency Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36,395 (June 25, 2010); SR Letter 08–09/CA 08–12, Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008); SR Letter 08–08/CA 08–11, Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles (Oct. 16, 2008).

Bank of America

Q.2. Last week, I sent a letter to the CEO of Bank of America regarding recent customer reports that the bank has asked existing account holders for their citizenship status, and in some cases the bank has frozen accounts when customers fail to respond.

Have any of your agencies directed or suggested to banks under your supervision to ask existing account holders for their citizenship status? Please provide any information about whether any institutions may have been asked or encouraged to collect citizenship information on existing customers.

A.2. The Federal Reserve is not aware of instances in which an institution we supervise has been directed by our examiners to request the citizenship status of an existing account holder. As you may know, banks are generally required under the Bank Secrecy Act (BSA) to have risk-based procedures to identify their customers at account opening and to conduct appropriate customer due diligence (CDD) throughout the lifespan of the account relationship. For example, under the Customer Identification Program (CIP) regulations adopted by the Federal Reserve and the Financial Crimes Enforcement Network (FinCEN), banks are required to obtain, at a minimum, the customer's name, date of birth, address, and identification number, and to verify the customer's identity using documentary or nondocumentary means. For a U.S. person, the identification number is their taxpayer identification number. For a non-U.S. person, the identification number may be a passport number, alien identification card, or any other Government-issued document evidencing nationality or residence and bearing a photograph or similar safe guard.

In addition, under the CDD regulations adopted by FinCEN, banks are required to collect customer information commensurate with the customer's risk profile. Indeed, the level and type of customer information gathered under the CDD rule may vary from customer to customer. Although citizenship information is not expressly required by the CIP or CDD regulations, banks may choose to collect additional customer information in accordance with their own policies and procedures. The Federal Reserve's supervisory expectation is that banks can offer account services to law-abiding customers, including those who are not U.S. citizens, by applying risk-based policies, procedures, and processes as required under the BSA.

Q.3. In April, you said that the Section 956 incentive-based compensation rulemaking "had not fallen behind the refrigerator."[2] In July, Chair Powell said that regulators had effectively ceased work on this rulemaking. He recently clarified in response to questions for the record that the agencies are continuing to consider the comments to the proposed rule.

Can you provide an update on this joint rulemaking? When can we expect to see a final rule?

A.3. The Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Securities Exchange Commission, National Credit Union Association, and the

[2] *https://plus.cq.com/doc/congressionaltranscripts-5302844?3.*

Federal Housing Finance Agency (the agencies), jointly published and requested comment on the revised proposed rule in June 2016. The agencies received over one hundred comments and many raised important and complicated questions. The agencies continue to consider the complex issues raised in comments and do not have a projected date for completion of this rulemaking.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR ROUNDS FROM RANDAL K. QUARLES

Q.1. Thank you for the dialogue during our recent hearing and for clarifying that the G–SIB surcharge will be a part of the Federal Reserve's larger regulatory review. As the sponsor of S. 366, the TAILOR Act, which would require Federal regulatory authorities to tailor regulations to the operational risk of a financial institution, I agree with you that reducing duplicative rules and regulatory inefficiencies is important.

This past January when you were speaking before the American Bar Association you mentioned that you would be working toward simplifying the framework regarding loss absorbency requirements, including the G–SIB surcharge, and that the 24 total loss absorbency requirements you counted in the existing regulatory framework "is too many." I appreciate your commitment and the commitment of Chairman Powell to engaging in a holistic review of these requirements and to examining the level of transparency in our regulatory process.

As the Federal Reserve undertakes its review of existing regulations, will you commit to instilling a greater degree of transparency in regulations, including by requests for public comment on the Federal Reserve's analysis?

A.1. Transparency is central to the Federal Reserve's mission and is key to ensuring that the Federal Reserve remains accountable to the public. In the rulemaking process, the Federal Reserve is committed to using public notice and comment procedures to ensure that its policymaking decisions are open to public scrutiny and participation. In addition, a transparent approach to rulemaking has the practical benefit of allowing the Federal Reserve to improve its proposals based on public input. Accordingly, the Federal Reserve will remain committed to the use of public notice and comment procedures to ensure a high degree of transparency in the development of regulations.

Q.2. As you are aware, Section 201 of S. 2155 requires Federal regulators to develop a Community Bank Leverage Ratio. If a community bank meets that ratio then they would automatically be considered to be in compliance with leverage capital requirements, risk-based capital requirements, and any other capital or leverage requirements to which that particular bank is subject to. This relief is critical for small institutions that are burdened by Dodd-Frank's regulatory overreach and have a more difficult time complying with regulations than do their larger counterparts.

When does the Federal Reserve intend to begin implementation of this section of the legislation?

A.2. As you indicate, the recent Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) requires the appropriate Federal banking agency to create a simple leverage ratio framework for community banks with less than $10 billion in total consolidated assets. The Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) are working to issue a joint notice of proposed rulemaking that would seek feedback from community banks, consumers, and the broader public. The Agencies expect to issue the proposed joint rulemaking for public comment in the near future.

Q.3. Last spring the Federal Reserve proposed changes to the regulatory capital framework that were designed to simplify capital management and increase transparency. An important part of that proposal were changes to certain CCAR assumptions the Federal Reserve has previously made. Many of the proposed CCAR changes are improvements on the existing regulatory process and would be more accurate reflections of how companies and markets react during periods of economic stress.

It would therefore seem to be unnecessary to delay making these improvements only because similar proposals made by the Federal Reserve like the stress capital buffer need additional improvements.

Because the next iteration of the CCAR process is due to begin soon, will you commit to finalizing the CCAR changes that the Federal Reserve proposed and incorporate them into the 2019 CCAR exercise?

A.3. The changes associated with the stress capital buffer proposal would simplify the Federal Reserve's capital rules for large banks, while preserving strong capital levels that would maintain their ability to lend to households and businesses under stressful conditions. The Federal Reserve Board (Board) is carefully reviewing comments received on the stress capital buffer proposal, including on the proposed modifications of several assumptions in the Comprehensive Capital Analysis and Review (CCAR) process to better align them with a film's expected actions under stress. The Board is working to complete its review in a timely manner.

Q.4. On July 12, 2018, I sent you written questions following the April 19th hearing before the Committee. The question related to how you were going to help farmers, ranchers and manufacturers in South Dakota that use derivatives markets to manage their risk.

Specifically, I asked if you plan to recognize margin contributed by clients for cleared derivatives as offsetting under the leverage ratio.

In response, you said you would look closely at adjusting the treatment of initial margin under the leverage ratio and that the Basel Committee on Banking Supervision is reviewing this issue to understand the impact of the leverage ratio on incentives to clear over the counter derivatives.

The Financial Stability Board, the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions jointly considered incentives to clear derivatives. On behalf of the United States, the Federal Reserve and CFTC contributed to this effort. A follow-up report that was released on August 7th of this year found that the current regulatory treatment disincentivized client clearing.

Europe has already proposed an offset of initial margin under the leverage ratio.

Now that the issue has been studied, can you provide an update on the Federal Reserve's plan to provide an offset of initial client margin for cleared derivatives under the leverage ratio?

A.4. The Board is committed to domestic and international policy initiatives that support the use of well-regulated and well-managed central counterparties to clear derivative contracts. On October 30, 2018, the Agencies approved a joint proposal that would implement a new standardized approach for calculating the exposure amount of derivative contracts in the Agencies' risk-based and leverage capital rules. As part of that proposal, the Agencies are inviting comment on the recognition of initial margin provided by clearing member clients for purposes of the supplementary leverage ratio, and asking for comment on the recent Basel Committee on Banking Supervision proposal regarding the recognition of client collateral in the leverage ratio.[1] The proposal allows for a 60-day comment period, and the Board will review comments on the proposal after the comment period ends.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR PERDUE FROM RANDAL K. QUARLES

Section 401 Regulations

Q.1. Vice-Chair Quarles, when Congress wrote Section 401 of S. 2155, it amended Section 165 of Dodd-Frank to raise the SIFI threshold up from $50 billion to $250 billion, but granted the Board of Governors of the Federal Reserve the right to promulgate rules for bank holding companies between $100 billion and $250 billion under certain circumstances. I would suggest that this is a forward looking provision that should serve as a safety valve should one of the firms become systemic. This is the logical course in light of the fact that you regulate these firms now and have repeatedly determined that they are not systemic to the financial system.

Q.1.a. Since the Board has determined that there must be rules for bank holding companies between $100 and $250 billion to mitigate risks to U.S. financial stability and promote safety and soundness, would you be sharing with us the empirical data that demonstrates that there is sufficient risk to the financial system poised by individual institutions between $100 and $250 billion?

A.1.a. Section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) increased the minimum threshold for automatic application of enhanced prudential standards (EPS) from $50 billion to $250 billion. With respect to a bank holding company with total consolidated assets of between $100 billion and $250 billion, section 401 provides the Federal Reserve Board (Board) with discretion to apply EPS to a bank holding

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[1] See *https://www.bis.org/bcbs/pub1/d451.pdf.*

company if the Board determines the application of the standard or standards is necessary to prevent or mitigate risks to financial stability or promote safety and soundness, and taking into consideration size, complexity, and other risk-related factors. Consistent with these legislative changes and building on the Board's prior tailoring of its regulations, the Board is seeking comment on two proposals, one with the other Federal banking agencies, which would establish four categories of prudential standards for large U.S. banking organizations. The proposed categories would set forth a framework for determining the application of prudential standards to firms with total consolidated assets of $100 billion or more but less than $250 billion, and for differentiating the standards that apply to all firms subject to prudential standards based on their risk profile. The proposal would also implement section 401(e) of EGRRCPA, which requires the Board to conduct periodic supervisory stress tests for bank holding companies with $100 billion or more, but less than $250 billion, in total consolidated assets.

The failure of a bank holding company with total consolidated assets of $100 billion or more but less than $250 billion could have a more significant negative effect on economic growth and employment relative to the failure or distress of smaller firms. In addition, the standards that would be applied to institutions of this size under the proposal would help promote the safety and soundness of these institutions and address weaknesses observed during the financial crisis. For example, the liquidity risk management and buffer requirements help to ensure that a large banking organization is equipped to manage its liquidity risk and to withstand disruptions in funding sources. These requirements address weaknesses observed during the financial crisis, when many banking organizations did not have adequate risk management practices to take into account the liquidity stresses of individual products or business lines, had not adequately accounted for draws from off-balance sheet exposures, or had not adequately planned for a disruption in funding sources.

Q.1.b. Under the proposed rule, is it the Board's intention to apply a tailored version of the enhanced prudential standard on every institution between $100 and $250 billion or will the Board conduct an activity based risk analysis on each institution and impose a tailored enhanced prudential standard on institutions deemed too risky?

A.1.b. Please see the response to question 1(a).

Recalibration of Thresholds

Q.2. Vice-Chair Quarles, S. 2155 raised the SIFI threshold under Section 165 of Dodd-Frank from $50 billion to $250 billion.

Do you believe that S. 2155 gives the Board the impetus to reevaluate whether or not it should readjust all other regulations where the Board relied upon Section 165's $50 billion threshold figure?

A.2. On October 31, 2018, the Board issued two notices of proposed rulemakings, one jointly with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), seeking comment on a framework for determining the prudential standards that apply to large U.S. banking organizations, based on the risk profiles of these firms. The proposals would build on the Board's existing tailoring of its rules and account for changes made by section 401 of EGRRCPA regarding enhanced prudential standards for these firms. In particular, the proposals would modify the enhanced prudential standards applicable to large banking organizations, including domestic and foreign banking organizations with more than $250 billion in total consolidated assets, based on the risk profile of these films. In addition, the proposals would modify the thresholds for application of other requirements that rely on a $50 billion asset threshold, but which were not affected by EGRRCPA, such as the capital plan rule.

FBO Treatment

Q.3. Vice-Chair Quarles, I understand from your testimony that the Board will continue to use the global consolidated assets for foreign banking organizations. FBO operations in the United States cover a wide spectrum of activities that encompasses consumer and commercial banking, wealth management, and capital markets.

Q.3.a. Will the Board tailor treatment for FBOs to differentiate based upon their active footprint in the United States for example will there be different treatment between an entirely depository IHC and one that is heavily invested in the capital markets?

A.3.a. As noted in the previous answer, on October 31, 2018, the Board issued two notices of proposed rulemaking, one together with the OCC and FDIC, seeking comment on a framework for determining the prudential standards that apply to large U.S. banking organizations, based on the risk profiles of these firms. As noted in the proposals, the Board is considering the appropriate application of the categories of prudential standards described in the proposal to the U.S. operations of foreign banking organizations, in light of the special structures through which these firms conduct business in the United States. The Board plans to issue a separate proposal for public comment regarding foreign banking organizations that would reflect the principles of national treatment and equality of competitive opportunity.

Q.3.b. After the Board released the U.S. IHC rules in 2014 that required foreign banks to hold additional capital and liquidity in the United States. Brussels retaliated in 2016 with reciprocal standards that eventually forced both sides to hold additional capital and liquidity. Does geographic ring fencing make the international banking system safer?

A.3.b. The prepositioning of capital and liquidity in local jurisdictions can minimize the temptation of host jurisdictions to restrict the transfer of assets ("ring fencing") held locally of internationally active banking groups during a time of stress. Ring fencing of assets during stress can further exacerbate a stress event and destabilize a group. The Federal Reserve recognizes that an appropriate balance between centrally managed resources at the home country level and prepositioned capital and liquidity in host jurisdictions is the key to effective cooperation among home and host supervisors to resolve troubled banking groups.

Q.3.c. Is there a better solution than creating additional capital trapped on both sides of the Atlantic?

A.3.c. Across the globe supervisors recognize the benefits of efficient cross-border banking and efficient movement of capital and liquidity but are focused on minimizing the costs of cross-border resolutions given the experience with the recent financial crisis. The single-point-of-entry resolutions and bail-in concepts hold promise for minimizing resolution costs, but cooperation between home and host country supervisors is critical to achieving success. The Federal Reserve continues to be open to considering adjustments that would improve transparency and efficiency and will continue to reassess its regime relating to cross-border resolution.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM RANDAL K. QUARLES

Q.1. Under the agencies' proposal to simplify and tailor the regulations implementing the Volcker Rule, the proposed "accounting prong" would cover all purchases or sales of financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards, which would subject a significantly higher number of financial activities to the rule.

Q.1.a. Given the agencies' policy goals of simplification and tailoring, how do you intend to revise the proposal to remain faithful to these goals?

A.1.a. The accounting prong was intended to give banking entities greater certainty and clarity about what financial instruments would be included in firm trading accounts, and would therefore be subject to the requirements of the regulation. The proposal specifically requested comment as to whether the proposed accounting prong might be overly broad, and if there were alternatives or modifications to the accounting prong that may be more appropriate.

The comment period for the proposal revising the rule implementing section 13 of the Bank Holding Company Act closed on October 17, 2018. The agencies received and are reviewing the comments addressing the accounting prong. Federal Reserve Board (Board) staff is currently in the process of carefully considering all comments received on the proposed rule, and will consider comments on the accounting prong and metrics reporting, as well as on other the aspects of the rule.

Q.1.b. The proposed amendments to the Volcker Rule would also introduce new metrics that could result in a nearly 50 percent increase in metrics reporting.

How do you intend to revise the proposal to ensure that covered institutions are not subject to additional compliance burdens?

A.1.b. The proposal aims to streamline the metrics reporting and recordkeeping requirements under the current regulations by further tailoring or eliminating certain metrics and providing additional time for reporting. In furtherance of this goal, the proposal requested comment on a broad range of issues related to metrics reporting and recordkeeping requirements. As noted above, the comment period for the proposal closed on October 17, 2018, and the Board is currently in the process of carefully considering all comments received on the proposal rule, including those related to the proposed metrics reporting and recordkeeping amendments.

Q.2. Your comments in both the hearing and your speech to the Utah Bankers Association seem to imply that banks between $100-$250 billion in size will be subject to tailoring of the Section 165 Enhanced Prudential Standards (EPS). Tailoring, as you are aware, only applies to institutions subject to a given rule. As one of those involved in the drafting of S. 2155, my intent and that of my colleagues was that banks in that asset class be released from EPS application, hence the raising of the threshold to $250 billion. Therefore, tailoring would not need to apply to those institutions and was envisioned for those banks over the threshold that have substantially similar business models as those below the new $250 billion line.

Q.2.a. Why do you continue to use the term tailoring for institutions that are mandated to be carved out of EPS application?

A.2.a. When speaking of Federal Reserve regulatory policy, I often use the word "tailoring" to refer to the general concept of ensuring that the nature and stringency of regulation is appropriate to the nature and risk factors of the firms being regulated. Our objective should be that simpler and less risky firms are not subject to the regulatory burden of complying with measures more appropriate to larger and more complex firms. Section 165(a)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act refers to this concept in requiring the Federal Reserve Board (Board) to tailor the application of enhanced prudential standards (EPS), but in my view this is a specific instance of the tailoring concept rather than the entire definition of it. Accordingly, my use of the word tailoring with regard to the treatment under the Economic Growth, Regulatory Relief, and Consumer Protection Act (BGRRCPA) of institutions with assets between $100 billion and $250 billion is not intended to suggest that those firms should necessarily remain subject to some form of modified or "tailored" EPS, but rather that their treatment under BGRRCPA is an example of the tailoring concept, as is the framework we have proposed for determining when BPS would apply.

Section 401 of BGRRCPA made a number of changes to the scope of application of BPS. For example, as you observe, section 401 increased from $50 billion to $250 billion the threshold for automatic application of BPS to bank holding companies. With respect to a bank holding company with total assets of between $100 billion and $250 billion, section 401 provides the Board with discretion to apply EPS to a bank holding company if the Board determines that application of the standard or standards is necessary to prevent or mitigate risks to financial stability or promote safety and soundness, taking into consideration size, complexity, and other risk-related factors: Under section 401(e) of BGRRCPA, the Board is required to conduct periodic supervisory stress tests of bank holding companies with $100 billion or more, but less than $250 billion, in total consolidated assets.

In light of these amendments, and consistent with the Board's ongoing refinement and evaluation of its regulations and supervisory program, the Board is seeking comment on a proposal that would establish four categories of prudential standards for large U.S. banking organizations. The proposed framework would determine the application of prudential standards to firms with total consolidated assets of $100 billion or more but less than $250 billion, and would differentiate the standards that apply to all firms subject to prudential standards based on their size, complexity, and other risk-based factors.

Q.2.b. Is it your view that the legislation begins with the presumption that those banks remain subject to EPS? Or, as the legislation clearly spells out, is it your understanding that those banks are out and that only through an empirically demonstrated determination can they be put back in?

A.2.b. As noted in my response to question 2(a), section 401 of EGRRCPA increased the threshold for automatic application of EPS from $50 billion to $250 billion. With respect to a bank holding company with total consolidated assets of between $100 billion and $250 billion, section 401 provides the Board with discretion to apply EPS to a bank holding company if the Board determines the application of the standard or standards is necessary to prevent or mitigate risks to financial stability or promote safety and soundness, and taking into consideration size, complexity, and other risk-related factors. Consistent with these statutory changes, the Board is seeking comment on a proposed framework to determine the application of prudential standards for large U.S. banking organizations—those with $100 billion or more in total assets-based on their risk profiles. Specifically, the proposed framework would take into consideration the risk profile of a large banking organization based on the following risk indicators: size, cross-jurisdictional activity, weighted short-term wholesale funding, off-balance sheet exposure, and nonbank assets. By taking into consideration the relative importance of each risk factor, the proposal would provide a basis for assessing a banking organization's financial stability and safety and soundness risks. The proposal also would implement section 401(e) of EGRRCPA, which requires the Board to conduct periodic supervisory stress tests of bank holding companies with $100 billion or more, but less than $250 billion, in total consolidated assets.

Q.3. After NASDAQ became an exchange in 2006, it is my understanding that the Federal Reserve has not undertaken any effort to update its rules to provide a pathway to margin eligibility for companies traded over-the-counter (OTC). Margin eligibility of OTC-traded stocks can be an important part of the growth of small and emerging companies, as it helps to improve the market quality of those securities, impact an investor's willingness to purchase those securities, and as a result have a direct impact on capital formation. In addition, U.S. investors in the American depositary receipts (ADR) for Roche [$10 billion yearly net income] and other large, international OTC-traded firms are also negatively impacted by the Federal Reserve's inaction on this issue.

Will the Federal Reserve take action to revive the margin list for certain OTC securities? If not, please explain why.

A.3. Responding to your question above and as previously posed regarding the List of Over-the-Counter Margin Stocks (OTC List) that is no longer published by the Federal Reserve Board (Board), staff have continued to monitor OTC market developments in the years since the publication of the OTC List ceased. Any expansion of the types of securities that are margin eligible would require careful consideration by the Board of the benefits of such an approach weighed against potential increased burden on banks and other lenders.

Please know that I appreciate your concerns as noted in your questions, and we are looking into potential approaches that may be considered while ensuring any changes would not pose additional regulatory burdens. By way of background, I am including a brief summary of the history of the Board's OTC List.

In 1968, Congress amended section 7 of the Securities Exchange Act of 1934 (SEA) to allow the Board to regulate the amount of credit that may be extended on securities not registered on a national securities exchange, or those securities known as "over-the-counter" or "OTC" securities. The following year, the Board adopted criteria to identify OTC stocks that have "the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer" to warrant treatment similar to equity securities registered on a national securities exchange. The Board's first periodically published OTC List became effective on July 8, 1969.

In 1975, Congress further amended the SEA to direct the Securities and Exchange Commission (SEC) to facilitate the development of a "national market system" (NMS) for securities to accomplish several goals, including price transparency. The SEC's criteria for NMS securities came to cover both exchange-traded stocks (which were always marginable) and a subset of stocks traded on NASDAQ, the largest and most technologically advanced over-the-counter market at that time. The majority of the securities traded on NASDAQ's NMS tier were covered by the Board's OTC margin stock criteria and appeared on the Board's OTC List. The Board's analysis, however, indicated that the liquidity and other characteristics of NMS securities generally compared favorably with those of exchange-traded securities. Accordingly, the Board amended its margin regulations in 1984 to give immediate margin status to OTC securities that qualified as NMS securities without regard to whether the stock appeared on the Board's OTC List. This action established a precedent for relying on NMS status under SEC rules as a substitute for identifying margin-eligible OTC securities through the application of Board-established criteria.

The Board ceased publication of its OTC List in 1998, and provided margin status to all securities listed on the NASDAQ Stock Market, after NASDAQ raised the listing standards for non-NMS securities trading on its market, making them comparable to those traded on national securities exchanges. Indeed, NASDAQ subsequently became a national securities exchange.

Q.4. Recently the "Interagency Statement Clarifying the Role of Supervisory Guidance" was issued. I think this directive is a very important step in ensuring that the regulation and supervision of financial institutions is conducted pursuant to legal standards. Each of you is the leader of an organization that has thousands of employees and examiners and are responsible for its implementation.

Q.4.a. How are you making sure examiners on the ground are following this statement?

A.4.a. We have taken a number of steps to reaffirm the role of supervisory guidance in our communications to examiners and to supervised institutions. First, on October 4, 2018, we conducted an internal, mandatory training session for all our supervisory staff to reinforce the distinctions between laws and regulations versus guidance and to clarify the use of guidance in the supervisory process. Second, we are helping examiners with outreach to supervised institutions in answering questions about the policy statement. Third, we are reviewing the templates examiners use when they reference supervisory guidance in their communications with supervised institutions. Fourth, we will continue to review supervisory findings to confirm that our examiners are referencing guidance appropriately. Finally, we regularly solicit the views of the firms we supervise on our supervisory process to include their views on our use of guidance in supervisory communications.

Q.4.b. Have you considered a formal rulemaking so that staff take this important statement seriously?

A.4.b. We have not yet assessed whether this matter should be the subject of a formal rulemaking, but we will consider this question in conjunction with our fellow regulators. This is an important issue. We are taking steps to ensure our examiners understand the issues and are acting in accordance with the public statement. We have a range of tools to ensure that examiners are following directives and instructions from the Board. As indicated above, we have already employed some of those tools in this particular case. If we determine that the steps we have employed so far are not sufficient, we will escalate the issue and take additional steps. But so far, we have evidence that our examiners understand the issues and are acting in accordance with the public statement.

Q.4.c. How will you independently verify that this statement is followed? (audits, surveys from supervised entities, other independent verification)

A.4.c. As described above, we will review samples of supervisory findings to confirm that our examiners are appropriately referencing supervisory guidance. As also noted, we regularly solicit feedback from supervised firms regarding our supervisory process, to include their views on our use of guidance in supervisory communications.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM RANDAL K. QUARLES

Q.1. I was the Attorney General of Nevada during the financial crisis and saw first-hand how big banks targeted vulnerable people and communities of color. This is exactly why it was so important that the CFPB required more data collection and more oversight over lending activities. The law signed by President Trump earlier this year eliminated some of the data we need to preserve this progress. Despite the loss of public HMDA data, each of your agencies still has a requirement to ensure that Latinos, African Americans, women and other people are not rejected for loans due to their gender or ethnicity.

Q.1.a. How many lenders supervised by your agency will not publicly report the additional data that was to be required this year? This data includes loan characteristics like credit score, fees, points, and interest rates.

A.1.a. With respect to Home Mortgage Disclosure Act (HMDA), the Federal Reserve supervises approximately 800 State member banks. Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) exempts certain institutions from reporting the additional HMDA data fields required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[1] However, institutions exempted by EGRRCPA that meet HMDA's data reporting threshold[2] must continue to report the HMDA data fields that are not the additional fields required by the Dodd-Frank Act. Based on previous HMDA reporting, approximately 350 of the Federal Reserve's supervised institutions will not be required to report the additional HMDA data fields.

Q.1.b. Would it have been easier to spot fair lending violations with transparent data reporting, rather than relying on your bank examiners to go bank by bank, loan by loan to root out discrimination?

A.1.b. The Federal Reserve's fair lending supervisory program reflects our commitment to promoting financial inclusion and ensuring that the financial institutions under our jurisdiction fully comply with applicable Federal consumer protection laws and regulations. For all State member banks, we enforce the Fair Housing Act, which means we can review all Federal Reserve-regulated institutions for potential discrimination in mortgages, including potential redlining, pricing, and underwriting discrimination. For State member banks of $10 billion or less in assets, we also enforce the Equal Credit Opportunity Act, which means we review these State member banks for potential discrimination in any credit product. Together, these laws prohibit discrimination on the basis of race, color, national origin, sex, religion, marital status, familial status, age, disability, receipt of public assistance, and the good faith exercise of rights under the Consumer Credit Protection Act (collectively, the "prohibited basis").

We evaluate fair lending risk at every consumer compliance exam based on the risk factors set forth in the 2009 Interagency Fair Lending Examination Procedures (Procedures).[3] The Procedures set forth risk factors for several types of potential fair lending issues. For example, a risk factor for potential discrimination

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[1] See EGRRCPA, § 104(a), Pub. L. No. 115–174, 132 Stat. 1296 (2018).

[2] In general, if a financial institution has assets exceeding $45 million and originated at least 25 closed-end mortgage loans in each of the two preceding calendar years, or originated at least 500 open-end lines of credit in each of the two preceding calendar years, it must meet the HMDA reporting requirements for its asset size. See A Guide To HMDA Reporting: Getting it Right!, Federal Financial Institutions Examination Council (Eff. Jan. 1, 2018), *https://www.ffiec.gov/Hmda/pdf/2018guide.pdf.*

[3] See Interagency Fair Lending Examination Procedures (August 2009), available at: *https://www.ffiec.gov/pd/fairlend.pdf.*

in pricing is the presence of a financial incentive for loan officers or brokers to charge higher prices for loans. Provisions in EGRRCPA related to HMDA data collection requirements for certain institutions will not affect the Federal Reserve's ability to fully evaluate the risk of mortgage pricing or underwriting discrimination. If warranted by risk factors, the Federal Reserve will request any data related to relevant pricing and underwriting criteria, such as the interest rate and credit score. These data can be requested from any Federal Reserve-supervised institution, including the institutions that were exempted from reporting additional HMDA data by EGRRCPA. The Federal Reserve's analysis then incorporates the additional data to determine whether applicants with similar characteristics received different pricing or underwriting outcomes on a prohibited basis (for example, on the basis of race), or whether legitimate pricing or underwriting criteria can explain the differences.

Q.1.c. Without the expanded HMDA data reporting slated to begin this year, what information will your agency's examiners have to trigger a review of potential discrimination?

A.1.c. As previously noted, the Federal Reserve is committed to promoting financial inclusion and a fair and transparent financial service market place. We take seriously our responsibilities to ensure that the financial institutions under our jurisdiction comply with applicable Federal consumer protection laws and regulations and evaluate fair lending risk at every consumer compliance exam based on the risk factors set forth in the Procedures.[4] With respect to potential discrimination in the pricing or underwriting of mortgages, if warranted by risk factors, the Federal Reserve will request data beyond the public HMDA data, including any data related to relevant pricing or underwriting criteria, such as applicant interest rates and credit scores. As noted in response to the subpart above, the Federal Reserve's practice of requesting data relevant to pricing and underwriting criteria, where warranted by risk factors, pre-dates EGRRCPA's enactment, and the practice will continue.

As noted in the prior response, exemptions of HMDA data reporting under EGRRCPA will not affect the Federal Reserve's ability to fully evaluate the risk of mortgage pricing or underwriting discrimination at these institutions, as data can be requested from any Board-supervised institution, including the institutions that were exempted from reporting additional HMDA data by EGRRCPA. Such additional data inform analysis that helps to determine whether applicants with similar characteristics received different pricing or underwriting outcomes on a prohibited basis (for example, on the basis of race), or whether legitimate pricing or underwriting criteria can explain the differences.

Community Reinvestment Act

Q.2. We have a massive affordable rental housing crisis in Nevada: 119,854 families pay more than half their income for rent.

[4] *Id.*

One of the few resources we have is the Low Income Housing Tax Credit. The new tax law is already making it harder to finance low-income housing because the cost of the credit has fallen.

Q.2.a. Will you commit to ensure that any changes you consider to the Community Reinvestment Act make Federal tools like the Low Income Housing Tax Credit and New Market Tax Credit work better in communities?

A.2.a. The Federal Reserve is committed to supporting efforts to facilitate credit flows to support creditworthy consumers and businesses in all communities, including in low- and moderate-income areas, to further economic development. We recognize the important role that tax credit programs have played in bringing private capital to lower-income communities for the financing of housing and other community projects. A bank can receive credit under its performance evaluation under Community Reinvestment Act (CRA) when the investments primarily benefit low- and moderate-income populations or communities.

Given that the Low Income Housing Tax Credit and the New Market Tax Credit programs provide important investment vehicles to support affordable housing and community economic development, our objective in modernizing the CRA regulations will be to ensure that they will continue to receive CRA consideration.

Q.2.b. Nonbanks provide more than half of all mortgages in this country. Six of the 10 largest mortgage lenders are not banks. Do you think nonbank mortgage lenders should be covered by the Community Reinvestment Act?

A.2.b. We recognize that the financial services marketplace is highly competitive and has many more nonbank participants than there were when the CRA was enacted, which has resulted in more retail lending activity taking place outside insured depository institutions. An expansion of coverage of the CRA would require congressional action. The Federal Reserve stands ready to implement any statutory changes that Congress may deem appropriate.

Section 108: Escrow Requirements

Q.3. For generations, lenders understood that they should require property taxes and homeowners insurance be placed in escrow, so that those obligations are always paid on time. But in the run-up to the foreclosure crisis, lenders cut corners so that they could misrepresent monthly payments to homeowners and put them into obligations they couldn't afford.

Q.3.a. How will your agencies monitor the implementation of the escrow exemption? Will your examiners monitor foreclosure activities resulting from unpaid property taxes and/or property insurance?

A.3.a. Section 108 of the EGRRCPA directs the Bureau of Consumer Financial Protection ("Bureau") to issue rules to adjust the threshold below which an institution is exempt from escrow requirements related to higher-priced mortgage loans. The Bureau has indicated in its Fall 2018 Unified Agenda that it is currently in a pre-rulemaking phase with respect to this provision. Once the Bureau engages in the rulemaking process, the Board will fulfill our consultative role as required by the Dodd-Frank Act.

The Federal Reserve monitors conditions in the residential real estate market, including mortgage performance trends associated with foreclosures. We remain committed to supervising for safety and soundness and enforcing applicable consumer protection laws. We also expect the financial institutions we supervise to underwrite residential mortgage loans in a prudent fashion and to address key risk areas in their residential mortgage lending programs, including borrower payment obligations.

Q.3.b. How will you communicate any findings or concerns from the elimination of the escrow requirement to us in Congress?

A.3.b. As you know, supervisory findings of examinations at individual banks are confidential. To the extent that the Board identifies areas for supervisory risk or concern at a broader level, we note such issues in various mediums, including our Annual Report, recently published Supervision and Regulation Report, Consumer Compliance Supervision Bulletin, as well as the Semi-Annual Supervision testimony and webinars such as "Ask the Fed" and "Outlook Live" to inform the industry, policymakers, and the public of such concerns.

RESPONSES TO WRITTEN QUESTIONS OF SENATORS WARNER, COTTON, TILLIS, AND JONES FROM RANDAL K. QUARLES

Q.1. Comptroller Otting has testified before that "the process for complying with current BSA/AML laws and regulations has become inefficient and costly." In talking with banks/credit unions it is clear that they do not object to the principle of complying with AML regulations, it is that they feel that much of the time, effort, and money spent on compliance is ineffective, and therefore, a waste of time. Banks/credit unions fill out forms invented in the 1970s and have little insight into whether it is doing any good. And we've heard from banks/credit unions that they believe AML examinations are done without respect to the riskiness of the institution or its activities.

Q.1.a. What improvements can be made so we have a cheaper & faster system that is better at catching criminals?

A.1.a. The Federal Reserve supports efforts to review the efficiency and effectiveness of the Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance framework for the banking organizations we supervise. To that end, the Federal Reserve is participating in a Treasury-led working group that will examine the BSA/AML framework, including the risk-focused approach to the examination process, and potential innovative ways in which financial institutions identify, detect, and report financial crime while still meeting the requirements of the statute and supporting law enforcement. Furthermore, in 2017, the Federal Reserve and other Federal banking agencies completed a review of regulations prescribed by the agencies to identify outdated, unnecessary, or overly burdensome regulations, consistent with the statutory mandate under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). As part of this review, several commenters suggested changes to the reporting requirements imposed under the regulations issued by Treasury's Financial Crimes Enforcement

Network (FinCEN). The Federal banking agencies have referred these EGRPRA comments to FinCEN as the agency with the responsibility and authority to amend the reporting obligations for banks under the BSA.

Q.1.b. Is there a place in a new AML regime for new technology, like artificial intelligence or machine learning?

A.1.b. The Federal Reserve recognizes that innovation by the private sector, including new ways of using existing tools and adopting new technologies, has the potential to improve the efficiency and effectiveness of a regulated institution's BSA/AML compliance program. While the Federal Reserve supports efforts by the banks we supervise to innovate, banks should also be prudent in evaluating the risks associated with any new technology and address information security issues, third-party risk management, and compliance with other applicable laws and regulations, including those related to customer notifications and privacy.

Q.1.c. What do you, as a regulator, think that it means to have a risk-based AML program?

A.1.c. A BSA/AML compliance program begins with a well-developed and documented risk assessment that identifies and limits the banking organization's risk exposure through its products, services, customers, and geographic locations. The Federal Reserve expects banking organizations to structure their BSA/AML compliance programs to adequately address their risk profiles, as identified by the risk assessment. Banking organizations should understand their BSA/AML risk exposure and develop the appropriate policies, procedures, and processes to monitor and control BSA/AML risks. It is essential that banking organizations make a judgment with respect to the level of risk customers pose. For example, the bank monitoring systems to identify, research, and report suspicious activity should be risk-based, with particular emphasis on higher-risk products, services, customers, entities, and geographic locations as identified by each bank's BSA/AML risk assessment.

Q.1.d. How do you implement the risk-based AML program requirement through examinations?

A.1.d. The Federal Reserve's BSA/AML examinations are risk-focused, so that supervisors apply the appropriate level of scrutiny to higher-risk business lines. To ensure consistent design and execution of our BSA/AML examinations, the Federal Reserve uses procedures developed jointly with the Federal Financial Institutions Examination Council (FFIEC),[1] FinCEN, and the Department of Treasury's Office of Foreign Assets Control (OFAC). The findings of the Federal Reserve's BSA/AML reviews are taken into account in determining examination ratings. The scoping and planning of an exam, such as the number of examiners and the length of the exam, is informed by the money laundering and terrorist financing risk profile of the supervised entity.

[1] The FFIEC is an interagency body made up of the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the National Credit Union Administration, as well as a State liaison committee comprised of State supervisors.

The Federal Reserve reinforces its supervisory program by conducting targeted examinations of financial institutions vulnerable to illicit financing. Banks are selected for such examinations based on a variety of factors including our analysis of the institution's payments activity, suspicious activity reports (SARs), currency transaction reports, and law enforcement activity.

Q.2. One common criticism of the current AML regime is the lack of feedback given to banks/credit unions after they file their SARs. The current system is extremely segmented, and as a consequence, it is not the "fault" of any one entity that there is little feedback given. But without a system to provide feedback, the quality of SARs suffer. A system that doesn't focus on the quality of reports being filed is one that is not optimized to catch criminals. Many banks/credit unions wish that they had an idea of what FinCEN is really trying to find, because then their cooperation and input might be more helpful and effective.

Q.2.a. How often does your agency meet with FinCEN and with the DOJ/FBI to discuss the usefulness of suspicious activity reports that are being filed?

A.2.a. As you know, the Federal Reserve does not have the authority to conduct criminal investigations or to prosecute criminal cases. Rather, the Federal Reserve and other Federal banking agencies ensure that suspected criminal activity is referred to the appropriate criminal authorities for prosecution, and the BSA rules are intended to achieve this purpose. Accordingly, the Federal Reserve relies on the Justice Department, other law enforcement agencies, and FinCEN as the primary liaison for law enforcement, to communicate whether the reporting obligations of banks are furthering law enforcement's objectives. Indeed, communication among law enforcement, FinCEN, and the banking industry is important to maintaining a high degree of usefulness in SAR reporting.

The Federal Reserve has regular contact with the agencies that have responsibility for the administration and enforcement of the BSA, including through participation in the FFIEC. The FFIEC has a BSA working group that meets monthly to discuss relevant issues and that includes representatives from FinCEN. In addition, the Federal Reserve participates in the Bank Secrecy Act Advisory Group (BSAAG), a public-private partnership established by Congress for the purpose of soliciting advice on the administration of the BSA, which facilitates sharing of information on regulatory policies and initiatives, industry developments, and emerging money laundering threats. As part of these ongoing initiatives, as well as other collaborations between FinCEN and the Federal banking agencies, the Federal Reserve has encouraged FinCEN to further consider ways to facilitate appropriate information sharing between the agencies and supervised institutions related to suspicious activity reporting.

Q.2.b. When a bank/credit union files a SAR, or a regulator is examining a financial institution, how much feedback is there across the system about whether or not the SARs they filed were found to be useful, informative, or effective?

A.2.b. The Federal Reserve examines, on a regular basis, institutions for which we have been granted supervisory authority from Congress and, through that activity, we provide feedback to institutions regarding their BSA/AML programs and their policies and procedures for monitoring, identifying and reporting suspicious activity to law enforcement. Federal Reserve examiners routinely discuss with management any supervisory concerns that arise during the examination with respect to the institution's BSA/AML program. These types of less formal communications are well-suited to address any deficiencies or violations of law that can be addressed while examiners are still onsite. Problems that cannot be easily corrected are formally reported to the institution in an examination report or supervisory letter as a matter requiring management's attention. Supervision staff will subsequently follow up on management's actions and engage in additional dialogue with the institution as needed to address our concerns. Importantly, the Justice Department is the agency with the authority to prosecute any suspected criminal activity identified and reported by the institutions we supervise. Accordingly, Federal Reserve examiners are not in a position to discuss with management the value of any information the institution has presented as part of a SAR.

Q.2.c. What are the legal hurdles that prevent more effective and more regular feedback within the Federal Government and between the Federal Government and financial institutions?

A.2.c. As described above, the Federal Reserve has exercised the authority provided by Congress to examine the BSA/AML compliance programs of the institutions we supervise and to provide feedback at appropriate points during the examination process. Notwithstanding our supervisory role, the Federal Reserve, like other Federal banking agencies, does not have unrestricted access to the information obtained by law enforcement officials during a criminal investigation that results from the filing of a SAR, nor does it have the authority to interpret the policies and regulations that govern the protection and release of information that Justice Department officials obtain in the course of these investigations.

Q.2.d. Will you pledge to institutionalize feedback mechanisms wherein banks/credit unions both get and can give feedback on how to constantly improve the process?

A.2.d. The Federal Reserve will continue to carry out its mandate from Congress to examine the BSA/AML programs of the institutions we supervise, and to provide feedback at appropriate points during the supervisory process. As noted above, the Federal Reserve relies on the Justice Department, other law enforcement agencies, and FinCEN to communicate whether the reporting obligations of banks are furthering law enforcement's objectives. We also support efforts by these agencies to share information with the financial institutions as appropriate.

Q.3. We hear from banks that they feel pressured to file SARs even when they believe the underlying transaction or activity does not rise to a level of suspiciousness that merits a filing. They say they do this because they are afraid of being second-guessed by examiners after the fact, and because there is no Government penalty for over-filing SARs—only a penalty for not filing a SAR. But banks bear the significant cost of filing unnecessary SARs.

What can be done to realign incentives so that banks/credit unions don't feel pressured to file SARs that they don't feel reflects activity warranting a filing?

A.3. When conducting a BSA/AML examination, the Federal Reserve utilizes procedures contained in the interagency examination manual that was developed jointly between the Federal Reserve and the other members of the FFIEC in consultation with FinCEN. The FFIEC manual describes the regulatory expectations for suspicious activity reporting requirements and explains how examinations will be performed. The interagency examination manual recognizes that the decision to file a SAR under the reporting requirement is an inherently subjective judgment. The manual directs examiners to focus on whether the institution has an effective SAR decision-making process, not individual SAR decisions. The Federal Reserve, along with the other Federal banking agencies, provides ongoing training opportunities to its examiners regarding BSA topics and various aspects of the BSA examination process.

The Federal Reserve recognizes that existing regulatory requirements governing the filing of SARs have prompted criticism due to the concern that they encourage institutions to report transactions that are unlikely to identify unlawful conduct. Recently, the Federal Reserve and the other Federal banking agencies completed a review of regulations consistent with the statutory mandate under EGRPRA. As part of this review, several commenters suggested regulatory changes to SAR and other reporting requirements, which were referred to FinCEN. FinCEN is the delegated administrator of the BSA, and any changes to SAR or other reporting requirements would require a change in FinCEN's regulations.

Q.4. Banks/credit unions commonly use "rules-based" software to screen transactions and alert AML compliance teams to suspicious activities. While these rules-based systems can be effective, we have concerns that they might not be the most effective tool available to us given advances in data science and machine learning, and further, that there may be opportunities for criminals to manipulate these rules-based systems.

Q.4.a. We have heard concerns that many criminals have access to the exact same products that are used by financial institutions—is this true?

A.4.a. Some financial institutions have implemented commercially available suspicious activity monitoring systems that use rules to identify suspicious activity, based on certain thresholds, geographies, and other factors. These rules may be common among multiple financial institutions or developed from publicly available lists of red flags, high-risk jurisdictions and other data. That does not, however, mean that these systems are not effective in monitoring for suspicious activity. Many systems have overlapping and complementary rules that are designed to resist manipulation. Moreover, financial institutions are periodically required to independently test the effectiveness of their suspicious activity monitoring systems.

Q.4.b. If criminals have access to similar products, or can easily come to understand the rules-based system, how easy is it to manipulate these detection systems?

A.4.b. Please see answer to 4(a) above.

Q.4.c. If there was a proven model of using a "learning," algorithmic system to flag potentially suspicious transactions, would this be an improvement on the current system? What are the hurdles to financial institutions adopting such systems?

A.4.c. As stated above, the Federal Reserve recognizes that innovation has the potential to augment aspects of banks' BSA/AML compliance programs, such as risk identification, transaction monitoring, and suspicious activity reporting. As with all applications and technologies that firms employ, the Federal Reserve expects financial institutions to innovate in a responsible manner and to consider and address information security issues, third-party risk management, and compliance with other applicable laws and regulations, including those related to customer notifications and privacy.

Q.4.d. In what ways is a bank's/credit union's "safety and soundness" implicated by its AML system?

A.4.d. A review of an institution's compliance with the BSA has been part of the Federal Reserve's supervision of banks for many years, and is integrally related to our assessment of an institution's safety and soundness. The Federal Reserve expects the institutions we supervise to identify, measure, monitor, and control the risks of an institution's activities. The inability to properly manage legal and compliance risk, for example, can compromise a bank's safety and soundness by reducing the confidence of its customers and counterparties and result in loss of capital, lower earnings, and weakened financial condition. For these reasons, Congress amended the Federal Deposit Insurance Act in 1986 to require the Federal Reserve and other Federal banking agencies to review the BSA/AML compliance program of the banks we supervise at each examination.

Under current interagency ratings guidance, the capability of the board of directors and management to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in the management or "M" component rating of banking agencies' CAMELS supervisory rating system. The Federal Reserve has established procedures to ensure that BSA/AML deficiencies are fully considered as part of an institution's management rating. Moreover, we direct our examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's management component rating.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN CRAPO FROM JELENA McWILLIAMS

Some provisions of S. 2155 may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking. The Congressional Review Act requires agencies to submit, with certain minor exceptions, all rules to Congress for review. Under the Congressional Review Act, a rule, by definition, is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." This definition is very broad. In order to ensure Congress can engage in its proper oversight role, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Q.1.a. Can you commit to following the law by submitting all rulemakings and guidance documents to Congress as required by the Congressional Review Act?

A.1.a. The Federal Deposit Insurance Corporation (FDIC) is committed to submitting all rulemakings and any guidance or other agency documents that meet the definition of "rule" under the Congressional Review Act (CRA) to Congress as required by the CRA.

Q.1.b. On July 6, 2018, the Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency issued an Interagency Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[1] It is my understanding that the Interagency Statement would qualify as a rule under the Congressional Review Act. Have the agencies submitted the Interagency Statement to Congress as required by the Congressional Review Act?

If not, can you commit to submitting the Interagency Statement to Congress?

A.1.b. The FDIC is committed to submitting all rulemakings and any guidance or other agency documents that meet the definition of "rule" under the CRA. The FDIC is currently reviewing the application of the CRA to documents such as the Interagency Statement issued on July 6.

Section 165 of Dodd-Frank established a $50 billion, and in some cases a $10 billion, threshold in total consolidated assets for the application of enhanced prudential standards. Such thresholds have been applied in rulemakings and guidance documents consistent with Dodd-Frank's requirements. As an example in 2012, regulators issued jointly supervisory guidance on company-run stress testing for banks with more than $10 billion in assets. The regulators have also applied numerous other standards using either the $10 billion or $50 billion asset threshold to be consistent with Section 165 of Dodd-Frank. For example, banks with $50 billion or more in total assets have historically been subject to CCAR, a supervisory test not required by statute.

Q.2. Can you commit to reviewing all rules and guidance documents referencing thresholds consistent with Section 165 of Dodd-Frank, and revise such thresholds to be consistent with S. 2155?

A.2. Please reference my letter to Chairman Crapo dated October 17, 2018, in response to this question, discussing the FDIC's

[1] See *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf.*

ongoing holistic review of its rules, regulations, guidance documents, and policies.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JELENA MCWILLIAMS

Q.1. Did these two applications raise issues that warrant the FDIC to review the current application process? If so, please describe those issues.

A.1. The Federal Deposit Insurance Corporation (FDIC) cannot comment on any specific applications. The FDIC is committed to working with any group interested in starting a *de novo* financial institution. Since beginning my tenure as Chairman, I have made it a priority to improve the *de novo* application process, provide additional technical assistance to applicants, and ensure the FDIC gives due consideration to deposit insurance applications that meet the statutory requirements of the FDIA. The FDIC evaluates all deposit insurance applications—including applications from entities that seek to be ILCs—under the framework of the statutory factors enumerated in section 6 of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1816.

Q.2. As the FDIC reviews industrial loan company (ILC) applications, please describe how the FDIC will consider: the risks posed to the Deposit Insurance Fund (DIF) by mixing banking and commerce; how ILC charters may create an unlevel playing field when compared to holding companies of banks and thrifts subject to consolidated supervision; and how the FDIC's examination, regulation and supervision authorities may or may not be sufficient to protect the DIF when the ILC is held by a commercial firm.

A.2. As with all other charter types, ILCs are considered depository institutions and such applications are reviewed under the framework of the statutory factors enumerated in Section 6 of the FDIA. ILCs may be insured if the application satisfies the statutory factors, including any potential risk to the DIF, and other requirements for deposit insurance. Applications should reflect, among other characteristics, a stand-alone, value-building franchise; viable long-term strategies; reasonable growth projections; appropriate diversification; acceptable capitalization and funding strategies; capable management; and appropriate risk management strategies given the underlying business model.

The safety and soundness of a given institution, including an ILC, depends on the characteristics of the institution. The risks posed depend on the appropriateness of the business plan, management's competency, risk-management processes, and the level of capital, among other factors. The FDIC uses a risk-focused supervision approach and assesses the condition and trends of each ILC using the CAMELS rating system using on- and off-site monitoring.

Because ILCs are not "banks" for purposes of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)), the parent companies of ILCs are not holding companies regulated by the Federal Reserve. The FDIC, in its examination and supervision of a given ILC, will pursue strategies to mitigate any potential risks related to the parent company structure. These include the use of parent company agreements, as well as capital and liquidity maintenance agreements. Additionally, when a parent company of an ILC has become troubled, the FDIC has successfully insulated the insured institutions from the troubled parent by imposing controls through Cease and Desist Orders. One common provision in such orders is to require prior regulatory approval of any affiliate transactions to prevent any improper actions by the parent.

Past experience, including the recent financial crisis, suggests that the FDIC's supervisory and enforcement authorities are sufficient to protect the DIF when the ILC is held by a commercial firm. Despite the failure and bankruptcy of a number of ILCs' parents, only two ILCs failed during the recent crisis, neither as a result of problems at the parent level. Other ILCs' parent companies or affiliates experienced severe stress, but their ILCs did not fail.

Q.3. In your testimony you indicated that the FDIC will seek comments on the current brokered deposit regulations later this year. Section 202 did not require the FDIC to take a broader look at the regulations for brokered deposits.

What led the FDIC to decide begin a process to take comments on brokered deposits regulation more generally?

A.3. As I said in my opening statement at the hearing, I am particularly interested in revisiting FDIC regulations that have not received recent or comprehensive public input. The FDIC's approach to brokered deposits and interest rate restrictions is one example. On December 18, the FDIC issued an advanced notice of proposed rulemaking seeking comments on brokered deposits and interest rate restrictions.

The banking industry has undergone significant changes since the law restricting brokered deposits and interest rates was first enacted in 1989. The regulations implementing the brokered deposit restrictions have not been revised since 1992, and the regulations implementing the interest rate restrictions were last revised in 2009. As such, the FDIC is soliciting comments on whether and how the regulations should be updated.

Q.4. In your testimony you stated that the FDIC will rescind more than one-half of its financial institution letters (FILs), over 400 letters.

Please outline the process that the agency will undertake to review each FIL, and how it will determine that the FIL is no longer needed or superseded.

A.4. The FDIC staff began reviewing the Financial Institution Letters (FILs) listed on the FDIC's public website to determine whether each FIL should remain active or be moved to an inactive status on the FDIC's website because it is no longer applicable, redundant, or has been replaced by more recent guidance. This comprehensive review found 664 active FILs issued between 1995 and the end of 2017 that relate to Risk Management Supervision. The FILs that had outdated content, or content that had been incorporated into a regulation or an examination policy manual/handbook, or were otherwise available on the FDIC website were proposed to be retired and moved to archived inactive status. This review identified 374 risk management FILs that were proposed to be retired.

On September 10, 2018, the FDIC solicited public comment on the proposed retirement of the 374 FILs. Sixteen comments were received, the majority of which support rescinding the 374 FILs. Because these 374 FILs are no longer applicable, redundant, or have been replaced by more recent guidance and public comments raised no additional issues with such FILs being archived, the FDIC has moved those FILs to archived inactive status.

In addition to the retirement of the 374 risk management FILs, the FDIC also reviewed the contents of the remaining FILs to identify those that need to be updated, revised, or consolidated with other outstanding FILs. For example, the FDIC worked with the other banking agencies to update and streamline a FIL issued in 2015 regarding Frequently Asked Questions on Appraisals.

The FDIC's Division of Depositor and Consumer Protection (DCP), which is responsible for the FDIC consumer compliance supervision program, began a similar FIL review process in the summer of 2018. FDIC staff members with subject matter expertise in the FIL topic areas were asked to review the FILs and to determine whether they should remain active or if they should be moved to archived inactive status, similar to their Risk Management Supervision counterparts. After the review process, 119 FILs have been moved to archived inactive status.

Q.5. The FDIC has previously dedicated resources to research on the current state of community banks—the Community Banking Initiative.

Under your leadership, will this continue, what issues will it prioritize, and what is the ongoing research it is conducting?

A.5. The FDIC will continue to place a high priority on understanding trends affecting community banks. Community banks, as defined by the FDIC for research purposes, are general-purpose financial institutions that take deposits and make loans within a relatively small geographic area. The vast majority of FDIC-insured institutions are community banks, and every quarter since 2014, the FDIC has published analysis in the *Quarterly Banking Profile* specifically addressing the condition and performance of this important segment of the banking industry.

Community banks play a very important role in meeting the credit needs of their local communities. As of June 30, 2018, community banks held 13 percent of the assets of insured banks but 42 percent of small loans to businesses and farms. As of the same date, about 73 percent of the banking offices in rural counties were operated by community banks, and in 627 U.S. counties, community banks provided the only physical banking presence.

Further study of banking industry consolidation and branch closings, and the effects of these developments on local economies, will remain a priority at the FDIC. Work in process includes an analysis of branching trends to reflect more recent data; an analysis of how best to measure the performance over time of groups of institutions given ongoing consolidation; an exploration of how mergers and acquisitions are affecting banks' small business lending and other types of lending; and an analysis of the relationship between bank capital requirements and lending activity.

As deposit insurer, and as Federal supervisor for the majority of community banks, the FDIC also has a continuing interest in the evolving financial performance and risk-profile of these institutions. This work will remain a priority as well.

Q.6. Please describe recent trends in bank consolidation and the role historically low interest rates have had on consolidation in the industry and the formation of new bank charters.

A.6. The number of FDIC-insured institutions stood at a little more than 18,000 in 1985 and has declined substantially since. During the post-crisis period from the end of 2013 to mid-2018, the number of FDIC-insured institutions decreased from 6,812 to 5,542, an annualized percentage decrease of 4.5 percent per year.

What distinguishes the recent post-crisis period from earlier periods has been the relative lack of new charter formation. From 1980 through 2007, the smallest number of new commercial banks chartered in any year was 40 in 1992. Since 2010, only 11 new banks have been chartered.

A number of factors may explain the reduction in the chartering of new banks. The prolonged period of low interest rates is one example. During much of the post-crisis period, low interest rates compressed the net interest margins available to banks. A study by Federal Reserve economists found a strong correlation between the number of new charters in a given year and the Federal funds rate.

Another factor that may have contributed to a reduction in new bank chartering was a significant supply of failing and troubled banks that needed capital during and after the crisis. Acquiring an existing bank may have been a cheaper way to enter the banking business rather than starting a new bank. Support for this idea is that price to book ratios for bank acquisitions declined substantially during the crisis and remained below their post-2006 average until 2016.

Finally, it is generally more expensive now to charter a new bank than it used to be. Challenges facing new banks in the areas of information technology and cyber-security are more complex than they have ever been, and the body of extant regulation has increased considerably since the crisis. While it is difficult to quantify the effects of these developments on the resources needed to establish a new bank, it is likely that the effect has not been negligible.

In this regard, one of my priorities as Chairman is to ensure that the FDIC is not placing needless obstacles in the way of new bank formation.

Q.7. Recently, former FDIC Chair Gruenberg noted that the Fed and OCC's proposal with regard to the enhanced supplemental leverage ratio (eSLR) would "significantly weaken constraints on financial leverage in systemically important banks put in place in response to the crisis" and that it would "make the banks themselves more vulnerable to disruption and failure."[1]

Do you agree with these comments? Does the FDIC plan to join the Fed and the OCC on the eSLR proposal?

[1] *https://www.fdic.gov/news/news/speeches/spsep0618.html.*

A.7. Strengthening capital requirements for our Nation's largest banks has been an important post-crisis reform which resulted in a complex, multifaceted framework that includes numerous risk-based requirements as well as multiple leverage ratio requirements for these banks. Because of the complexity of this framework, it is important to ensure that the various elements work in cohesion and are appropriately calibrated to achieve the intended goal, including a careful consideration of any unintended consequences. At this time, I am reviewing the enhanced supplementary leverage ratio (eSLR) proposal issued by the Federal Reserve and the OCC to better understand the policy objective.

Additionally, section 402 of the Economic Growth, Regulatory Relief, and Consumer Protection Act also impacts the eSLR. The banking agencies should faithfully implement what the law requires and consider the interaction of section 402 with the eSLR proposal issued by the Federal Reserve and OCC.

Q.8. Do you agree that the FDIC would be best served by a having a full board?

A.8. The FDIC Board of Directors currently has sufficient membership to conduct its important business. We are prepared to welcome new members as they are nominated by the President and approved by Congress.

Q.9. The Federal financial agencies often take intermediate steps to address problems in the financial institutions they regulate before formal enforcement actions are taken. For example, we know that the OCC had taken supervisory actions related to concerns about Wells Fargo's sales practices before the 2016 enforcement action.

Please describe the process for how your agency determines what type of supervisory action to take when it finds a problem at a financial institution it regulates, how it expects the financial institution to address the problem, how much time a financial institution is given to address the problem, how the agency follows up with the financial institution on the problem, and how the agency makes a determination that a problem has not been addressed and warrants escalated action.

A.9. The FDIC is the primary Federal supervisor for all State nonmember banks and State-chartered savings institutions. Examinations are conducted according to statutorily established timeframes. These examinations assess an institution's overall financial condition, management practices and policies, compliance with applicable laws and regulations, and the adequacy of internal control systems to identify, measure, and control risks.

The goal of the FDIC's supervisory process is to identify problems and seek solutions early enough to enable remedial action that will prevent serious deterioration in a bank's condition and reduce risk to the FDIC's deposit insurance fund. When problems are detected, examiners and other supervision staff must determine the severity along with the timing and form of necessary corrective actions. The FDIC uses a number of tools to address supervisory concerns which are tailored to each situation.

The FDIC uses supervisory recommendations to inform the bank of the FDIC's views about changes needed in the bank's practices, operations, or financial condition. The FDIC Board directs staff to make supervisory recommendations when a bank's practices, operations, or financial condition could have a detrimental effect on the financial institution or could result in customer harm if left unaddressed. Each supervisory recommendation is tailored to the concern identified, including the corrective action needed and the timeframe in which it should occur. Supervisory recommendations are not formal or informal enforcement actions, are generally correctable in the normal course of business, and include items highlighted in a report of examination as a Matter Requiring Board Attention (MRBA). The remediation of supervisory recommendations is checked through the institution's response to the report of examination and by examiners at the next onsite examination. Institution responses to MRBAs are formally tracked and reported on in the FDIC's Annual Performance Plan.

The FDIC initiates informal corrective action, such as a Board Resolution, Memorandum of Understanding, or Compliance Plan under Section 39 of the FDI Act, as a structured way to correct problems at institutions that have moderate weaknesses, but have not deteriorated to a point requiring formal corrective actions.

The FDIC initiates formal corrective action to remedy practices or conditions determined by the FDIC Board of Directors to be unsafe or unsound. Similar to informal actions, formal actions contain specific corrective action requirements and timeframes, and require quarterly progress reporting by the institution. The FDIC monitors an institution's progress in achieving the requirements of an outstanding formal action through offsite monitoring of progress reports, visitations, and examinations. Formal actions are enforceable in a court of law and an institution and its management may be assessed civil money penalties for failing to comply with the requirements of such an action.

Q.10. As you know, financial institution misconduct often continues for many years, and it raises concerns that the current supervisory process is ineffective in addressing problems.

Given that the details about supervisory actions including "matters requiring attention" or "MBAs" are considered confidential supervisory information, please provide the Committee for each year starting in 2005 the aggregate number of outstanding MBAs from the FDIC for the U.S. G–SIBs, and the aggregate number of MBAs that were satisfactorily addressed and are no longer outstanding.

A.10. The FDIC is not the primary Federal regulator for depository institutions owned by the U.S. G–SIBs and, therefore, does not directly open or close MBAs for any of these institutions.

RESPONSE TO WRITTEN QUESTION OF SENATOR TOOMEY FROM JELENA McWILLIAMS

Q.1. As I stated during the hearing, I greatly appreciated the recent Interagency Statement Clarifying the Role of Supervisory Guidance.

Could you describe what, if any, additional steps you have taken to ensure that the content of the statement is understood and observed by your examination staff? Additionally, have past supervisory actions been reviewed to confirm that they are consistent with the statement? If so, have any problems been identified?

A.1. The Federal Deposit Insurance Corporation (FDIC) has issued instructions to supervision staff emphasizing that supervisory communications should distinguish clearly and accurately between the requirements of laws and regulations, which are legally binding and enforceable, and supervisory guidance. These instructions were reinforced through an examiner all-hands conference call and again through twelve, in-person, training sessions covering more than 1,000 commissioned examiners. The instructions were additionally incorporated into the FDIC's core training curriculum for pre-commissioned examiners. This training is delivered through five in-person courses delivered multiple times per year at the FDIC's Seidman Center training facility.

More generally, the FDIC takes many steps to ensure that its onsite examination activity is carried out consistently and that the findings of examinations are presented in a manner that is consistent with FDIC rules and regulations, policies, and procedures. For example, each report of examination goes through at least one level of review by a case manager or review examiner, who is trained to conduct those reviews and ensure that reports of examination are consistent with FDIC policy. In the case of more complex or troubled—institutions, a report of examination goes through additional levels of review by an assistant regional director, deputy regional director, or regional director.

Each final report of examination mailed to an institution is accompanied by a survey to obtain banker feedback about the pre-examination process, the examiners' knowledge and responsiveness, the examination process, and the content and utility of the examination report. The survey also affords bankers the opportunity to provide written commentary and request a follow-up contact.

Each region's implementation of FDIC policy, including its review of reports of examination, is subject to triannual internal review by an independent staff from the Washington Office.

Finally, the FDIC's supervision process is subject to audit by the OIG and GAO. The FDIC also regularly conducts internal reviews of all FDIC regional offices where independent staff from the Washington Office verify compliance with existing FDIC policies and procedures. To the extent those policies and procedures are not followed, including instances with respect to the treatment of guidance, regional offices are directed to correct the issue.

RESPONSE TO WRITTEN QUESTION OF SENATOR HELLER FROM JELENA McWILLIAMS

Your agencies have been working on regulations to implement the Biggert-Waters Flood Insurance Reform Act of 2012 for the last 6 years. The rule regarding acceptance of private flood insurance has been proposed in draft form twice, the last time on January 6, 2017. Nearly all comments submitted on the two drafts expressed serious concerns over the proposals, and the unintended consequences that would result.

Q.1. What steps are each of your agencies taking to address the concerns expressed during the comment period?

A.1. The agencies have given careful consideration to the comments received in response to the private flood insurance notice of proposed rulemaking. The Federal Deposit Insurance Corporation (FDIC) received 60 comments from members of the public with important experience and insights related to these issues, including lenders, insurers, consumer organizations, State regulators, and trade associations. The agencies are taking the feedback seriously and are drafting a final rule that is intended to achieve the legislative goals of effectively and efficiently while minimizing regulatory burdens on the banking industry and public.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JELENA MCWILLIAMS

Sales practices

The Wells Fargo fraudulent account scandal exposed how abusive sales practices and incentive compensation place consumers at risk of harm. In the 2 years since the first Wells Fargo scandal, we've watched as bank executives blamed low-paid employees for sales practices gone wrong, but in reality, these scandals reflect a failure of risk management and bank culture that comes from the top. Anew report by the National Employment Law Project found that 90 percent of bank employees surveyed stated that failure to meet sales quotas still results in bullying, disciplinary action or possible termination.

Q.1.a. Are your agencies incorporating reviews of sales practices and compensation programs into your supervision?

A.1.a. Yes. Incentive compensation programs are reviewed as part of the examination process to ensure that they provide employees incentives that appropriately balance risk and reward; are compatible with effective controls and risk-management; and are supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The Federal Deposit Insurance Corporation (FDIC) conducted a horizontal review of sales practices at larger FDIC-supervised institutions in 2016 and 2017, subsequent to findings at Wells Fargo. This review focused on 17 FDIC-supervised institutions with total assets greater than $10 billion, and was part of a collaborative effort among the FDIC, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Consumer Financial Protection Bureau. FDIC staff also participated in reviews of OCC-supervised institutions.

In addition, FDIC's Division of Depositor and Consumer Protection performs risk-focused consumer compliance examinations, based on the potential for compliance issues that have or may have an adverse impact on banking customers. As part of the examination process, FDIC consumer compliance examiners review consumer complaints that the bank has received from customers as well as complaints made directly to the FDIC. Examiners may also look to external sources for complaints such as other regulatory agencies, blogs, or social media. Based on the findings of the complaint review process, compliance examiners may seek additional information about a bank's sales practices and incentive compensation plans to determine if the potential for consumer harm exists.

Q.1.b. If so, does that include any input or feedback from frontline employees? If not, how are you monitoring possible misconduct related to sales practices?

A.1.b. On-site supervisory reviews typically include discussions with multiple levels of institution staff and management, including frontline employees. This is an important part of the supervisory process as it allows for identification of any discrepancies in the implementation of written policies and procedures, or if statements made by management differ from actual practice. As an example, client-facing employees, including those under incentive compensation programs, may be interviewed by examiners.

Bank of America

Last week, I sent a letter to the CEO of Bank of America regarding recent customer reports that the bank has asked existing account holders for their citizenship status, and in some cases the bank has frozen accounts when customers fail to respond.

Q.2. Have any of your agencies directed or suggested to banks under your supervision to ask existing account holders for their citizenship status? Please provide any information about whether any institutions may have been asked or encouraged to collect citizenship information on existing customers.

A.2. The FDIC is the primary Federal supervisor for State-chartered nonmember financial institutions, most of which are community banks. The FDIC has not instructed staff and is not aware of instances where staff have directed or suggested to its supervised banks that they are required to request citizenship status from existing account holders. Under Bank Secrecy Act and anti-money laundering requirements and guidelines, financial institutions are required to gather customer information at account opening, but there are no requirements to request citizenship status at account opening or thereafter. The requirement to identify beneficial ownership, which became effective in May 2018 and required financial institutions to update individual customer information for certain accounts, also does not require citizenship status as part of identification requirements. Financial institutions must also comply with Office of Foreign Assets Control (OFAC) restrictions. OFAC maintains ongoing lists of individuals in addition to countries and other entities where the U.S. Government has implemented sanctions, and financial institutions are prohibited from transacting with these parties.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JELENA MCWILLIAMS

Thank you for your commitment to finalizing a rule on private flood insurance. As Congress clarified in its passage of the Biggert-Waters Flood Insurance Reform Act of 2012, consumers should have choices when it comes to obtaining flood insurance. While there is nothing in Federal law prohibiting homeowners from purchasing private flood insurance, there is regulatory uncertainty about what policies banks can accept for mandatory purchase requirements. The lack of a finalized rule on the topic for over 6 years has exacerbated this uncertainty.

The November 2016 proposed rule is too narrow and raises obstacles to the participation of private flood insurers in the market, which runs directly counter to congressional intent. The prompt finalization of a rule adopting an identical approach to the Flood Insurance Market Parity and Modernization Act would address these concerns.

If further delay would be necessary for the FDIC and its peers to adopt the rule jointly, I urge, the FDIC to separately consider interim guidance or other approaches to promptly resolve the regulatory ambiguities that impede mandatory and discretionary acceptance of private flood insurance by banks.

Please answer the following with specificity:

Q.1. Will you commit to looking at the Flood Insurance Market Parity and Modernization Act as a model for a final rule on private flood insurance?

A.1. The Federal Deposit Insurance Corporation (FDIC) continues to monitor congressional activity regarding private flood insurance and has been mindful of it during the interagency private flood insurance rulemaking process.

Q.2. Will you commit to coordinating the finalization of the rule with those who have an expertise in insurance regulation, such as the National Association of Insurance Commissioners and representatives from the insurance industry?

A.2. The FDIC, along with the other Federal regulatory agencies, has reached out to the NAIC, insurance commissioners from 12 States, and other groups (*e.g.,* the Independent Community Bankers of America, the American Bankers Association, the Florida Office of Insurance Regulation, the International Underwriting Association, and the Consumer Federation of America) during its rulemaking process. The agencies have also received comment letters from NAIC, the States, insurance companies, and other insurance professionals, and have taken their comments into consideration when drafting the final rule.

Q.3. Can you provide a timeline for finalization of the rule?

A.3. The FDIC expects to complete the final rule for private flood insurance by February 2019.

RESPONSE TO WRITTEN QUESTION OF SENATOR COTTON FROM JELENA MCWILLIAMS

AR Banks Wish They Could Service More of Their Customers' Mortgages—This is About Mortgage Servicing Rights (MSR)

One thing I hear from AR banks is that they after they make a mortgage loan, they like keeping the mortgage servicing rights (MSR) even if they wind up selling the mortgage itself. But current regulations, like the Basel III rules, make this difficult. These small lenders prefer to keep a relationship with their mortgage customers, which includes handling any issues with their mortgage. For these often-rural small banks, service is a competitive advantage for them over the big banks. So, as you might imagine, it's tough having to tell your longtime customer that she has to call some 1–800 number for questions about her mortgage.

Q.1. Last year, good news appeared on the way when regulators issued proposed rule that allowed banks to keep a greater portion of their mortgage servicing rights, but it seems the rule got put on the backburner during the S. 2155 debate. So, can I tell my constituents that help is on the way—and you plan to finalize the capital relief provisions soon? Any color on how soon?

A.1. The agencies should move quickly to finalize the capital simplification proposal, and I have begun discussions with the other agencies to accomplish that. I discussed this issue during a speech on November 16, in which I said "I see no reason to delay any further. Finalizing the capital simplification proposal will provide certainty and clarity to community banks and take a step toward simplifying the risk-based capital rules."[1] I also plan to simplify the capital rules for community banks more broadly. We recently issued for public comment a proposal to implement section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, the community bank leverage ratio (CBLR), which will substantially simplify the agencies' regulatory capital rules for qualifying community banks. We also are looking closely at the agencies' rules implementing the Basel III standardized approach for banks that do not qualify for the CBLR, beyond the capital simplification rule proposed last September, to find ways to further simplify the rules.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM JELENA McWILLIAMS

Recently, the "Interagency Statement Clarifying the Role of Supervisory Guidance" was issued. I think this directive is a very important step in ensuring that the regulation and supervision of financial institutions is conducted pursuant to legal standards. Each of you is the leader of an organization that has thousands of employees and examiners and are responsible for its implementation.

Q.1. How are you making sure examiners on the ground are following this statement?

A.1. The Federal Deposit Insurance Corporation (FDIC) has issued instructions to supervision staff emphasizing that supervisory communications should distinguish clearly and accurately between the requirements of laws and regulations, which are legally binding and enforceable, and supervisory guidance. These instructions were reinforced through an examiner all-hands conference call and again during 12, in-person, training sessions covering more than 1,000 commissioned examiners. The instructions were additionally incorporated into the FDIC's core training curriculum for pre-commissioned examiners. This training is delivered through five in-person courses delivered multiple times per year at the FDIC's Seidman Center training facility.

[1] *https://www.fdic.gov/news/news/speeches/spnov1618html.*

Q.2. Have you considered a formal rulemaking so that staff take this important statement seriously?

A.2. The FDIC received a petition for rulemaking on the role of supervisory guidance on November 5, 2018, from the Bank Policy Institute and the American Bankers Association under Section 553(e) of the Administrative Procedure Act. The FDIC is currently considering this petition, as required by law.

Q.3. How will you independently verify that this statement is followed (audits, surveys from supervised entities, other independent verification)?

A.3. FDIC takes many steps to ensure that its onsite examination activity is carried out consistently and that the findings of examinations are presented in a manner that is consistent with FDIC rules and regulations, policies, and procedures. For example, each report of examination goes through at least one level of review by a case manager or review examiner, who is trained to conduct those reviews and ensure that reports of examination are consistent with FDIC policy. In the case of more complex or troubled institutions, a report of examination goes through additional levels of review by an assistant regional director, deputy regional director, or regional director.

Each final report of examination mailed to an institution is accompanied by a survey to obtain banker feedback about the pre-examination process, the examiners' knowledge and responsiveness, the examination process, and the content and utility of the examination report. The survey also affords bankers the opportunity to provide written commentary and request a follow-up contact.

Each region's implementation of FDIC policy, including its review of reports of examination, is subject to triannual internal reviews by an independent staff from the Washington Office.

Finally, the FDIC's supervision process is subject to audit by the OIG and GAO.

Q.4. Under the agencies' proposal to simplify and tailor the regulations implementing the Volcker Rule, the proposed "accounting prong" would cover all purchases or sales of financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards, which would subject a significantly higher number of financial activities to the rule.

Q.4.a. Given the agencies' policy goals of simplification and tailoring, how do you intend to revise the proposal to remain faithful to these goals?

A.4.a. The comment period for the agencies' proposal to simplify and tailor the Volcker Rule has recently closed. The FDIC has received more than 50 unique comment letters that are currently under review. The FDIC will be coordinating with the other Volcker Rule agencies as we review the comments and develop a way forward. As such, it is too early in the process to determine how the Volcker Rule may be modified.

Q.4.b. The proposed amendments to the Volcker Rule would also introduce new metrics that could result in a nearly 50 percent increase in metrics reporting. How do you intend to revise the proposal to ensure that covered institutions are not subject to additional compliance burdens?

A.4.b. The agencies are currently considering the public comments received on the proposed changes to the metrics reporting requirements in the recent Volcker Rule NPR. As the agencies consider the comments, we will carefully consider any incremental burden that the proposed changes to the metrics reporting requirements may introduce.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM JELENA McWILLIAMS

Section 104, Home Mortgage Disclosure Act (HMDA)

I was the Attorney General of Nevada during the financial crisis and saw first-hand how big banks targeted vulnerable people and communities of color. This is exactly why it was so important that the CFPB required more data collection and more oversight over lending activities. The law signed by President Trump earlier this year eliminated some of the data we need to preserve this progress. Despite the loss of public HMDA data, each of your agencies still has a requirement to ensure that Latinos, African Americans, women and other people are not rejected for loans due to their gender or ethnicity.

Q.1. How many lenders supervised by your agency will not publicly report the additional data that was to be required this year? This data includes loan characteristics like credit score, fees, points, and interest rates.

A.1. The Federal Deposit Insurance Corporation (FDIC) estimates that of the roughly 1,850 FDIC-supervised institutions that reported HMDA data in 2017, approximately 240 will be required to publicly report the additional HMDA data that was to be required this year. Therefore, approximately 1,610 will not be required to report the additional data.

Q.2. Would it have been easier to spot fair lending violations with transparent data reporting, rather than relying on your bank examiners to go bank by bank, loan by loan to root out discrimination?

A.2. Evaluating lending practices to identify potential discrimination, bank-by-bank, is an important part of the FDIC's examination program. The FDIC performs a fair lending review as part of every consumer compliance examination we conduct. Even with the changes enacted under S. 2155, more than 1,600 FDIC-supervised banks will still report most of the same HMDA data points they did prior to the passage of the Dodd-Frank Act. Moreover, our examiners typically have full access to the information necessary to conduct an effective fair lending review, as they did before the additional HMDA reporting requirements were adopted.

When data are not available through a HMDA Loan Application Register (LAR), examiners can aggregate information from a variety of internal bank data sources or by conducting loan file reviews.

This approach is familiar to examiners, who are used to performing fair lending reviews in the absence of HMDA data. (For example, HMDA data are not available for banks that are not HMDA reporters or when reviewing nonmortgage lending, such as unsecured installment lending and auto lending.)

Q.3. Without the expanded HMDA data reporting slated to begin this year, what information will your agency's examiners have to trigger a review of potential discrimination?

A.3. As mentioned, FDIC-supervised banks still will report most of the same HMDA data points they have reported in the past. In addition, examiners typically can use information in internal bank records and reports, such as a loan trial balance or loan reconciliation reports. FDIC examiners will continue to have tools necessary to identify potential underwriting, pricing, redlining, and some steering discrimination. When necessary, examiners will be able to follow up and perform in-depth analysis, as they did prior to the enactment of the new law.

Community Reinvestment Act

We have a massive affordable rental housing crisis in Nevada: 119,854 families pay more than half their income for rent.

One of the few resources we have is the Low Income Housing Tax Credit. The new tax law is already making it harder to finance low-income housing because the cost of the credit has fallen.

Q.4. Will you commit to ensure that any changes you consider to the Community Reinvestment Act make Federal tools like the Low Income Housing Tax Credit and New Market Tax Credit work better in communities?

A.4. The agencies have been meeting to discuss potential changes to the CRA regulations, including the ideas put forward by the Treasury Department. In addition, on August 28, 2018, the Office of the Comptroller of the Currency (OCC) published an advance notice of proposed rulemaking (ANPR) inviting public comment on ways to "transform or modernize" the CRA regulations. We look forward to reviewing feedback provided by the public in response to the OCC's ANPR and to further engagement with the OCC and the Federal Reserve Board (FRB) on opportunities to improve the CRA's effectiveness. Any potential changes will focus on achieving the congressional intent of the CRA.

Q.5. Nonbanks provide more than half of all mortgages in this country. Six of the 10 largest mortgage lenders are not banks.

Do you think nonbank mortgage lenders should be covered by the Community Reinvestment Act?

A.5. An expansion of the coverage of the CRA is a legislative question for Congress and the President.

Section 108: Escrow Requirements

For generations, lenders understood that they should require property taxes and homeowners insurance be placed in escrow, so that those obligations are always paid on time. But in the run-up to the foreclosure crisis, lenders cut corners so that they could misrepresent monthly payments to homeowners and put them into obligations they couldn't afford.

Q.6. How will your agencies monitor the implementation of the escrow exemption? Will your examiners monitor foreclosure activities resulting from unpaid property taxes and/or property insurance?

A.6. The FDIC conducts consumer compliance examinations of supervised institutions to assess whether financial institutions are meeting their responsibilities to comply with applicable Federal consumer protection laws and regulations. During examinations, examiners monitor, review, and become aware of issues related to banks' implementation of statutory and regulatory requirements. Issues related to escrow requirements are among the many supervisory issues the FDIC reviews through the risk-based examination approach.

The FDIC monitors activities in the financial services industry related to consumer compliance issues, including foreclosure issues, in a number of ways. Among other things, it meets with and engages stakeholders such as trade associations, consumer groups, and bank representatives; reviews consumer complaints from a number of sources; and monitors publications.

Q.7. How will you communicate any findings or concerns from the elimination of the escrow requirement to us in Congress?

A.7. As previously described, the FDIC will monitor this issue and, of course, be prepared to answer any questions that may come from Congress regarding this issue.

Section 103. Rural Appraisal Exemption (exemptions less than $400,000)

Chair McWilliams, in your written testimony, you say that the appraisal exemption will not apply if the regulator requires an appraisal for safety and soundness reasons.

Q.8. What would be your agency's standard to step in and curb loans made without appraisals? How will you communicate any concerns to members of Congress?

A.8. The FDIC may require a financial institution to obtain appraisals to address safety and soundness concerns on a case-by-case basis. For example, the FDIC may require a financial institution to obtain appraisals after documenting weak underwriting practices, identifying weaknesses in its valuation program, or ascertaining that declining property values in its primary markets have significantly increased its risk profile. The FDIC could communicate any concerns to members of Congress through ongoing dialogue, as needed.

RESPONSES TO WRITTEN QUESTIONS OF SENATORS WARNER, COTTON, TILLIS, AND JONES FROM JELENA MCWILLIAMS

Comptroller Otting has testified before that "the process for complying with current BSA/AML laws and regulations has become inefficient and costly." In talking with banks/credit unions it is clear that they do not object to the principle of complying with AML regulations, it is that they feel that much of the time, effort, and money spent on compliance is ineffective, and therefore, a waste of time. Banks/credit unions fill out forms invented in the 1970s and have little insight into whether it is doing any good. And we've heard from banks/credit unions that they believe AML examinations are done without respect to the riskiness of the institution or its activities.

Q.1. What improvements can be made so we have a cheaper and faster system that is better at catching criminals?

A.1. The Federal Deposit Insurance Corporation (FDIC), together with the Federal banking agencies [1] and the U.S. Department of the Treasurys,[2] has established a working group to identify ways to ensure the Bank Secrecy Act (BSA)/anti-money laundering (AML) regime fosters a financial system that is efficient, transparent, and resilient to illicit financial activity. The working group is looking at ways to:

(i) improve the efficiency and effectiveness of the BSA/AML regulations;

(ii) improve supervision and the examination process;

(iii) continue to fully support law enforcement; and

(iv) facilitate innovation and responsible integration of technology.

On October 3, 2018, the working group issued a statement to address instances in which certain banks and credit unions may decide to enter into collaborative arrangements to share resources to manage their BSA/AML obligations more efficiently and effectively.

On December 3, 2018, the working group issued a joint statement to encourage banks and credit unions to consider, evaluate, and, where appropriate, responsibly implement innovative approaches to meet their BSA/AML compliance obligations.

The working group is also drafting a statement to clarify instructions for risk-focused BSA/AML examinations.

Q.2. Is there a place in a new AML regime for new technology, like artificial intelligence or machine learning?

A.2. The Federal banking agencies, together with the Treasury Department's Financial Crimes Enforcement Network (FinCEN), issued a joint statement [3] to encourage innovative approaches to detect and report financial crime and meet other regulatory obligations related to AML and countering the financing of terrorism (CFT). The statement recognizes that private sector innovation, including new ways of using existing tools or adopting new technologies can help banks and credit unions identify and report money laundering, terrorist financing, and other illicit financial activity by enhancing the effectiveness and efficiency of banks' BSA/AML compliance programs. The statement points out the Federal banking agencies and FinCEN's commitment to engage with the private sector and other interested parties.

Artificial intelligence and machine learning, for example, may enhance the effectiveness and efficiency of banks' and credit unions' BSA/AML compliance programs.

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[1] The Federal banking agencies are the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency.

[2] Specifically, the Office of Terrorism and Financial Intelligence (TFI) and the Financial Crimes Enforcement Network (FinCEN).

[3] *https://www.fdicgov/news/news/press/2018/pr18091a.pdf.*

Q.3. What do you, as a regulator, think that it means to have a risk-based AML program?

A.3. A risk-based BSA/AML program is one for which the institution's management team has a well-developed risk assessment that documents and supports the institution's BSA/AML risk profile, while also ensuring the BSA/AML program meets the minimum regulatory requirements. The risk profile is institution-specific and should be based on a risk assessment that properly considers all risk areas, including products, services, customers, entities, transactions, and geographic locations. The risk assessment format may vary, but should be easily understood by all appropriate parties, which includes staff, management, and directorate, as well as auditors and regulators. This risk assessment process enables management to better identify and mitigate gaps in the institution's controls.

A depository institution's BSA/AML compliance program should be commensurate with the institution's overall risk profile and based on a comprehensive assessment of money laundering and terrorist financing risks. The BSA/AML compliance program must be written, approved by the board of directors, and includes six components:

- a system of internal controls to ensure ongoing compliance,
- independent testing of BSA/AML compliance,
- a designated individual or individuals responsible for managing BSA compliance,
- training for appropriate personnel,
- an established customer identification program, and
- procedures for customer due diligence.[4]

The cornerstone of a strong BSA/AML compliance program is the adoption and implementation of risk-based customer due diligence (CDD) policies, procedures, and processes for all customers, particularly those that present a higher risk for money laundering and terrorist financing. The objective of CDD is to enable the depository institution to understand the nature and purpose of customer relationships, which may include understanding the types of transactions in which a customer is likely to engage. These processes assist the institution in determining when transactions are potentially suspicious.

Q.4. How do you implement the risk-based AML program requirement through examinations?

A.4. Examiners assess the adequacy of the bank's BSA/AML compliance program and determine whether the institution has developed, administered, and maintained an effective program for compliance with the BSA and its implementing regulations. FDIC examiners tailor the BSA/AML examination plan according to the bank's business model, complexity, and risk profile. Tools that can be used include the bank's risk assessment which should be comprehensive and cover all customer types, products, services, and geographies in which the bank operates and transacts business. Similarly, examiners evaluate the adequacy of a bank's independent

[4] 31 CFR § 1020.310 and 31 CFR § 1020.320.

test of the BSA/AML compliance program so that they can determine what level of reliance they can place on them, and then evaluate the results of the independent tests to initially understand the risk profile along with supervisory materials.

Q.5. One common criticism of the current AML regime is the lack of feedback given to banks/credit unions after they file their SARs. The current system is extremely segmented, and as a consequence, it is not the "fault" of any one entity that there is little feedback given. But without a system to provide feedback, the quality of SARs suffer. A system that doesn't focus on the quality of reports being filed is one that is not optimized to catch criminals. Many banks/credit unions wish that they had an idea of what FinCEN is really trying to find, because then their cooperation and input might be more helpful and effective.

How often does your agency meet with FinCEN and with the DOJ/FBI to discuss the usefulness of suspicious activity reports that are being filed?

A.5. The FDIC is a member of the Bank Secrecy Act Advisory Group (BSAAG), which is chaired by the Financial Crimes Enforcement Network (FinCEN). The BSAAG is a forum for the regulators, law enforcement, and the private sector to have shared input on multiple BSA/AML regulatory, supervisory, and implementation issues. The BSAAG holds two plenary meetings each year, and has committees that meet to consider money laundering risk compared to regulatory obligations, as well as feedback to industry on the use of and potential improvements to suspicious activity reports (SARs).

The FDIC also participates in regional SAR Review teams, which are comprised of IRS—Criminal Investigations, ICE, DEA, FBI, U.S. Secret Service, U.S. Attorney's Offices, regulatory agencies, and State & local law enforcement. These teams meet at least monthly and review SARs from their respective geographic locations. The teams discuss SAR filings and periodically provide presentations to banks on the importance of SAR filings and ways to improve the filing process.

In addition, I have personally met with FinCEN Director Ken Blanco on several occasions to discuss improvements to the BSA/AML reporting requirements.

Q.6. When a bank/credit union files a SAR, or a regulator is examining a financial institution, how much feedback is there across the system about whether or not the SARs they filed were found to be useful, informative, or effective?

A.6. Law enforcement would be the appropriate agency to determine the usefulness and effectiveness of SARs in initiating or supplementing money laundering or terrorist financing investigations and other criminal cases.

There is no communication mechanism in place for the FDIC to know when a SAR filed by a bank was useful, informative or effective for law enforcement purposes.

Q.7. What are the legal hurdles that prevent more effective and more regular feedback within the Federal Government and between the Federal Government and financial institutions?

A.7. The FDIC may share SAR information "as necessary to fulfill official duties consistent with Title II of the Bank Secrecy Act."[5] The FDIC shares SAR information with Federal law enforcement and other Federal banking agencies as necessary.

Q.8. Will you pledge to institutionalize feedback mechanisms wherein banks/credit unions both get and can give feedback on how to constantly improve the process?

A.8. The BSAAG offers a BSA/AML feedback mechanism. As mentioned above, the FDIC is a member of the BSAAG, which is chaired by FinCEN. The Annunzio-Wylie Anti-Money Laundering Act of 1992 required the Secretary of the Treasury to establish a BSAAG consisting of representatives from Federal regulatory and law enforcement agencies, financial institutions, and trade groups with members subject to the requirements of the BSA. The BSAAG is the means by which the Treasury receives advice on the operations of the Bank Secrecy Act. Relevant issues are placed before the BSAAG for review, analysis, and discussion. The BSAAG is a major vehicle for the regulators, law enforcement, and the private sector to have shared input on multiple BSA/AML regulatory, supervisory, and implementation issues. Non-Government participants represent financial sectors with BSA obligations, though it is heavily oriented to the depository institutions reflecting the significant role of banks as the primary gatekeepers of the financial system. The BSAAG holds two plenary meetings each year, and has committees that meet to consider money laundering risk compared to regulatory obligations as well as feedback to industry on the use of and potential improvements to suspicious activity reports.

Q.9. We hear from banks that they feel pressured to file SARs even when they believe the underlying transaction or activity does not rise to a level of suspiciousness that merits a filing. They say they do this because they are afraid of being second-guessed by examiners after the fact, and because there is no Government penalty for over-filing SARs—only a penalty for not filing a SAR. But banks bear the significant cost of filing unnecessary SARs.

What can be done to realign incentives so that banks/credit unions don't feel pressured to ale SARs that they don't feel reflects activity warranting a filing?

A.9. Examiners follow the FFIEC BSA/AML Examination Manual when performing BSA/AML examinations. Examiners focus on whether the depository institution has an effective SAR decision-making process, not individual SAR decisions. Examiners may review individual SAR decisions as a means to test the effectiveness of the SAR monitoring, reporting, and decision-making process. The regulators are currently reviewing the risk-focused approach to BSA/AML supervision and will consider this concern in our review.

Additionally, FinCEN is undertaking a project to evaluate the usefulness of BSA data. As a stakeholder of this data, the FDIC has provided feedback regarding suspicious activity reports. We are committed to working with FinCEN and law enforcement to improve the suspicious activity reporting regime.

[5] 31 CFR 1020320(e)(2).

Q.10. Banks/credit unions commonly use "rules-based" software to screen transactions and alert AML compliance teams to suspicious activities. While these rules-based systems can be effective, we have concerns that they might not be the most effective tool available to us given advances in data science and machine learning, and further, that there may be opportunities for criminals to manipulate these rules-based systems.

We have heard concerns that many criminals have access to the exact same products that are used by financial institutions—is this true?

A.10. Companies that sell AML software used to screen transactions for suspicious activity may sell their products to the public. Because there is no contractual obligation or authority to require these companies to disclose to the Federal regulators who purchase their products, we are not able to confirm this statement.

Q.11. If criminals have access to similar products, or can easily come to understand the rules-based system, how easy is it to manipulate these detection systems?

A.11. Financial institutions use various static (fixed) rules within screening software programs to review transactions for potential suspicious activity. Generally, financial institutions do not rely exclusively on these static rules within software programs. Institutions deploy other manual and automated risk techniques and controls to help them identify a suspicious transaction that otherwise passes the static rules review.

The software programs allow each financial institution to select its own unique thresholds and other features for the static screening rules, based on the financial institution's unique risk assessment. Accordingly, even if a criminal has access to the screening rules options available within a particular software program, the criminal would not necessarily know how a particular financial institution implemented those rules options for its own transaction screening.

Financial institutions and the technology service providers that support financial institutions are starting to enhance their traditional transaction screening software programs with new techniques, such as machine learning/artificial intelligence and statistical analyses of customers' payments and deposits activity. These new techniques should decrease the likelihood that a criminal can avoid detection by structuring a transaction to avoid the static rules automated review.

Q.12. If there was a proven model of using a "learning," algorithmic system to flag potentially suspicious transactions, would this be an improvement on the current system? What are the hurdles to financial institutions adopting such systems?

A.12. Innovative companies are in the process of building and offering these types of systems to flag potentially suspicious transactions. "Learning" algorithmic systems (algorithmic systems) may be cost prohibitive for some depository institutions to implement. While an algorithmic system may assist depository institutions in the identification of or alert to unusual activity, the SAR decision-making process requires human decision-making expertise, experience, and training.

Q.13. In what ways is a bank's/credit union's "safety and soundness" implicated by its AML system?

A.13. The Federal banking agencies adopted a uniform interagency system for rating the safety and soundness of the Nation's depository institutions. The Uniform Financial Institutions Rating System involves an assessment of six components of a depository institution's condition and operations. Management is one of those components. In this area, examiners incorporate the results of the BSA/AML examination when evaluating the board of directors and management's capability to identify, measure, monitor, and control the risks of an institution's activities and to ensure a depository institution's safe, sound, and efficient operation in compliance with applicable laws and regulations.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN CRAPO FROM J. MARK McWATTERS

Q.1. Some provisions of S. 2155 may be implemented through guidance or other policy statements that do not go through formal notice and comment rulemaking. The Congressional Review Act requires agencies to submit, with certain minor exceptions, all rules to Congress for review. Under the Congressional Review Act, a rule, by definition, is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." This definition is very broad. In order to ensure Congress can engage in its proper oversight role, I encourage the regulators to follow the Congressional Review Act and submit all rules to Congress, even if they have not gone through formal notice and comment rulemaking.

Can you commit to following the law by submitting all rulemakings and guidance documents to Congress as required by the Congressional Review Act?

A.1. The NCUA is committed to following the law by submitting to Congress all rulemakings and any guidance documents required by the Congressional Review Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM J. MARK McWATTERS

Q.1. You and Board Member Metsger have proposed a revision to the NCUA's risk-based capital rule. You and Mr. Metsger have been able to compromise and reach unanimous votes on all issues the Board has considered for over 2 years—while you have been Chair and when he was Chair.

What are the principal changes to the rule this revision makes and when does the agency plan to finalize the rule? Why is this compromise preferred to legislation currently being considered in Congress?

A.1. The NCUA Board approved the final risk-based capital supplemental rule (Supplemental Rule) on October 18, 2018.[1] The Supple-

[1] 83 FR 55467 (Nov. 6, 2018).

mental Rule delays the implementation of the 2015 final risk-based capital rule (2015 Final Rule)[2] one year from January 1, 2019 to January 1, 2020 and increases the definition of complex credit union (those subject to the risk-based capital requirement) from $100 million to $500 million in total assets. This definitional change exempts nearly 90 percent of all credit unions, while still subjecting 76 percent of the total assets in the credit union system to the risk-based capital requirement. The amended definition reduces burden while not subjecting the National Credit Union Share Insurance Fund (NCUSIF) to undue risk. The delay provides covered credit unions and the NCUA with additional time to prepare for the rule's implementation.

The proposed legislation before Congress is limited to delaying the effective date of the 2015 Final Rule. While the legislation provides for a 2-year delay, it does not lessen the impact of the risk-based capital rule. Further, with the delay adopted by the NCUA Board in the Supplemental Rule, credit unions will have over 4 total years to prepare for the new risk-based capital requirement. The NCUA Board does not believe further delay is necessary.

Q.2. The Federal financial agencies often take intermediate steps to address problems in the financial institutions they regulate before formal enforcement actions are taken. For example, we know that the OCC had taken supervisory actions related to concerns about Wells Fargo's sales practices before the 2016 enforcement action.

Please describe the process for how your agency determines what type of supervisory action to take when it finds a problem at a financial institution it regulates, how it expects the financial institution to address the problem, how much time a financial institution is given to address the problem, how the agency follows up with the financial institution on the problem, and how the agency makes a determination that a problem has not been addressed and warrants escalated action.

A.2. The NCUA's supervisory actions vary depending on the severity of the problems identified at a credit union and its management's willingness and ability to correct the problems. The extent and severity of the concerns also affect a credit union's CAMEL rating and the frequency of supervision.[3]

Typically, upon identification of significant violations and safety and soundness problems, the agency initially takes informal action. Informal enforcement actions can include the issuance of a Document of Resolution (DOR),[4] Preliminary Warning Letter (PWL),[5] or Letter of Understanding and Agreement (LUA).[6]

Some violations and safety and soundness problems are so serious or egregious, however, that the NCUA pursues a formal

[2] 80 FR 66626 (Oct. 29, 2015).

[3] The CAMEL rating system is based upon an evaluation of five critical elements of a credit union's operations: capital adequacy; asset quality; management; earnings; and liquidity/asset-liability management.

[4] A DOR is similar to the other Federal banking agencies' "Matters Requiring Attention," as a DOR outlines the problem(s) identified and corrective action(s) needed to resolve the problem(s).

[5] A PWL is a warning of potential formal enforcement action if corrective action is not taken.

[6] An LUA is a written agreement between the NCUA and the credit union signed by both parties. An LUA lists a credit union's specific material problems and the corrective actions necessary to resolve them.

enforcement action at the outset. A formal enforcement action will also be used when a credit union fails to remedy serious problems on a timely basis. Formal enforcement actions include such actions as a published LUA, cease and desist order, civil money penalty, involuntary liquidation, conservatorship, prohibition, or termination of insurance. Decisions to use formal enforcement actions, including in cases where serious problems have not been timely addressed and escalated action is required, are vetted by agency counsel and headquarters staff. These actions typically require the NCUA Board's approval. Relatedly, the Federal Credit Union Act's (FCU Act) "prompt corrective action" provisions also require the NCUA to take certain actions when a credit union's net worth level falls below certain thresholds.[7]

In terms of secondary steps, the NCUA's National Supervision Policy Manual (NSPM) requires field staff to follow-up on all significant supervisory matters within 120 days after the due date(s) for corrective action.[8] The timeframe for each corrective action vary depending on the nature and severity of the issues identified, as well as practical considerations for how long it will take for the issue to be resolved.

Q.3. As you know, financial institution misconduct often continues for many years, and it raises concerns that the current supervisory process is ineffective in addressing problems.

Given that the details about supervisory actions including "matters requiring attention" or "MRAs" are considered confidential supervisory information, please provide the Committee for each year starting in 2005 the aggregate number of outstanding MRAs from the NCUA for the credit unions you regulate, and the aggregate number of MRAs that have been satisfactorily addressed and are no longer outstanding.

A.3.

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
DORs Resolved	5,745	9,896	8,328	8,547	9,080	11,119	11,371	8,385	5,481	3,267	2,842	2,376	1,415	100
DORs Unresolved	0	0	0	1	0	0	1	5	8	30	105	330	1,463	641

Note: The increasing number of unresolved DORs in recent years properly reflects the problem resolution life cycle for credit unions and is a normal occurrence. The NCUA only clears issues as resolved during onsite examinations. Additionally, the majority of well-run credit unions are on an 18-month extended examination cycle. Due to the timing of examinations and the extended examination cycle, it may take more than one exam cycle, and sometimes two or more years, for the NCUA to classify an issue as resolved.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM J. MARK MCWATTERS

Q.1. I understand that the NCUA is pursuing a number of examination modernizations initiatives.

[7] See 12 U.S.C. § 1790d.

[8] Follow-up for significant recordkeeping issues or Bank Secrecy Act (BSA) deficiencies are required to be completed within 90 days.

Could you describe your modernization priorities and explain how they will lead to more efficient and effective oversight?

A.1. The NCUA Board approved the following five initiatives to modernize the agency's exam processes:

- The Flexible Examination Pilot Program (FLEX);
- Office of National Examinations and Supervision (ONES) Data Driven Supervision;
- The Shared NCUA–State Regulator federally Insured State-Chartered Credit Union (FISCU) Program;
- The Enterprise Solution Modernization Program (ESM); and
- The Virtual Examination Program

These five initiatives are interrelated and complement each other. As these initiatives support and build upon each other, they will ultimately result in a fully modernized examination and supervision program with various incremental improvements occurring along the way.

The FLEX pilot program was developed to allow examiners to perform certain existing exam procedures offsite. From mid-2016 through August 2018, 58 participants completed 87 FLEX pilot exams. Based on the results of the pilot, which ended in December 2018, the agency plans to roll out the ability for all examiners to perform more exam work offsite. This will reduce burden to credit unions and improve quality of life for examiners, with the added benefit of travel cost savings to the agency.

The ONES Data Drive Supervision initiative began in 2018 as an effort to move to a continuous supervision model for the largest credit unions, which are supervised by the NCUA's Office of National Examinations and Supervision (ONES). The continuous supervision model will use data-driven analytics to monitor and identify credit union risk and support the transition to credit union-driven stress testing. This work may lead to analytical advancements that can be adapted for use in the supervision of some or all other insured credit unions.

In 2017, the NCUA created the Joint NCUA–State Supervisor Working Group (working group). This working group is tasked with collaborating to improve coordination and scheduling of joint exams, provide scheduling flexibility, and reduce redundancy where possible. The goal is to minimize the burden on FISCUs resulting from having a separate regulator and insurer. In addition, the group is tasked with evaluating the efficacy, appropriateness, and feasibility of adopting an alternating examination approach for FISCUs. The working group is developing a pilot program to explore and evaluate the effectiveness of an alternating examination program. A pilot will allow the NCUA, State regulators, and stakeholders to evaluate benefits and challenges prior to finalizing a decision on an alternating exam program. Such a pilot will need to run about 3 years in order to evaluate one full alternating exam cycle.

The ESM initiative was designed to replace legacy applications such as the examination system (AIRES) and the Call Report data collection tool (CU Online). ESM will also introduce emerging and secure technology that supports the NCUA's examination, data collection, and reporting efforts. The result will be a flexible technology architecture that integrates modernized systems and tools across the agency. The new systems will streamline processes and procedures helping create a more effective, less burdensome process.

In 2017, the NCUA Board approved the Virtual Examination Program and associated resources to research methods to conduct offsite as many aspects of examinations as possible. By identifying and adopting alternative techniques to remotely analyze much of the financial and operational condition of a credit union, with equivalent or improved effectiveness relative to current examinations, it may be possible to significantly reduce the frequency and scope of onsite examinations. Onsite examination activities could potentially be limited to periodic data quality and governance reviews, interventions for material problems, and meetings or other examination activities that need to be handled in person. The scope of the Virtual Examination Program includes research, planning, design, development, testing, and the transition from the existing examination program to the Virtual Examination Program. The project team is currently in the research phase of the project, which is expected to last 24 months.

Q.2. As I stated during the hearing, I greatly appreciated the recent Interagency Statement Clarifying the Role of Supervisory Guidance.

Could you describe what, if any, additional steps you have taken to ensure that the content of the statement is understood and observed by your examination staff? Additionally, have past supervisory actions been reviewed to confirm that they are consistent with the statement? If so, have any problems been identified?

A.2. Shortly after issuance of the Interagency Statement, the NCUA's leadership provided all field staff with additional reinforcement of the principles outlined in the Interagency Statement and the NCUA's long-standing position on the use of supervisory guidance. Additionally, the direction provided further explained the role agency guidance plays in the examination and supervision process, particularly as it relates to educating examiners and ensuring consistency of application. The agency incorporates these policies in examiner training. The NCUA will remain diligent in holding examination staff accountable for following agency policies as part of its quality control processes for examinations and supervision contacts. In addition, credit unions can take advantage of the NCUA's extensive informal and formal appeals options to address any improper use of supervisory guidance. As this has been the long-standing policy of the NCUA, the agency did not conduct any additional reviews of prior supervisory actions.

RESPONSE TO WRITTEN QUESTION OF SENATOR HELLER FROM J. MARK MCWATTERS

Q.1. Your agencies have been working on regulations to implement the Biggert-Waters Flood Insurance Reform Act of 2012 for the last 6 years. The rule regarding acceptance of private flood insurance has been proposed in draft form twice, the last time on January 6, 2017. Nearly all comments submitted on the two drafts expressed serious concerns over the proposals, and the unintended consequences that would result.

What steps are each of your agencies taking to address the concerns expressed during the comment period?

A.1. In November 2016, the NCUA, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Farm Credit Administration (the Agencies) issued a joint notice of proposed rulemaking to implement the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012.[1]

The Agencies received approximately 60 comments on the proposed rule from a wide range of commenters, including: financial institutions; the insurance industry; various trade associations; individuals; a flood risk management association; a State-regulatory organization; a Federal agency; and others.

In developing a final rule, the Agencies have carefully considered all of the comments received and deliberated on the various views expressed. The Agencies are working toward a final rule with the goals of reducing regulatory burden and achieving efficiency.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM J. MARK McWATTERS

As part of S. 2155, Congress approved extended 18-month examination cycles for well-run banks below $3 billion in assets. It's my understanding that credit unions were not included in this section because the NCUA already has authority to provide any credit union an extended examination cycle and the Administration has adopted a policy that any well-run credit union under $1 billion in assets should have an extended exam cycle—much like what was in place for banks before S. 2155.

I'd also like to applaud your proposal to delay implementation of the Risk-Based Capital rule, which is functionally unnecessary and will hurt the ability of credit unions to serve their communities.

Please answer the following with specificity:

Q.1. Has the extended examination cycle for credit unions under $1 billion been carried out in practice by the NCUA, and to what degree?

A.1. The NCUA has been very successful in implementing its Examination Flexibility Initiative approved in 2016. After an initial transition period, the NCUA is now fully carrying out the extended examination cycle. As of the second quarter of 2018, 650 of 730 qualifying credit unions, or 89 percent, received an extended examination cycle.

Q.2. Has the NCUA taken any steps to align its policy on exam cycles to what is now in place for banks and raise the $1 billion threshold/or extended exam cycles?

A.2. The agency is going to look into whether the exam cycle should be extended for credit unions with assets greater than $1 billion. We have to consider the risk to the National Credit Union Share Insurance Fund (NCUSIF) against any relief this could

[1] 81 FR 78063 (Nov. 7, 2016).

provide. It is important to remember that the NCUSIF is much smaller than the FDIC's deposit insurance fund and has a different funding structure. This funding structure provides less loss absorbing capacity before costs are passed on to insured institutions. Thus, adopting the same threshold as used for banks would represent much higher relative risk to the NCUSIF and the credit union community.

Credit unions with assets between $1 billion and $3 billion represent 26 percent of total insured shares. Banks with assets between $1 billion and $3 billion only represent 5.9 percent of total insured bank deposits. Also, total assets in credit unions with assets less than $3 billion are over 42 times the size of the NCUSIF—the comparable statistic for the FDIC's fund is only about 12 times. Even with the current extended examination threshold of $1 billion, total assets in these institutions are 25 times the size of the NCUSIF.

Given the difference in relative loss absorbing capacity between the NCUSIF and the FDIC's deposit insurance fund, the NCUA Board needs to consider additional supplemental supervisory methods as part of any decision to extend the exam cycle for larger institutions.

Q.3. What is the Administration's timing for acting on the proposed delay of the Risk-Based Capital rule? Do you believe there could be additional improvements to the rule made by the NCUA or an act of Congress?

A.3. On October 18, 2018, the NCUA Board approved the final risk-based capital supplemental rule (Supplemental Rule).[1] The Supplemental Rule delays the implementation of the 2015 final risk-based capital rule (2015 Final Rule)[2] from January 1, 2019 to January 1, 2020 and increases the definition of complex credit union from $100 million to $500 million in total assets.

Providing credit unions an additional year before implementing the 2015 Final Rule, a total implementation period of 4 years, is more than sufficient to allow credit unions to incorporate the changes in the definition of complexity made under the Supplemental Rule. The change made by the Supplemental Rule to the definition of complex credit unions will exclude approximately 90 percent of credit unions from the risk-based capital requirement, while still covering approximately 76 percent of the assets held by federally insured credit unions.

Since the 2015 Final Rule was approved in October 2015, the cumulative net worth of credit unions with more than $500 million in assets has grown by more than 34 percent. Credit unions that meet the definition of complex already hold, on average, more than 17 percent capital, or 70 percent more than the 10 percent required to be well-capitalized under the risk-based capital rule. As such, the rule will not impair the ability of credit unions to serve their communities.

The NCUA is planning to propose a rule to allow complex credit unions to issue subordinated debt that counts as capital for purposes of the risk-based capital requirement. The goal is to finalize

[1] 83 FR 55467 (Nov. 6, 2018).
[2] 80 FR 66626 (Oct. 29, 2015).

this authority before the January 2020 effective date of the risk-based capital rule.

The NCUA Board does not anticipate any additional changes to the risk-based capital rule at this time. However, the Board will continue to periodically review all of the NCUA's regulations to ensure they remain up-to-date and impose the least possible burden to achieve the desired outcomes.

RESPONSE TO WRITTEN QUESTION OF SENATOR ROUNDS FROM J. MARK McWATTERS

Q.1. In August of this year, you outlined an extensive exam modernization project that you indicated had the intended benefits of creating more efficient examinations and supervision, reducing regulatory burdens, and creating more consistent and accurate supervisory determinations.

Can you provide an update on this project and outline how you expect it will lead to fewer regulatory burdens on credit unions?

A.1. The NCUA Board approved the following five initiatives to modernize the agency's exam processes:

- The Flexible Examination Pilot Program (FLEX);
- Office of National Examinations and Supervision (ONES) Data Driven Supervision;
- The Shared NCUA–State Regulator federally Insured State-Chartered Credit Union (FISCU) Program;
- The Enterprise Solution Modernization Program (ESM); and
- The Virtual Examination Program

These five initiatives are interrelated and complement each other. As these initiatives support and build upon each other, they will ultimately result in a fully modernized examination and supervision program with various incremental improvements occurring along the way.

The FLEX pilot program was developed to allow examiners to perform certain existing exam procedures offsite. From mid-2016 through August 2018, 58 participants completed 87 FLEX pilot exams. Based on the results of the pilot, which ended in December 2018, the agency plans to roll out the ability for all examiners to perform more exam work offsite. This will reduce burden to credit unions and improve quality of life for examiners, with the added benefit of travel cost savings to the agency.

The ONES Data Drive Supervision initiative began in 2018 as an effort to move to a continuous supervision model for the largest credit unions, which are supervised by the NCUA's Office of National Examinations and Supervision (ONES). The continuous supervision model will use data-driven analytics to monitor and identify credit union risk and support the transition to credit union-driven stress testing. This work may lead to analytical advancements that can be adapted for use in the supervision of some or all other insured credit unions.

In 2017, the NCUA created the Joint NCUA–State Supervisor Working Group (working group). This working group is tasked with collaborating to improve coordination and scheduling of joint exams, provide scheduling flexibility, and reduce redundancy where possible. The goal is to minimize the burden on FISCUs resulting from having a separate regulator and insurer. In addition, the group is tasked with evaluating the efficacy, appropriateness, and feasibility of adopting an alternating examination approach for FISCUs. The working group is developing a pilot program to explore and evaluate the effectiveness of an alternating examination program. A pilot will allow the NCUA, State regulators, and stakeholders to evaluate benefits and challenges prior to finalizing a decision on an alternating exam program. Such a pilot will need to run about 3 years in order to evaluate one full alternating exam cycle.

The ESM initiative was designed to replace legacy applications such as the examination system (AIRES) and the Call Report data collection tool (CU Online). ESM will also introduce emerging and secure technology that supports the NCUA's examination, data collection, and reporting efforts. The result will be a flexible technology architecture that integrates modernized systems and tools across the agency. The new systems will streamline processes and procedures helping create a more effective, less burdensome process.

In 2017, the NCUA Board approved the Virtual Examination Program and associated resources to research methods to conduct offsite as many aspects of examinations as possible. By identifying and adopting alternative techniques to remotely analyze much of the financial and operational condition of a credit union, with equivalent or improved effectiveness relative to current examinations, it may be possible to significantly reduce the frequency and scope of onsite examinations. Onsite examination activities could potentially be limited to periodic data quality and governance reviews, interventions for material problems, and meetings or other examination activities that need to be handled in person. The scope of the Virtual Examination Program includes research, planning, design, development, testing, and the transition from the existing examination program to the Virtual Examination Program. The project team is currently in the research phase of the project, which is expected to last 24 months.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM J. MARK MCWATTERS

Recently the "Interagency Statement Clarifying the Role of Supervisory Guidance" was issued. I think this directive is a very important step in ensuring that the regulation and supervision of financial institutions is conducted pursuant to legal standards. Each of you is the leader of an organization that has thousands of employees and examiners and are responsible for its implementation.

Q.1. How are you making sure examiners on the ground are following this statement?

A.1. Shortly after issuance of the Interagency Statement, the NCUA's leadership provided all field staff with additional reinforcement of the principles outlined in the Interagency Statement and the NCUA's long-standing position on the use of supervisory guidance. Additionally, the direction provided further explained the role agency guidance plays in the examination and supervision process, particularly as it relates to educating examiners and ensuring consistency of application. The agency incorporates these policies in examiner training. The NCUA will remain diligent in holding examination staff accountable for following agency policies as part of its quality control processes for examinations and supervision contacts. In addition, credit unions can take advantage of the NCUA's extensive informal and formal appeals options to address any improper use of supervisory guidance.

Q.2. Have you considered a formal rulemaking so that staff take this important statement seriously?

A.2. The NCUA issues various internal instructions and policy manuals related to conducting examinations and supervising credit unions, which create binding requirements for staff. Additionally, the NCUA provides continuous training through various core classes and specialized training for examiners to further reinforce the roles of regulation and guidance. Agency staff are held accountable for following internal policies, which include the proper use of agency guidance.

Q.3. How will you independently verify that this statement is followed? (audits, surveys from supervised entities, other independent verification)

A.3. The NCUA has an established quality control program in place to ensure compliance with agency policy. In fact, the agency is in the process of expanding its quality control process before examination reports are released to credit unions. As noted above, the agency will remain diligent in holding examination staff accountable if they fail to use guidance in accordance with policy.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM J. MARK McWATTERS

Section 104, Home Mortgage Disclosure Act (HMDA)

I was the Attorney General of Nevada during the financial crisis and saw first-hand how big banks targeted vulnerable people and communities of color. This is exactly why it was so important that the CFPB required more data collection and more oversight over lending activities. The law signed by President Trump earlier this year eliminated some of the data we need to preserve this progress. Despite the loss of public HMDA data, each of your agencies still has a requirement to ensure that Latinos, African Americans, women and other people are not rejected for loans due to their gender or ethnicity.

Q.1. How many lenders supervised by your agency will not publicly report the additional data that was to be required this year? This data includes loan characteristics like credit score, fees, points, and interest rates.

A.1. As noted in your question, the partial exemption granted in Section 104 of S. 2155 does not eliminate the need for HMDA filing. Rather, it exempts some credit unions from reporting on additional data points. All HMDA filers continue to report major loan characteristics.

As of June 30, 2018, there were 5,480 federally insured credit unions. Approximately 30 percent (1,675) of all federally insured credit unions file annual HMDA reports. The NCUA estimates that, of the 1,675 credit unions required to file annual HMDA reports, two-thirds (1,125) qualify for the partial HMDA exemptions provided in S. 2155. These 1,125 credit unions will still file annual HMDA reports, containing all the data points specifically identified in the Dodd-Frank Act and the original HMDA regulation.

Q.2. Would it have been easier to spot fair lending violations with transparent data reporting, rather than relying on your bank examiners to go bank by bank, loan by loan to root out discrimination?

A.2. HMDA data is an important supervisory tool to assist in identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes. The NCUA uses HMDA data as a starting point to evaluate fair lending risks in our regulated credit unions. With HMDA data, the NCUA is able to determine if a particular credit union approves and prices their mortgage loans at rates similar to other financial institutions that operate in the same market, and it can compare data based on gender, race, and ethnicity. While HMDA data is a valuable risk evaluation tool, the NCUA cannot use HMDA data alone to prove illegal discrimination. NCUA examiners will continue to evaluate credit unions institution-by-institution and loan-by-loan in order to identify illegal discrimination.

Q.3. Without the expanded HMDA data reporting slated to begin this year, what information will your agency's examiners have to trigger a review of potential discrimination?

A.3. The NCUA uses HMDA data, consumer complaints, compliance risk assessments, compliance violations, and regional recommendations to identify and conduct necessary fair lending examinations in federally insured credit unions. The information that the NCUA receives directly from consumers is critically important when evaluating credit unions for fair lending reviews because it describes actual interactions between consumers and their credit unions. The NCUA also relies heavily on district examiner observations when evaluating credit unions for fair lending oversight. District examiners evaluate each credit union's compliance risk based on the credit union's overall compliance profile. They may cite violations of consumer regulations, suggesting that a detailed fair lending review is appropriate.

Section 108: Escrow Requirements

For generations, lenders understood that they should require property taxes and homeowners insurance be placed in escrow, so that those obligations are always paid on time. But in the runup to the foreclosure crisis, lenders cut comers so that they could misrepresent monthly payments to homeowners and put them into obligations they couldn't afford.

Q.4. How will your agencies monitor the implementation of the escrow exemption? Will your examiners monitor foreclosure activities resulting from unpaid property taxes and/or property insurance?

A.4. Section 108 of S. 2155 amended the Truth in Lending Act by adding new criteria for a consumer credit transaction (secured by a principal dwelling) to be exempt from escrow requirements. Essentially, the changes establish a broad exemption, with criteria different than the Consumer Financial Protection Bureau (CFPB) previously established by regulation for exemption from some escrow requirements. Under the new law, credit unions with assets of less than $10 billion that, together with their affiliates, originated 1,000 or fewer first lien mortgages during the preceding calendar year may qualify for the expanded exemption. At this point, the CFPB has not indicated when it plans to issue a proposed rule on implementing the new criteria for exempting escrow requirements.

The NCUA, as the primary regulator of Federal credit unions, will monitor implementation of the escrow exemption and foreclosure activities through the quarterly call report function and the agency's risk-focused examination program. Examinations of these institutions routinely encompass assessing controls over material lending programs, including reviewing loan policies, underwriting, portfolio management procedures, governance, and tools/models used to evaluate and report credit risk. Loan data queries are typically performed to identify anomalies or unusual trends in consumer accounts. At Federal credit unions with total assets of $10 billion or less,[1] baseline reviews include, but are not limited to: loans granted during the prior 6 months, including a sample from identified loan concentrations; riskier loan types, such as residential real estate; insider loans; extensions; loan modification programs; delinquency and collection procedures, including analysis of foreclosure activities; and management's due diligence over third-party service providers.

Q.5. How will you communicate any findings or concerns from the elimination of the escrow requirement to us in Congress?

A.5. The NCUA issues examination reports to credit union officials. These reports provide the financial data and narrative information necessary to concisely communicate the NCUA's analysis, conclusions, and recommendations. Any findings or concerns related to the escrow requirements would be documented in these reports. Examination reports are exempt from public disclosure, but the agency's findings or concerns related to escrow requirements could be communicated to Members of Congress if requested.

Section 103. Rural Appraisal Exemption (exemptions less than $400,000)

Recently, the NCUA announced appraisal exemptions for some loans of up to a million dollars in rural areas. I met recently with half a dozen credit union leaders from Nevada and they were not likely to make such a large loan without an appraisal.

Q.6.a. Why is NCUA considering allowing loans up to $1 million for some loans without appraisals?

[1] The CFPB has supervision and enforcement responsibility for financial institutions, including credit unions, with total assets of more than $10 billion.

A.6.a. At its September 2018 meeting, the NCUA Board approved a notice of proposed rulemaking to amend the agency's real estate appraisal requirements for certain transactions.[2] The proposed rule would provide a measure of regulatory relief and increased clarity by:

- Increasing the threshold for required appraisals in nonresidential real estate transactions from the current $250,000 to $1 million;
- Reorganizing the appraisal regulation to make it easier to determine when a written estimate or an appraisal is required; and
- Incorporating the rural exemption contained in S. 2155.

The proposal did not include a change to the residential real estate appraisal threshold, which is set at $250,000. Additionally, it is worth noting that the appraisal rules adopted by the other Federal banking agencies do not require an appraisal for qualifying business loans under $1 million.

In proposing the single, $1 million threshold for commercial real estate transactions that provides more flexibility for credit unions to use their judgment about when to obtain an appraisal for commercial real estate-related transactions, the NCUA considered the following factors:

- For commercial lending, cash-flow and the resiliency of the business are the primary underwriting factors, not the real estate collateral. The cash-flow of the business ultimately depends on the success of its business model. Thus, the precision that goes into the estimate of the collateral value is not as important as the rigor that goes into the analysis of the cash-flows and resiliency of the business. It is also important to remember that an appraisal is only a point-in-time estimate of value, and the collateral value is subject to future changes in market conditions. Advancements in the availability of data and analytical techniques make it possible to produce more reliable estimates of market value without obtaining an appraisal.
- Commercial real estate lending relative to net worth is relatively low for credit unions. Commercial real estate lending comprises 46 percent of net worth in credit unions offering commercial real estate loans. In comparison, commercial real estate lending represents 138 percent of tier 1 capital in the banking industry. Commercial real estate loans represent 5 percent of total assets in credit unions compared to 13 percent in banks. In addition, under the Federal Credit Union Act, most credit unions are restricted to holding no more than 1.75 times the credit union's total net worth for member business loans.[3] The statutory ceiling of 1.75 times net worth limits risk for credit unions granting all forms of commercial loans, of which nonresidential real estate transactions are a subset. Therefore, increasing the threshold to $1 million would not pose the same safety and soundness risk to credit unions as it

[2] 83 FR 49857 (Oct. 3, 2018).
[3] 12 U.S.C. § 1757a.

would to similarly situated banking organizations, which do not have the same commercial lending restrictions.

- The analysis of supervisory information concerning losses on commercial real estate transactions suggests that faulty valuations of the underlying real estate collateral have not been a material cause of losses. In the last three decades, the banking industry suffered two crises in which poorly underwritten and administered commercial real estate loans were a key feature in elevated levels of loan losses, and bank and credit union failures. Supervisory experience and an examination of material loss reviews covering those decades suggest that factors other than faulty appraisals were the cause(s) for an institution's loss experience. For example, larger acquisition, construction, and development transactions were more likely to be troublesome. This is due to the lack of appropriate underwriting and administration of issues unique to larger properties, such as longer construction periods, extended "lease up" periods (the time required to lease a building after construction), and the more complex nature of the construction of such properties.
- The agency's analysis suggests that increasing the threshold to $1 million would significantly increase the number of commercial real estate transactions exempted from appraisal requirements. However, the total dollar amount of commercial real estate transactions that the proposal would exempt is relatively small and would not expose credit unions to undue risk. The total dollar volume of exempted commercial real estate transactions would only increase from 1.8 percent to 13 percent. The estimated percentage of the number of commercial transactions that would be exempted from the appraisal requirement would increase from 27 percent to 66 percent. Exempting an additional 39 percent of commercial real estate transactions would provide significant burden relief to credit unions, but would still cover almost 90 percent of the total dollar volume of such transactions. This incremental risk can be addressed through sound risk management practices.
- Under the proposal, even though an appraisal may not be required, credit unions would be required to obtain a written estimate of market value performed by a qualified and experienced individual that possesses the necessary degree of independence.

At the present time, the agency believes statutory limits, combined with appropriate prudential and supervisory oversight, sufficiently mitigate the incremental risk of raising the appraisal threshold for commercial real estate-related transactions. The NCUA Board will thoughtfully consider stakeholder comments on the proposed rule and carefully evaluate the benefits and risks before finalizing the rule.

Q.6.b. What risks would credit unions take on if they began doing most of their lending in rural areas without appraisals?

A.6.b. If credit unions in rural areas comply with the independence, qualification, and experience requirements for individuals performing written evaluations for commercial real estate-related transactions, and follow the 2010 Interagency Appraisal and Evaluation Guidelines, the incremental risk exposure in these credit unions should be minimal.

Q.7. What feedback mechanism does NCUA have in place if more foreclosures occur due to inflated appraisals that lead to underwater borrowers? How will NCUA let us know if you see such a problem?

A.7. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) directs each Federal financial institutions regulatory agency to publish appraisal regulations for federally related transactions.[4] To guard against inflated appraisals, § 722.4 of the NCUA's regulations outlines minimum appraisal standards, including the requirements that appraisals conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice, and be performed by State-licensed or State-certified appraisers.[5]

Additionally, the NCUA monitors individual credit unions' performance through quarterly Call Reports and examination and supervision contacts. If real estate loan delinquencies and loan losses rise to a level of concern, the NCUA can take steps to address this and report it to Congress.

RESPONSES TO WRITTEN QUESTIONS OF SENATORS WARNER, COTTON, TILLIS, AND JONES FROM J. MARK McWATTERS

Comptroller Otting has testified before that "the process for complying with current BSA/AML laws and regulations has become inefficient and costly." In talking with banks/credit unions it is clear that they do not object to the principle of complying with AML regulations, it is that they feel that much of the time, effort, and money spent on compliance is ineffective, and therefore, a waste of time. Banks/credit unions fill out forms invented in the 1970s and have little insight into whether it is doing any good. And we've heard from banks/credit unions that they believe AML examinations are done without respect to the riskiness of the institution or its activities.

Q.1. What improvements can be made so we have a cheaper and faster system that is better at catching criminals?

A.1. An interagency working group led by the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) has begun to identify ways to reduce regulatory burden and improve the effectiveness of BSA/AML requirements and compliance reviews. This review process includes considering the impact innovation and technology have on financial institutions' BSA/AML compliance efforts and the role they could play in regulatory reviews of this area during examinations.

On October 3, 2018, the NCUA, FinCEN and the Federal banking agencies issued joint guidance on the appropriate use of shared BSA resources to enhance the effectiveness of BSA/AML programs

[4] 12 U.S.C. § 3331 *et seq.*
[5] 12 CFR 722.4.

while limiting or reducing costs associated with meeting BSA/AML compliance obligations.[1]

Subsequently, on December 3, 2018, the NCUA, FinCEN, and the Federal banking agencies issued a joint statement encouraging financial institutions to "consider, evaluate, and where appropriate, responsibly implement innovative approaches to meet their [BSA/AML] compliance obligations, in order to further strength the financial system against illicit financial activity."[2] In the joint statement, the agencies noted their commitment to continued engagement with the private sector and other interested parties to help financial institutions in their innovation efforts. The agencies also provided a separate electronic means for the financial services industry to provide feedback on how the regulators can best support innovative efforts.

Q.2. Is there a place in a new AML regime for new technology, like artificial intelligence or machine learning?

A.2. New technology likely will have a place in a new AML regime and will have the power to transform the way we conduct business. Technology firms are exploring how new technology, such as artificial intelligence and machine learning, as well as identity management, could be used to enhance BSA/AML compliance efforts. These and other technological developments may help credit unions more efficiently monitor transactions and accounts for suspicious activity as the technologies become more mainstream and cost effective.

Q.3. What do you, as a regulator, think that it means to have a risk-based AML program?

A.3. A credit union's BSA/AML program should appropriately scale to address the specific risks involved in the institution's business model and practices. BSA/AML compliance programs are not "one-size-fits-all" and should be customized to the risks presented by the products and services offered, the geographic area in which the credit union is located and conducts business, the field of membership served, the types of members (business entities or individuals), and the volume of activity running through the credit union.

Q.4. How do you implement the risk-based AML program requirement through examinations?

A.4. Examiners are trained to start with core statutory BSA/AML requirements and then amend the scope of examinations based on the unique characteristics of each credit union, using historical information, ongoing risk analysis, and other risk indicators such as products, services, customer base and geographic region in which the credit union does business. During each examination, an examiner will review a credit union's risk assessments and testing of its overall BSA/AML risk and risks of specific products, services, operations and customer types, such as money services businesses (MSBs), for adequacy and appropriateness.

[1] NCUA *et. al.,* Interagency Statement on Sharing Bank Secrecy Act Resources (2018), available at *https://www.ncua.gov/files/press-releases-news/interagency-statement-sharing-bsa-resources.pdf.*

[2] NCUA *et. al.,* Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing (2018), available at *https://www.ncua.gov/newsroom/Documents/joint-statement-bsa-innovation.pdf.*

Risk assessments determined to be inadequate or inappropriate require more in-depth assessment of risk and potentially expanded reviews of BSA policies, processes, and procedures, as well as additional transaction testing. An examiner will address incomplete risk assessments, or risk assessments that are not commensurate with the credit union's complexity and operations, in the appropriate section of the examination report provided to officials. Prior to issuing the report, an examiner will communicate with credit union management to ensure they fully understand the concern and agree to take appropriate action to resolve it.

Q.5. One common criticism of the current AML regime is the lack of feedback given to banks/credit unions after they file their SARs. The current system is extremely segmented, and as a consequence, it is not the "fault" of any one entity that there is little feedback given. But without a system to provide feedback, the quality of SARs suffer. A system that doesn't focus on thequality of reports being filed is one that is not optimized to catch criminals. Many banks/credit unions wish that they had an idea of what FinCEN is really trying to find, because then their cooperation and input might be more helpful and effective.

How often does your agency meet with FinCEN and with the DOJ/FBI to discuss the usefulness of suspicious activity reports that are being filed?

A.5. The new interagency working group, which meets monthly, is exploring how to improve the usefulness of SARs and better convey to financial institutions the important role SARs play in law enforcement activities. Further, the FBI or DOJ may reach out to the NCUA if they have questions or need more information about a specific credit union.

Q.6. When a bank/credit union files a SAR, or a regulator is examining a financial institution, how much feedback is there across the system about whether or not the SARs they filed were found to be useful, informative, or effective?

A.6. During an examination an examiner may review a sample of the SARs filed by a credit union. As part of this review, the examiner may provide recommendations as to what information should be included in future SARs to maximize their utility to law enforcement. Law enforcement does not generally provide feedback or contact a financial institution unless more information is needed.

Q.7. What are the legal hurdles that prevent more effective and more regular feedback within the Federal Government and between the Federal Government and financial institutions?

A.7. The NCUA is not aware of specific legal barriers, other than those intentionally designed to preserve the confidentiality of SARs and not jeopardize the activities of law enforcement. That said, there has been a greater emphasis in recent years on privacy generally, and avoiding sharing personal information unless necessary. There is also the need to keep investigations confidential. The need for confidential investigations coupled with the greater privacy emphasis certainly discourage feedback, especially as it relates to a particular SAR. Additionally, while not a "legal" hurdle, finite law enforcement resources may limit the time dedicated to providing SARs feedback as that time is devoted to investigating useful leads.

Q.8. Will you pledge to institutionalize feedback mechanisms wherein banks/credit unions both get and can give feedback on how to constantly improve the process?

A.8. The NCUA will work with FinCEN and law enforcement agencies to identify feasible methods for credit unions to receive and provide feedback on BSA filings in order to improve the information contained therein. Information sharing between institutions and between regulators may also provide opportunities to identify efficiencies that can be incorporated into the BSA reporting process. Additionally, as part of the joint Interagency Statement on innovative efforts to combat money laundering and terrorist financing, issued on December 3, 2018, the issuing agencies encouraged industry feedback on how the agencies can support innovative BSA/AML efforts and provided a means for submission of electronic feedback.[3]

Q.9. We hear from banks that they feel pressured to file SARs even when they believe the underlying transaction or activity does not rise to a level of suspiciousness that merits a filing. They say they do this because they are afraid of being second-guessed by examiners after the fact, and because there is no Government penalty for over-filing SARs—only a penalty for not filing a SAR. But banks bear the significant cost of filing unnecessary SARs.

What can be done to realign incentives so that banks/credit unions don't feel pressured to file SARs that they don't feel reflects activity warranting a filing?

A.9. Credit unions are encouraged to document their rationale for not filing a SAR after reviewing the facts of what, on its face, may appear to be suspicious activity. While a SAR filing is required in certain circumstances, many other situations call for credit union management's judgment regarding whether to file. In addition to financial institutions bearing the cost of filing unnecessary SARs, these unnecessary filings also create a burden for law enforcement, which may take valuable resources away from reviewing and investigating SARs more likely to involve criminal activity. Historically, comparatively few credit unions have been penalized for insufficient SAR filing. We believe that the NCUA has implemented an effective and balanced risk-based approach to our supervisory processes. NCUA staff will generally rely on the procedures, controls, risk assessments, and testing of the credit union provided they are appropriately aligned with the risk posed by the credit union's unique characteristics. Testing performed by examiners are limited samples to validate the integrity of a credit union's controls. The issue of insufficient SAR filing would typically only arise if there is a clear red flag, such as ineffective or insufficient resources or controls for the given level of risk.

Q.10. Banks/credit unions commonly use "rules-based" software to screen transactions and alert AML compliance teams to suspicious

[3] NCUA *et. al.,* Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing (2018), available at ***https://www.ncua.gov/newsroom/Documents/joint-statement-bsa-innovation.pdf.***

activities. While these rules-based systems can be effective, we have concerns that they might not be the most effective tool available to us given advances in data science and machine learning, and further, that there may be opportunities for criminals to manipulate these rules-based systems.

We have heard concerns that many criminals have access to the exact same products that are used by financial institutions—is this true?

A.10. The NCUA does not maintain the requisite expertise to opine on these sorts of criminal activities and largely relies on information shared by those charged with investigating and prosecuting these criminal activities.

Q.11. If criminals have access to similar products, or can easily come to understand the rules-based system, how easy is it to manipulate these detection systems?

A.11. The NCUA does not maintain the requisite expertise to opine on these sorts of criminal activities and largely relies on information shared by those charged with investigating and prosecuting these criminal activities.

Q.12. If there was a proven model of using a "learning," algorithmic system to flag potentially suspicious transactions, would this be an improvement on the current system? What are the hurdles to financial institutions adopting such systems?

A.12. The NCUA, FinCEN and the banking agencies recently issued guidance on the adoption of innovation and innovative technologies to enhance and improve AML programs. We encourage institutions to embrace technology and innovation in their approach toward BSA. Such systems may be useful in suspicious activity and transaction monitoring, permitting human BSA compliance resources to review more complex and higher-risk activities as well as those transactions and activities that are close/judgment calls. The NCUA does not endorse any particular systems, products, or models. Credit unions use different methods to monitor suspicious activity.

In terms of barriers to adoption, approximately three-fourths of all federally insured credit unions are "small," defined as under $100 million in assets and generally represent a low risk of illicit finance. Many of these credit unions simply lack the resources and/or the need to acquire such high-tech monitoring systems.

Q.13. In what ways is a bank's/credit union's "safety and soundness" implicated by its AML system?

A.13. AML systems can impact a credit union's safety and soundness in a number of ways. Publicized BSA violations may negatively affect how a credit union's members view the institution. Negative publicity can cause members and potential members to lose confidence in credit union management and the safety of their deposits and data. Additionally, with the size and velocity of transactions, a significant violation can result in monetary penalties significant enough to threaten the ongoing viability of small- and medium-sized credit unions. The risk of insolvency because of large penalties or the seizure of illicit funds is higher in some small credit unions.

Many credit unions are very small and represent a very low risk of monetary system compromise through undetected money laundering activities. An overly burdensome set of statutory requirements can contribute to significant regulatory burden in the design and implementation of a credit union's AML systems. These costs can impact profitability in credit unions already operating on very narrow margins.

Further, if criminals are able to launder money successfully through a credit union, there is a chance they may be exploiting the credit union in other ways—or will before they move on to the next institution. In other words, inadequate controls may result in insufficient risk assessment and monitoring for BSA/AML compliance, as well as poor monitoring of financial transactions and accounting records in general.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

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September 25, 2018

Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown,

Thank you for the opportunity to comment on the hearing scheduled for October 2, 2018 on the implementation of S.2155. Three of us sent you a letter on March 6, 2018 when the law was being discussed.[1] We were concerned that the "tailoring" proposed in S.2155 would be used to lower equity requirements and thus endanger the financial system. These concerns are even stronger today. We are alarmed by the recent push from some industry participants and policymakers to weaken capital regulation, since capital regulation, when implemented properly, is the most essential, beneficial, and cost-effective part of banking regulation.

Effective capital regulation requires that financial institutions obtain a substantial part of their funding from equity by issuing stock or retaining earnings. Substantial equity means significantly more than current regulations require: at least 15 percent of properly measured assets, compared to levels such as 3 percent under Basel III or 5 percent for the largest Bank

[1] https://www.gsb.stanford.edu/sites/gsb/files/admati-pfleiderer-seru-letter-s.2155-final.pdf

Holding Companies in the U.S.[2] Equity capital automatically absorbs losses and reduces the chances of insolvency, bankruptcy, financial crises, and bailouts. Equity capital makes the financial system on its own resilient to losses, and also insulates the system against regulators' failure or inability to spot risks ahead of time or to properly regulate risk-taking.

The flaws in current regulation go beyond dangerously low equity requirements. The rules allow banks to count as regulatory capital some debt securities that are much inferior to equity for loss absorption. These are referred to as Tier 2 capital, contingent capital, or Total Loss Absorbing Capacity (TLAC). These securities are poor substitutes for equity in capital regulations. Shareholders absorb losses automatically through declines in the share value, while the other securities involve triggers and complex mechanisms to impose losses on creditors. In the financial crisis, the holders of such securities were paid in full and did not absorb losses even as the issuing institutions received massive supports from governments and central banks.

The use of asset risk weights to calibrate capital requirements is also inherently flawed. In the financial crisis and more recently in Europe, many institutions collapsed from losses on securities considered perfectly safe by such regulations. Risk weights distort banks' investment decisions away from lending to consumers and businesses and toward securities, many constructed to meet risk weights. Risk weights encourage innovation to manipulate rules in ways that often increase systemic risk.

Financial institutions often complain that raising equity is costly. This complaint ignores the distinction between private and social costs. Equity appears costly to banks because the use of debt allows them to enjoy higher subsidies through tax savings and the ability to shift risks to the taxpayers. But more equity capital is not more expensive to society as a whole, which pays those subsidies. Banks clamouring for looser capital requirements are, in effect, clamouring for taxpayer subsidies, subsidies that perversely increase systemic risk. You must resist. Bank stocks have boomed in the last few years, even as capital requirements have risen, showing how empty is the claim that banks cannot function with higher equity capital requirements.

Regulators and bankers may tell you that the Fed's stress tests should reassure us about the safety of banks, despite banks' extensive reliance on borrowed money. However, risks facing financial institutions are inherently difficult to predict, describe, and quantify, and they are hard to anticipate both by the banks and by their regulators. Stress tests are based on models with numerous questionable assumptions. These models cannot reliably identify major sources

[2] A 2010 letter from twenty finance and banking scholars whose signatories include Nobel-prize winners William F. Sharpe and Eugene F. Fama states that "if at least 15 percent of total, non-weighted assets were funded with equity, the social benefits would be substantial. And the social costs would be minimal, if any," https://www.gsb.stanford.edu/faculty-research/excessive-leverage/healthy-banking-system-goal

of risk and their consequences in the highly complex and interconnected system. Stress tests gives a false sense of safety.

The claim that some institutions should be allowed to operate with less equity because they are not "systemic" is also false. Many crises, including the huge banking crisis of the Great Depression and the Savings and Loan debacle of the 1980s, involved the simultaneous failure of many small institutions. During the financial crisis of 2008-2009, thousands of banks of all sizes, not just the largest, as well as some non-banks, required support that was delivered through trillions in loans and investments by governments and central banks in US and Europe. Creditors run on small banks as well as on big ones if they are concerned about the safety of their funds. Proper equity requirements are critical for institutions of all sizes.

You might also hear that current capital requirements lead big banks to trade less than they used to trade, thus making some markets less "liquid." But this claim too argues for *more*, not less, equity. It is actually poor-capitalization of banks and the many prior debt commitments hanging over them that distort their trading decisions. If banks have enough equity that their debt is close to being risk free, the distortions that arise from overhanging debt would disappear.

We do not write in support of all regulations. Many regulations are not targeted at documented market failures or are too complex and costly relative to their benefits. These regulations are wasteful for society. Regulating the mix of funding to require more equity and less short-term debt, however, goes to the heart of fragility in banking. It removes distortions caused by government subsidies and can be done simply and transparently. Indeed, requiring more equity capital is a step toward de-regulation since it would enable the simplification or elimination of complex, expensive or counterproductive regulations, and promote competition and innovation.

The current high profitability of banks and strong economy provide regulators with a golden opportunity to strengthen and improve equity requirements so the financial system can continue to function well in a downturn.

Historically, regulators have eased off in the boom, often caving in to pressure from enthusiastic bankers, and thereby making the subsequent crisis worse. We must not repeat the same mistakes.

At this hearing, we urge you to press the banking regulators to answer the following question:

> *Over the 10 years since the crisis, regulators have substantially increased capital requirements. The economy is booming, lending is up, and bank profits are high. Now that we have all learned that the scare stories about capital are false, why would you not complete the job, raising equity capital requirements further so that the financial system can easily weather the next downturn? You need only to require firms to retain earnings*

rather than pay them out to shareholders. Why repeat the errors of the past by loosening capital requirements in the boom that always precedes a bust?

Sincerely,

Anat R. Admati (admati@stanford.edu) John H. Cochrane (john.cochrane@stanford.edu)

Paul Pfleiderer (pfleider@stanford.edu) Amit Seru (aseru@stanford.edu)

Cc: The Honorable Richard Shelby
The Honorable Jack Reed
The Honorable Bob Corker
The Honorable Robert Menendez
The Honorable Patrick J. Toomey
The Honorable Jon Tester
The Honorable Dean Heller
The Honorable Mark R. Warner
The Honorable Tim Scott
The Honorable Elizabeth Warren
The Honorable Ben Sasse
The Honorable Heidi Heitkamp
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October 2, 2018

The Honorable Mike Crapo	**The Honorable Sherrod Brown**
Chairman	**Ranking Member**
U.S. Senate Committee on Banking,	**U.S. Senate Committee on Banking,**
Housing, & Urban Affairs	**Housing, & Urban Affairs**
534 Dirksen Senate Office Building	**534 Dirksen Senate Office Building**
Washington, D.C. 20510	**Washington, D.C. 20510**

Dear Chairman Crapo and Ranking Member Brown:

The Center for American Progress ("CAP") is pleased to submit the below statement for today's hearing entitled, "Implementation of the *Economic Growth, Regulatory Relief, and Consumer Protection Act*" in the U.S. Senate Committee on Banking, Housing, & Urban Affairs.

In May, President Donald Trump signed S.2155, the *Economic Growth, Regulatory Relief, and Consumer Protection Act*, into law.[1] Among other provisions, the bill rolled back the Dodd-Frank Act's stronger financial safeguards for banks with between $50 billion and $250 billion in assets. These stronger safeguards, known as "enhanced prudential standards," include capital and liquidity requirements, living wills, risk management standards, and other rules. Under the law, the Federal Reserve Board ("Fed") has the authority, but not an obligation, to reapply enhanced standards to banks with between $100 billion and $250 billion in assets.

If the Fed does not act, however, these large banks will be deregulated to the detriment of U.S. financial stability. The banks deregulated by S.2155, roughly 25 of the largest 40 banks in the country, collectively hold about 16% of the assets in the entire U.S. banking sector and received $47 billion in TARP bailout funds during the 2007-2008 financial crisis.[2] They are not small, local community banks. For some context, Countrywide—a key player in the financial crisis—was a $200 billion bank. If one or several of these banks failed during a period of stress in the financial system, it could threaten U.S. financial stability and negatively impact the economy at a regional and national level.[3] The Fed should prevent this imprudent deregulation and use its authority to reapply these vital safeguards to each and every bank with between $100 billion and $250 billion in assets.

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[1] *Economic Growth, Regulatory Relief, and Consumer Protection Act*, S.2155, 155 Cong. 2 Sess. (Government Printing Office, 2017).
[2] Gregg Gelzinis and Joe Valenti, "Fact Sheet: The Senate's Bipartisan Dodd-Frank Rollback Bill," (Washington: Center for American Progress, 2018), available at https://www.americanprogress.org/issues/economy/reports/2018/02/28/447264/fact-sheet-senates-bipartisan-dodd-frank-rollback-bill/.
[3] Elizabeth Warren, "Don't Let Big Banks Escape the Fed's Scrutiny," *Bloomberg*, October 26, 2017, available at https://www.bloomberg.com/view/articles/2017-10-26/elizabeth-warren-don-t-let-big-banks-escape-the-fed-s-scrutiny.

The bill also changed the frequency of stress testing for firms with between $100 billion and $250 billion in assets from annual to periodic. The Fed's annual stress testing framework has been one of the most important prudential tools implemented following the financial crisis. The Fed should continue to subject these firms to robust annual stress testing—not a "stress testing-lite" regime conducted less frequently.

Comments and actions taken by the Fed, however, suggest it will not aggressively exercise its discretion under S.2155. The Fed joined the Office of the Comptroller of the Currency ("OCC") and proposed a rule that would lower the loss-absorbing capital requirements at the eight most systemically important banks in the country.[4] The Fed also joined four other financial regulators and proposed a rule that would significantly undermine the Volcker Rule.[5] Additionally, the Fed's recent stress testing proposal would loosen certain assumptions used in the stress tests, resulting in an aggregate decrease in capital for the banks subject to the tests.[6]

Beyond these concerning deregulatory actions, Fed Vice Chairman for Supervision Randal Quarles has suggested in speeches that the Fed may roll back additional post-crisis rules for banks with more than $250 billion in assets and a recent speech revealed that the Fed may not reapply crucial living will requirements to most banks with between $100 billion and $250 billion in assets.[7] The misguided regulatory rollbacks and recent public comments provide no confidence that the Fed will aggressively use its authority to reapply the Dodd-Frank Act's enhanced standards to the class of deregulated banks.

The *Economic Growth, Regulatory Relief, and Consumer Protection Act* contained another deeply troubling provision relevant to today's hearing on implementation. Section 402 of the bill loosened the calculation of the supplementary leverage ratio ("SLR") for banks predominantly

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[4] Board of Governors of the Federal Reserve System, "Rule proposed to tailor 'enhanced supplementary leverage ratio' requirements," Press Release, April 11, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm; Gregg Gelzinis, "This is not the time to loosen rules on bank capital," *MarketWatch*, May 2, 2018, available at https://www.marketwatch.com/story/this-is-not-the-time-to-loosen-rules-on-bank-capital-2018-05-02.

[5] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Commodity Futures Trading Commission, "Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (2018), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180530a1.pdf; Gregg Gelzinis, "Regulators' dangerous plan to carve up the Volcker Rule," American Banker, June 18, 2018, available at https://www.americanbanker.com/opinion/regulators-dangerous-plan-to-carve-up-the-volcker-rule.

[6] Board of Governors of the Federal Reserve System, "Federal Reserve Board seeks comment on proposal to simplify its capital rules for large banks while preserving strong capital levels that would maintain their ability to lend under stressful conditions," Press Release, April 10, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.

[7] Randal K. Quarles, "Speech: Early Observations on Improving the Effectiveness of Post-Crisis Regulation," Board of Governors of the Federal Reserve System, January 19, 2018, available at https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm; Randal K. Quarles, "Getting It Right: Factors for Tailoring Supervision and Regulation of Large Financial Institutions," Board of Governors of the Federal Reserve System, July 18, 2018, available at https://www.federalreserve.gov/newsevents/speech/quarles20180718a.htm.

engaged in custody banking by excluding central bank deposits from the denominator of the SLR. This change violates the principle of the risk-neutral leverage ratio and lowers the capital requirements at the three largest custody banks in the U.S.—banks that collectively hold $70+ trillion in assets under custody and administration. The Fed should not magnify the harm of this misguided policy by applying the change to other banks with sizeable custody businesses or by finalizing proposed changes to the enhanced supplementary leverage ratio ("eSLR").

During consideration of S.2155, Section 402 was altered from a clear quantitative threshold to a qualitative description. The qualitative description creates the possibility that regulators will apply the weaker requirement to other Wall Street banks with significant custody banking operations. The Congressional Budget Office assigned this outcome a 50% probability in its analysis of the bill.[8] If the Fed extends this rollback to additional Wall Street firms, it will severely increase the potential harm of this policy. Decreasing capital increases the likelihood of bank failure, and in turn, the likelihood of another devastating crash.

Separately, the joint eSLR proposed rule from the Fed and OCC would have a particularly large impact on custody bank capital. The two custody banks that qualify as G-SIBs would see their leverage requirements drop from 5% to 3.75% at their holding companies and drop from 6% to 3.75% at their insured depository institutions. With Section 402 and the eSLR proposal, not only would custody banks have a lower numerical capital requirement, they will use a weaker calculation to meet that lower requirement. The combination could effectively drop G-SIB custody bank leverage requirements below 3%, using today's SLR calculation method. Custody banks are vital to the plumbing of the financial sector. The combination of Section 402 and the proposed eSLR rule would leave their capital requirements dangerously low. Regulators must consider the drastic consequences of a potential custody bank failure and withdraw the eSLR proposal given, among other considerations, its interaction with Section 402 of S.2155.

Bank profits are at all-time highs.[9] Lending has grown at a healthy rate and has supported economic growth following the depths of the financial crisis.[10] Market liquidity is well-within historical norms and in some cases is healthier than pre-crisis levels.[11] All the while, in the 9th year of the post-crisis economic expansion, risks are starting to build in the financial system. Valuations across asset classes are stretched, nonfinancial sector leverage is elevated, and the credit quality of firms taking on significant leverage has deteriorated.[12] Moreover, a large body of research from academia and regulators alike demonstrates that bank capital requirements,

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[8] Jeff Stein, "Senate banking bill likely to boost chances of bank bailouts, CBO says," *The Washington Post*, March 5, 2018, available at https://www.washingtonpost.com/news/wonk/wp/2018/03/05/senate-banking-bill-would-boost-the-chances-of-more-bank-bailouts-cbo-report-says/?utm_term=.ef520f1a6464.
[9] Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Second Quarter 2018" (2018), available at https://www.fdic.gov/bank/analytical/qbp/2018jun/qbp.pdf.
[10] Federal Reserve Bank of St. Louis, "Loans and Leases in Bank Credit, All Commercial Banks," available at https://fred.stlouisfed.org/series/TOTLL (last accessed September 2018).
[11] Division of Economic and Risk Analysis, "Access to Capital and Market Liquidity" (Washington: Securities and Exchange Commission, 2017), available at https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.
[12] Jeff Spross, "Corporate debt is a ticking time bomb," *The Week*, August 17, 2018, available at http://theweek.com/articles/790578/corporate-debt-ticking-time-bomb.

while improved, are still too low.[13] Policymakers should be strengthening financial safeguards, not rolling them back.

Just 10 years after the financial crisis, memories in Washington, D.C. have clearly faded. Millions of American lost their jobs, homes, and savings due to unchecked risk-taking on Wall Street. Many Americans across the country still carry the economic scars from the crisis. They have not forgotten the feeling of having a house foreclosed on or getting a pink slip at work—not knowing how their family will make ends meet. Wall Street CEOs who pushed the U.S. economy to the brink of collapse were bailed out, faced no discipline, and many are wealthier today than they were in 2008. It is inexplicable that policymakers care more about the complaints of bankers—currently making record profits—than the potential harm that rolling back these reforms will do to workers and families across the country.

Sincerely,

Gregg Gelzinis
Research Associate, Economic Policy
Center for American Progress

[13] Gregg Gelzinis, Andy Green, and Marc Jarsulic, "Resisting Financial Deregulation" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/12/04/443611/resisting-financial-deregulation/.

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NAFCU
National Association of Federally-Insured Credit Unions

Carrie R. Hunt
Executive Vice President of Government Affairs
and General Counsel

October 3, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing,
& Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
& Urban Affairs
United States Senate
Washington, DC 20510

RE: Hearing on the Implementation of the *Economic Growth, Regulatory Relief and Consumer Protection Act*

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only trade association exclusively representing the federal interests of our nation's federally-insured credit unions, I write to share our thoughts in regard to yesterday's hearing on the implementation of the *Economic Growth, Regulatory Relief and Consumer Protection Act* (S. 2155). NAFCU would like to thank the Committee for its leadership on this legislation, which contained a number of important provisions for credit unions. We are pleased that S. 2155 has been signed into law and appreciate the implementation updates provided by the financial services regulators, including the National Credit Union Administration (NCUA). We also urge the Committee to continue its regulatory relief efforts by considering additional bipartisan relief measures, such as the *JOBS and Investor Confidence Act*, which passed the House overwhelmingly, and is pending before the Senate.

Since the financial crisis, the credit union industry has lost over 1,500 institutions. This dramatic consolidation is due, in large part, to increased regulatory compliance requirements. NAFCU supports enhanced regulatory relief to preserve the credit union industry and allow institutions to grow and compete. We urge you to continue to work to create a regulatory environment where credit unions can thrive. As we have previously communicated to you, NAFCU supports the following five tenets of a healthy regulatory environment:

- **NAFCU supports a regulatory environment that allows credit unions to grow.** NAFCU believes that there must be a regulatory environment that neither stifles innovation nor discourages credit unions from providing consumers and small businesses with access to credit. This includes protecting the current tax status of credit unions. It also includes the ability of credit unions to establish healthy fields of membership that are not limited by outdated laws or regulatory red tape. Credit unions need modernized capital standards that reflect the realities of the 21st century financial marketplace. Additionally, there must be a housing finance system that works for credit unions.

- **NAFCU supports appropriate, tailored regulation for credit unions and relief from growing regulatory burdens.** Credit unions are swamped by an ever-increasing regulatory burden from the Bureau of Consumer Financial Protection (Bureau) and other regulatory entities, often on rules that are targeting bad actors and not community institutions. NAFCU supports cost-benefit analysis in regulation, and wants to ensure that we have an effective regulatory environment where positive regulations may be easily implemented and negative ones may be quickly eliminated. NAFCU also believes that enforcement orders from regulators should not take the place of regulation or agency guidance to provide clear rules of the road. This includes seeking regulatory relief and reform that allows credit unions to better serve their members.

- **NAFCU supports a fair playing field.** NAFCU believes that credit unions should have as many opportunities as banks and non-regulated entities to provide provident credit to our nations' consumers. NAFCU wants to ensure that all similarly situated depositories follow the same rules of the road and unregulated entities, such as predatory payday lenders, do not escape oversight. We also believe that there should be a federal regulatory structure for non-bank financial services market players that do not have a prudential regulator, including emerging fintech companies. Additionally, retailers and others who handle personal financial information should be held responsible for protecting that information, and should pay their share for costs associated with data breaches and using the payments system.

- **NAFCU supports government transparency and accountability.** NAFCU believes regulators need to be transparent in their actions, with the opportunity for public input, and should respect possible different viewpoints. We believe a bipartisan commission structure is the best form of regulatory governance for independent agencies, and all stakeholders should be able to have input into the regulatory process.

- **NAFCU supports a strong, independent NCUA as the primary regulator for credit unions.** NAFCU believes that the National Credit Union Administration is best situated with the knowledge and expertise to regulate credit unions due to their unique nature. The current structure of the NCUA, including a three-person board, has a track record of success. The NCUA should be the sole regulator for credit unions and work with other regulators on joint rulemaking when appropriate. Congress should make sure that the NCUA has the tools and powers that it needs to effectively regulate the industry.

NAFCU commends the NCUA on its efforts to implement S. 2155 and provide important relief for credit unions. The NCUA has already proposed or finalized regulations to incorporate the exemption from appraisals in rural areas, the revised member business loan definition, and increased budget transparency provisions of S. 2155. NAFCU also appreciates the agency's leadership on changes to the *Home Mortgage Disclosure Act* (HMDA) as provided in Section 104 of S. 2155. Nonetheless, the NCUA has been apprised of additional measures in S. 2155 that impact credit unions and require clarification or collaboration with other federal agencies. For example, Section 213 of S. 2155, titled "Making Online Banking Initiation Legal and Easy," requires credit unions to permanently delete copies or images of a driver's license or personal identification card after using the consumer's information to open an account or permit access to a financial product or service through an online service. Credit unions are required to maintain internal Customer Identification Program policies and this deletion requirement may directly conflict with such a policy, potentially exposing the credit union to being designated as in violation of its own policies during its NCUA examination. The NCUA should coordinate with the Financial Crimes Enforcement Network (FinCEN) to ensure that credit unions may properly comply with the requirements of the *Bank Secrecy Act* and guarantee proper fraud protection measures while not running afoul of the mandate in S. 2155. For your reference, we have attached NAFCU's "S. 2155 Analysis of Regulatory Relief for Credit Unions," which outlines sections of S. 2155 that are relevant to credit unions and may require additional clarification or regulation from federal agencies.

Even though the Bureau was not present at this hearing, it plays a key role in implementing several provisions of S. 2155 that are relevant and important to credit unions. NAFCU has highlighted, both in writing and in-person, the sections of S. 2155 that the Bureau needs to implement so that credit unions can realize the regulatory relief intended by the legislation. We have attached a June 14, 2018 letter to Acting Director Mulvaney that provides a detailed outline of the sections requiring conforming regulations.

Furthermore, NAFCU supports NCUA's call for legislative action in a number of areas, including: improvements to field of membership (FOM) requirements; enhancing the ability of all credit unions to add underserved areas to their FOM; expanding access to alternative forms of capital; and providing loan maturity and loan rate ceiling adjustments. Although NAFCU and its member credit unions also appreciate the NCUA's efforts to reduce regulatory burden on credit unions, we are troubled by the NCUA's call for expanded vendor authority over third-party vendors and credit union service organizations (CUSOs).

NAFCU does not support NCUA's continued efforts for additional authority over third-party vendors of credit unions in order to assess cybersecurity risks. The NCUA, as the primary regulator of credit unions, is tasked with examining credit unions to preserve safety and soundness in the industry. The NCUA does not currently have statutory examination and enforcement authority over third-party, private companies. Granting such authority would not only run counter to some of the key objectives of S. 2155, which include regulatory relief and greater budget transparency and responsibility for the NCUA, but would also create additional obstacles for credit unions seeking to partner with fintech companies and CUSOs.

NAFCU has long-opposed the expansion of the NCUA's vendor authority because it would marginalize the significance of credit unions' existing due diligence requirements with regard to cybersecurity. Credit unions must evaluate their contracts with vendors to ascertain whether there are sufficient mechanisms to assess and mitigate risk. Additionally, most major service providers are examined by other banking regulators as the Federal Financial Institutions Examination Council (FFIEC) Supervised Technology Service Providers. Moreover, the NCUA already has access to information and examination reports from technology vendors through its role with the FFIEC and maintains its authority over credit unions to ensure due diligence with any vendor a credit union chooses to use. NAFCU believes that the additional layer of oversight that would be provided by the NCUA if it were to begin conducting its own examinations would not meaningfully improve supervision of credit unions.

The NCUA's recent experience developing its Automated Cybersecurity Assessment Tool (ACET) demonstrates its level of collaboration with other regulatory agencies to craft information technology (IT) related guidance. Importantly, such collaboration makes sense in an environment where cybersecurity talent is relatively scarce and other banking regulators are equipped with greater resources. Examiner training for the ACET has revealed the difficulty of procuring specialists to implement the NCUA's more ambitious IT initiatives. Extending the NCUA's vendor authority would generally duplicate the efforts of larger banking agencies and create more regulatory hurdles for credit unions looking to establish partnerships with fintech companies or CUSOs. Achieving strong cybersecurity measures and examination protocols requires increased collaboration, not independent analysis. The NCUA's proposed solution to defending against cybersecurity risks in the credit union system is well intentioned, but has the potential to be an impediment to credit union growth and development in the fintech space.

Once again, we thank you for your leadership with S. 2155. Still, NAFCU strongly urges you to consider additional regulatory relief measures for credit unions. We thank you for the opportunity to share our input and look forward to continuing to work with the Committee to balance minimizing regulatory burden with enhancing the safety and soundness of the credit union system. Should you have any questions or require any additional information, please contact me or Brad Thaler, NAFCU's Vice President of Legislative Affairs, at 703-842-2204 or bthaler@nafcu.org.

Sincerely,

Carrie R. Hunt
Executive Vice President of Government Affairs and General Counsel

cc: Members of the Committee on Banking, Housing, and Urban Affairs

Attachments

S. 2155 Analysis of Regulatory Relief for Credit Unions

September 2018

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Minimum Standards for Residential Mortgage Loans (Section 101)	Adds a new safe harbor category of Qualified Mortgages (QMs) to Section 129C(b)(2) of the *Truth in Lending Act* (TILA) for mortgages originated and retained in portfolio by insured credit unions with less than $10 billion in assets that meet certain criteria. This section also notes that compliance with Appendix Q of Regulation Z may not be required and "multiple methods of documentation" shall be permitted. This section codifies a version of the Small Creditor Portfolio QM category and allows credit unions expanded flexibility with respect to making QM loans.	May 24, 2018; Conforming Regulations Expected	Bureau of Consumer Financial Protection
Safeguarding Access to Habitat for Humanity Homes (Section 102)	Amends Section 129E(i)(2) of TILA to make it easier for appraisers to donate their services to charitable organizations by clarifying that this does not violate the customary-and-reasonable fee requirement in TILA. For credit unions partnering with charitable organizations such as Habitat for Humanity, this is important to note as you work to provide affordable mortgage financing to your communities.	May 24, 2018; Conforming Regulations May Be Necessary	Bureau of Consumer Financial Protection

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Exemption from Appraisals of Real Property Located in Rural Areas (Section 103)	Amends Title XI of the *Financial Institutions Reform, Recovery, and Enforcement Act of 1989* to waive the independent home appraisals requirement for federally related mortgages under $400,000 in rural areas where the lender has contacted three state-licensed or state-certified appraisers who could not complete an appraisal in "a reasonable amount of time." This reduces a significant regulatory hurdle for credit unions in rural areas where appraisers can sometimes be hard to find or work with within the timeframe for closing on the mortgage.	May 24, 2018; Conforming Regulations May Be Necessary	Bureau of Consumer Financial Protection
Home Mortgage Disclosure Act Adjustment and Study (Section 104)	Exempts credit unions that have originated less than 500 closed-end mortgage loans or less than 500 open-end lines of credit in each of the two preceding calendar years from certain disclosure requirements under the *Home Mortgage Disclosure Act* (HMDA). This does not completely eliminate all HMDA reporting obligations – it only applies to certain reportable items that were added by the *Dodd-Frank Wall Street Reform and Consumer Financial Protection Act* (Dodd-Frank Act). Credit unions that qualify for this exemption—but are considered financial institutions under Regulation C—may still need to report non-excluded HMDA items (i.e., the data that was required prior to January 1, 2018). NOTE: The Bureau of Consumer Financial Protection issued a final rule to implement and clarify the requirements of this section, noting that credit unions have the option to "report exempt data fields as long as they report all data fields within any exempt data point for which they report data."	May 24, 2018; Conforming Regulations Issued September 1, 2018	Bureau of Consumer Financial Protection

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Credit Union Residential Loans (Section 105)	Amends the *Federal Credit Union Act* (FCU Act) to provide that a 1- to 4-family dwelling that is not the primary residence of a member will not be considered a member business loan (MBL) for purposes of the MBL cap. On June 1, 2018, the NCUA approved a final rule to amend its definition of a member business loan to conform to S. 2155's language. Although section 105 and the NCUA's final rule do not address maturities on such loans, NAFCU continues to advocate for and support increased statutory flexibility for maturity limits.	June 5, 2018	National Credit Union Administration (NCUA)
Eliminating Barriers to Jobs for Loan Originators (Section 106)	Amends the S.A.F.E. Mortgage Licensing Act of 2008 (S.A.F.E. Act) and describes an individual's temporary authority to originate loans for a state-licensed loan originator, such as a credit union that is licensed or registered under state law to engage in residential mortgage loan originations and processing activities. This section applies indirectly to credit unions to the extent that it provides additional flexibility when hiring mortgage loan originators.	November 24, 2019 (18 Months After May 24, 2018 Enactment of S. 2155)	Bureau of Consumer Financial Protection
Escrow Requirements Relating to Certain Consumer Credit Transactions (Section 108)	Amends Section 129D of TILA to exempt qualifying credit unions from the escrow requirements contained in subsection (a). As amended, (c)(2) provides that loans made by an insured credit union, which are secured by a first lien on a principal dwelling, are exempt from the requirement, subject to certain conditions.	May 24, 2018; Conforming Regulations Expected	Bureau of Consumer Financial Protection

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
No Wait for Lower Mortgage Rates (Section 109)	Adds a new subsection to Section 129(b) of TILA to provide an exception to the required three-day waiting period for disclosures if a creditor extends a second offer with a lower annual percentage rate (APR). Congress presumably intended to eliminate the TRID Rule's three business-day waiting period for closing a mortgage loan when the APR has decreased by more than the applicable tolerance after issuance of the initial Closing Disclosure; however, this provision actually amends the waiting period requirements for only high-cost mortgage loans. If Congress intended this change to apply to all mortgage disclosures, then it must adopt amendments to S. 2155 to fix this.	May 24, 2018; Conforming Regulations Expected	Bureau of Consumer Financial Protection
Budget Transparency for the NCUA (Section 212)	Amends Section 209(b) of the FCU Act to require the NCUA to publish a draft of its annual "detailed business-type budget" in the *Federal Register*, hold a public hearing on the draft, and address comments submitted by the public. This does not change regulatory requirements for credit unions.	May 24, 2018	NCUA
Making Online Banking Initiation Legal and Easy (Section 213)	Permits credit unions to record personal information from and make a copy of a driver's license or personal identification card for purposes of opening an account or obtaining a financial product or service through an online service. Also requires credit unions to permanently delete copies or images of a driver's license or personal identification card after using the image for the purposes described in this section, including Customer Identification Program requirements.	May 24, 2018; Conforming Regulations Expected	NCUA and Financial Crimes Enforcement Network (FinCEN)

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Reducing Identity Fraud (Section 215)	Directs the Social Security Administration (SSA) to establish and maintain a database that allows certain financial institutions to receive consumers' consent by electronic signature to verify their name, date of birth, and Social Security number. Such a database will make it significantly easier and more efficient for credit unions to receive confirmation of fraud protection from the SSA. NOTE: On August 21, 2018, NAFCU sent a letter to the SSA asking the agency to adopt a procedure that allows credit unions to self-certify their compliance with the Gramm-Leach-Bliley Act in order to start using the database, as required by this section.	May 24, 2018; Conforming Regulations Expected	Social Security Administration
Treasury Report on Risks of Cyber Threats (Section 216)	Requires the Secretary of the Treasury to submit to Congress a report on the risks of cyber threats to financial institutions and capital markets in the United States, including an assessment of the material risks of cyber threats to financial institutions, the impact and potential effects of material cyberattacks, an analysis of how federal banking agencies are addressing these material risks, and a recommendation of whether any agency needs additional legal authorities or resources to adequately address such risks.	May 24, 2018; Conforming Regulations May Be Necessary	Treasury and NCUA

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Protecting Consumers' Credit (Section 301)	Amends the *Fair Credit Reporting Act* (FCRA) to require credit reporting agencies (CRAs) to provide fraud alerts for consumer files for at least one year when a consumer notifies a CRA that he or she has been or may become a victim of fraud or identity theft. Consumers are also afforded unlimited free security freezes and removals of security freezes. Although this does not directly affect credit union operations, it is important to be aware of these changes to inform members of their rights in the event of a data security breach or fraudulent activity on their account(s).	September 21, 2018 (120 Days After May 24, 2018 Enactment of S. 2155); Conforming Regulations May Be Necessary	Bureau of Consumer Financial Protection and Federal Trade Commission (FTC)
Protecting Veterans' Credit (Section 302)	Amends the FCRA to require that certain information related to medical debt incurred by a veteran be excluded from the veteran's credit report for one year after the date the medical service was provided. Additionally, this requires any information related to medical debt that is characterized as delinquent, charged off, or in collection be removed once the debt is fully paid or settled. Also creates a dispute process for veterans to request the removal of information related to such debt and requires CRAs to offer free credit monitoring to active duty military members. Although this does not directly affect credit union operations, it can help credit unions provide loans to their veteran members by informing the member that they may improve their credit score if they request the removal of medical debt from their credit report.	May 24, 2019 (One Year After May 24, 2018 Enactment of S. 2155); Conforming Regulations May Be Necessary	Bureau of Consumer Financial Protection and FTC

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Immunity from Suit for Disclosure of Financial Exploitation of Senior Citizens (Section 303)	Protects credit unions and certain credit union employees that report suspected exploitation of senior citizens by providing whistleblower protections. Specifically, section 303 protects employees who have received appropriate training, such as *Bank Secrecy Act* officers, from liability for disclosing—in good faith and with reasonable care—suspected exploitation of a senior citizen by another individual, such as a caregiver or fiduciary. Credit unions will need to develop an appropriate training program in order to ensure that relevant employees—along with the credit union itself—qualify for civil liability protections when reporting suspected exploitation of senior citizens.	May 24, 2018; Conforming Regulations Expected	Bureau of Consumer Financial Protection, FinCEN, and NCUA
Restoration of the Protecting Tenants at Foreclosure Act of 2009 (Section 304)	Permanently restores the *Protecting Tenants at Foreclosure Act of 2009* (PTFA), which contains protections intended to ensure that tenants facing eviction from a foreclosed property have adequate time to find alternative housing. Under the PTFA, the immediate successor in interest of a dwelling or residential real property must provide at least 90-days advance notice to tenants who are asked to vacate. Subject to certain exceptions, tenants also must be permitted to stay in the residence until the end of their leases. Credit unions who are successors in interest to foreclosed properties will need to develop appropriate compliance mechanisms to ensure that tenants receive required notices and that eviction is not undertaken prematurely.	June 23, 2018 (30 Days After May 24, 2018 Enactment of S. 2155)	U.S. Department of Housing and Urban Development

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Property Assessed Clean Energy Financing (Section 307)	Amends TILA to require creditors to verify a borrower's ability to repay home improvement loans that are financed through Property Assessed Clean Energy (PACE) programs. Section 307 also grants the Bureau the authority to collect such information and data that the Bureau determines is necessary to implement regulations. Accordingly, credit unions should anticipate future regulation that will extend ability to repay requirements to PACE loans.	May 24, 2018; Conforming Regulations Expected	Bureau of Consumer Financial Protection
Protecting Veterans from Predatory Lending (Section 309)	Establishes additional consumer protections for veterans who are refinancing home loans. This Section applies to credit unions that refinance VA loans and provides that the VA may only insure or guarantee refinancing under certain conditions.	November 20, 2018 (180 Days After May 24, 2018 Enactment of S. 2155)	U.S. Department of Veterans Affairs
Credit Score Competition (Section 310)	Amends the *Federal National Mortgage Association Charter Act* by adding new provisions requiring the FHFA to create a process for new credit scoring models to be validated and approved for use by Fannie Mae and Freddie Mac in the purchase of residential mortgages. FHFA must also publicly disclose its validation and approval process. NOTE: On July 23, 2018, the FHFA announced it would no longer pursue its own credit score initiative and instead focus on implementing this section of S. 2155.	November 20, 2018 (180 Days After May 24, 2018 Enactment of S. 2155); Conforming Regulations Expected	Federal Housing Finance Agency (FHFA)

SECTION	KEY PROVISIONS	EFFECTIVE DATE	AGENCY
Foreclosure Relief and Extension for Servicemembers (Section 313)	Makes permanent a one year protection period for any pending enforcement action against the servicemember under the *Servicemembers Civil Relief Act*. Credit unions must now wait the duration of the protection period before enforcing legal action against the servicemember. This applies to credit unions to the extent that they lend to servicemembers on active duty and need to take legal action to enforce a real estate debt against the servicemember.	May 24, 2018	U.S. Department of Veterans Affairs
Protections in the Event of Death or Bankruptcy (Section 601)	Amends TILA to prohibit private student lenders from declaring a default or accelerating a debt against a student borrower on the sole basis of bankruptcy or death of a co-signer, and releases co-signers of private student loans from their obligations following the death of a student borrower. The amendments to TILA also specify new notice requirements for lenders to follow in the event of a student borrower's death. Credit unions will want to review cosigner agreements to ensure that provisions related to cosigner release and notice requirements are not in conflict with the amendments to TILA. NOTE: NAFCU has asked the Bureau of Consumer Financial Protection for model forms to help credit unions comply with this section.	Applies to loan agreements entered into on or after November 20, 2018 (180 Days After May 24, 2018 Enactment of S. 2155); Conforming Regulations May Be Needed	Bureau of Consumer Financial Protection

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National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

June 14, 2018

The Honorable Mick Mulvaney
Acting Director
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, D.C. 20552

RE: Regulatory Changes In Light of S. 2155

Dear Acting Director Mulvaney:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I would like to share with you a list of recommended regulatory action the Bureau of Consumer Financial Protection (Bureau) should pursue in light of the enactment of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (S. 2155 or the Act). NAFCU and its member credit unions encourage the Bureau to promptly provide the financial services industry with additional clarity and certainty regarding the compliance impact of S. 2155's provisions. The Act's most significant changes concern the *Truth in Lending Act* (TILA), the *Home Mortgage Disclosure Act* (HMDA), and the *Fair Credit Reporting Act* (FCRA), among others, as detailed in the section-by-section analysis below. As the Bureau crafts its interpretation of the Act's provisions, it should ensure that any new conforming regulations account for the unique nature of credit unions and do not impose undue burden on the industry.

Section 101 – Minimum Standards for Residential Mortgage Loans

In 2013, the Bureau of Consumer Financial Protection amended Regulation Z to adopt a rule that implemented the Ability-to-Repay/Qualified Mortgage (ATR/QM) provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) and established several additional categories of QMs, including the Small Creditor Portfolio QM. For mortgages that meet the criteria to qualify under this category, the Small Creditor Portfolio QM establishes a presumption of compliance with the ATR requirements and provides less strict underwriting requirements in order to reduce regulatory burden on small lenders. Section 101 of the Act codifies a version of the Small Creditor Portfolio QM category to allow credit unions expanded flexibility with respect to making QM loans.

More specifically, Section 101 of the Act amends Section 129C(b)(2) of TILA, as implemented by Regulation Z, to add a section providing that mortgages originated and retained in portfolio by insured credit unions with less than $10 billion in assets will be deemed QMs. *See* 15 U.S.C. § 1639c(b)(2). S. 2155's new safe harbor requires that such a QM: (1) is originated and held in portfolio for the life of the loan (with some exceptions); (2) complies with existing provisions in the ATR/QM rule regarding prepayment penalties; (3) meets the 3 percent points and fees limitation; and (4) does not have negative amortization or interest-only features. For this safe harbor to apply, the credit union must also have considered and documented the debt, income, and financial resources of the member. This section also notes that compliance with Appendix Q of Regulation Z may not be required and "multiple methods of documentation" shall be permitted.

NAFCU urges the Bureau to quickly provide guidance to credit unions that further expands upon the qualifications for this QM category. In particular, the Bureau should detail the type of documentation of "debt, income, and financial resources" a credit union must consider when making a residential mortgage loan to a member. It is unclear whether this provision refers to the debt-to-income (DTI) requirements in Regulation Z or establishes a new standard. Additionally, this section's reference to the applicability of Appendix Q creates further confusion. Congress's vague reference to "multiple methods of documentation" certainly prompts the Bureau to define exactly what these multiple methods may be. NAFCU supports increased flexibility in the calculation of DTI and ATR and recommends the Bureau issue regulations that provide credit unions with enhanced opportunity to extend credit to those consumers who need it the most.

Section 104 – Home Mortgage Disclosure Act Adjustment and Study

Section 104 of the Act provides regulatory relief to small depository institutions that have originated less than 500 closed-end mortgage loans or less than 500 open-end lines of credit in each of the two preceding calendar years by exempting them from certain disclosure requirements under HMDA, as implemented by Regulation C. More specifically, credit unions that qualify for the exemption are not required to report the items contained in 12 U.S.C §§ 2803(b)(5) and (b)(6), which include certain HMDA data points that were added by Section 1094 of the Dodd-Frank Act. Other reportable items listed in 12 U.S.C § 2803(b)—the HMDA data that was required prior to January 1, 2018—may still be reportable if a credit union is a financial institution as defined in 12 CFR § 1003.2(g). Consequently, Section 104 of the Act does not provide an exemption for all HMDA reporting, and only excludes certain reportable items added by the Dodd-Frank Act.

NAFCU asks that the Bureau amend its transactional thresholds under Regulation C to achieve parity with the exemption contained in Section 104 of the Act. It is essential that credit unions that do not originate a significant number of closed-end mortgage loans or open-end lines of credit receive comprehensive relief from HMDA requirements. Furthermore, NAFCU believes that such relief would reduce the operational complexity that may arise when a credit union is subject to both statutory and regulatory HMDA exemptions—which are similar but not equal in scope. For example, a credit union that is a financial institution but does not originate 500 closed-end mortgage loans or 500 open-end lines of credit would not need to follow "the requirements of paragraphs (5) and (6)" of 12 U.S.C. 2803(b); however, if it originates more than 25 closed-end mortgage loans, it would be required to report the non-excluded items in § 2803(b). Credit unions may face technical challenges when selectively reporting HMDA data. Furthermore, parallel regulatory and statutory exemptions may create confusion and incur additional reporting costs if the Bureau is not prepared to accept limited HMDA submissions. To mitigate technical complexity and ensure that credit unions are not subject to unreasonable or unnecessary costs, NAFCU asks that the Bureau swiftly amend its definition of a financial institution to achieve parity with the 500 closed-end and 500 open-end threshold envisioned by Section 104 of the Act.

Section 108 – Escrow Requirements Relating to Certain Consumer Credit Transactions

This section amends Section 129D of TILA to exempt qualifying small credit unions from the escrow requirements contained in subsection (a). As amended, 15 U.S.C. Section 1639d(c)(2) provides that loans made by an insured credit union which are secured by a first lien on a principal dwelling are exempt from the requirement in 1639(d)(a) if the following conditions are met: (1) the credit union has assets of $10 billion or less; (2) during the preceding calendar year the credit union originated 1,000 or fewer loans secured by a first lien on a principal dwelling; and (3) the transaction satisfies the criteria in Sections 1026.35(b)(2)(iii)(A), 1026.35(b)(2)(iii)(D), and 1026.35(b)(2)(v) of Regulation Z. The Bureau should work quickly to provide additional information on the exemption requirements outlined above, specifically regarding the interaction with specific sections of Regulation Z.

Section 109 – No Wait for Lower Mortgage Rates

Section 109 adds a new subsection to Section 129(b) of TILA (15 U.S.C. § 1639(b)) to provide an exception to the required three-day waiting period for disclosures if a creditor extends a second offer with a lower annual percentage rate (APR). In this section of the Act, Congress presumably intended to amend TILA to eliminate the Bureau's TILA-*Real Estate Settlement Procedures Act* (RESPA) Integrated Disclosure (TRID) Rule three business-day waiting period for closing a mortgage loan when the APR has decreased by more than the applicable tolerance after issuance of the initial Closing Disclosure. In the TRID final rule, the Bureau cites 15 U.S.C. 1638(b)(2)(B)(ii) and (b)(2)(D) of TILA as the sections that control when a creditor must provide Closing Disclosures before consummation. Unfortunately, in S. 2155, Congress does not reference the correct section of TILA, but actually amends 15 U.S.C. § 1639(b), which only applies to the waiting period requirements for high-cost mortgage loans, as amended by the *Home Ownership and Equity Protection Act* (HOEPA).

This inconsistency is already creating immense confusion across the credit union industry. NAFCU urges the Bureau to provide a clarification regarding this section so that the exception applies to all residential mortgage loans, as Congress likely intended. If such action exceeds the Bureau's authority, NAFCU encourages the Bureau to support a legislative fix for this portion of the Act. Additionally, NAFCU implores the Bureau to provide clearer, authoritative guidance on those issues pointed out by Congress in the remainder of Section 109, including: (1) the applicability of the TRID Rule to mortgage assumption transactions; (2) the applicability of the TRID Rule to construction-to-permanent home loans, and the conditions under which these loans can be properly originated; and (3) the extent to which lenders can rely on model disclosures published by the Bureau without liability if recent changes to regulations are not reflected in the sample TRID Rule forms published by the Bureau. Although this section does not direct the

Bureau and only provides the Bureau "should endeavor" to issue such guidance, NAFCU urges the Bureau to act swiftly to pursue further rulemaking or release additional guidance on these issues.

Section 301 – Protecting Consumers' Credit

Section 301 amends the FCRA (15 U.S.C. Section 1681) to require credit reporting agencies (CRAs) to provide fraud alerts for consumer files for at least one year when a consumer notifies a CRA that he or she has been or may become a victim of fraud or identity theft. This is an increase from the previous rule requiring alerts for only 90 days. Additionally, this section amends the FCRA to provide consumers unlimited free security freezes and removals of security freezes in an effort to prevent fraud and identity theft. Once a security freeze is placed, the consumer will be notified of the right to opt out of personal information being sent to others for marketing purposes. Finally, this section amends the FCRA to provide new protections for the credit reports of minors and individuals who are incapacitated.

NAFCU urges the Bureau to implement conforming rulemaking, as necessary, to amend Regulation V to (1) increase the length of time credit reporting agencies are required to provide fraud alerts to victims of fraud or identity theft; (2) provide victims with unlimited free security freezes; and (3) implement new protections for the credit reports of minors and incapacitated individuals. This section provides essential safeguards in protecting consumers' information. In light of the largest data breaches in history occurring last year that collectively exposed nearly 179 million records, it is imperative that the Bureau act quickly to implement new rulemakings to protect consumers' credit.

Section 302 – Protecting Veterans' Credit

Section 302 amends Section 605(a) of the FCRA to require that certain information related to medical debt incurred by a veteran be excluded from the veteran's credit report for one year after the date the medical service was provided. Additionally, this section includes a provision requiring the removal of information related to medical debt that is characterized as delinquent, charged off, or in collection from a veteran's credit report once the debt is fully paid or settled. This section also mandates the creation of a dispute resolution process for veterans to request the removal of information related to a debt once the veteran notifies and provides documentation to a CRA demonstrating that the U.S. Department of Veterans Affairs (VA) is paying the debt. Lastly, this section amends the FCRA to require CRAs to offer free credit monitoring to active duty military members.

NAFCU urges the Bureau to implement conforming rulemaking, as necessary, to amend Regulation V in the manner explained in this section. The Act specifically charges the Secretary of Veterans Affairs and the Federal Trade Commission (FTC) with promulgating regulations for certain portions of this provision, but because the Bureau has concurrent jurisdiction over implementation of the FCRA, it should coordinate with the VA and FTC to issue a rulemaking, as necessary, to implement these changes. These additional safeguards to veterans and active military service-members will allow them financial peace of mind and ensure their long-term financial health.

Section 303 – Immunity from Suit for Disclosure of Financial Exploitation of Senior Citizens

This section extends protections to certain individuals who, in good faith and with reasonable care, disclose the suspected exploitation of a senior citizen to a regulatory or law-enforcement agency. Section 303 protects certain financial institution employees, such as *Bank Secrecy Act* (BSA) officers, from liability for disclosing suspected exploitation of a senior citizen (not younger than 65 years of age) by another individual, such as a caregiver or fiduciary. Section 303(b) specifies that financial institutions or a third party selected by a covered financial institution may provide the training to individuals specified in this section, such as credit union employees. This section also describes the content and timing of the training as well as the maintenance of records to document the completion of training. Section 303(c) also specifies that no provision shall be "construed to preempt or limit any provision of State law, except only to the extent that subsection (a) provides a greater level of protection against liability to an individual described in subsection (a)(2)(A) or to a covered financial institution described in subsection (a)(2)(B) than is provided under State law."

NAFCU recommends the Bureau provide credit unions with further details on the training criteria necessary to comply with the requirements of Section 303. NAFCU encourages the Bureau to coordinate with the U.S. Department of the Treasury's Financial Crimes Enforcement Network to detail how this section and any implementing regulations interact with existing BSA training requirements. Furthermore, the Bureau should interpret and explain the disclosure requirement of this section by providing clear guidelines for the manner in which such disclosures must be made. NAFCU also asks that the Bureau act swiftly to implement any other conforming regulations related to this section as necessary.

Section 307 – Property Assessed Clean Energy Financing

Section 307 of the Act applies certain consumer protections to real property retrofit loans. Specifically, this section amends Section 129C(b)(3) of TILA to require creditors to verify a borrower's ability to repay home improvement loans that are financed through Property Assessed Clean Energy (PACE) programs. Section 307 is not self-implementing and requires the Bureau to "prescribe regulations that carry out the purposes of subsection (a)" of 12 U.S.C. 1639c. Section 1639c(a) contains TILA's ATR requirements. This section also grants the Bureau the authority to collect such information and data that the Bureau determines is necessary to effectuate implementing regulations. Lastly, it directs the Bureau to consult with state and local governments and bond-issuing authorities.

NAFCU asks that the Bureau issue implementing regulations and implementation guidance to ensure that credit unions are adequately informed of regulatory expectations. With respect to any proposed information collection deemed necessary to effectuate implementation, NAFCU urges the Bureau to minimize burdens on credit unions to the maximum extent possible. Credit unions are already subject to numerous reporting requirements under other Bureau regulations and it would be counterproductive to the purpose of the Act to institute new information collection obligations.

Section 601 – Protections in the Event of Death or Bankruptcy

Section 601 prohibits private student lenders from declaring a default or accelerating a debt against a student borrower on the sole basis of bankruptcy or death of a cosigner, and releases cosigners of private student loans from their obligations following the death of a student borrower. Section 601 amends section 140 of TILA (15 U.S.C. 1650), which includes provisions related to the prevention of unfair and deceptive private educational lending practices. New section 1650(g)(2)(A) would specify that "the holder of a private education loan, when notified of the death of a student obligor, shall release within a reasonable timeframe any cosigner from the obligations of the cosigner under the private education loan." Section 601 does not specify exactly what constitutes a reasonable timeframe. Accordingly, NAFCU urges the Bureau to issue guidance to clarify what constitutes a "reasonable timeframe" under Section 601 (i.e., when a cosigner must be released after a student obligor dies). NAFCU asks that the Bureau issue guidance before Section 601's requirements attach to loan agreements entered on or after November 20, 2018.

Conclusion

Thank you for your consideration and attention to these important matters. We look forward to working with you as you interpret and issue regulations on the provisions outlined above. If you have any questions or would like additional information, please do not hesitate to contact me or NAFCU's Director of Regulatory Affairs, Alexander Monterrubio, at 703-842-2244, or amonterrubio@nafcu.org.

Sincerely,

B. Dan Berger
President and CEO

BETTER MARKETS

October 1, 2018

Honorable Michael Crapo	Honorable Sherrod Brown
Chairman	Ranking Member
Committee on Banking, Housing, and Urban Affairs	Committee on Banking, Housing, and Urban Affairs
United States Senate	United States Senate
Washington, D.C. 20510	Washington, D.C. 20510

Re: Regulatory Implementation of the Economic Growth, Regulatory Relief and Consumer Protection Act

Dear Chairman Crapo and Ranking Member Brown:

Having participated in more than 200 rulemakings and related activities since our founding in 2010,[1] including the privilege of testifying before this Committee a number of times,[2] Better Markets[3] appreciates the invitation to comment on the October 2, 2018 Senate Banking Committee hearing on the regulatory implementation of the Economic Growth, Regulatory Relief and Consumer Protection Act, formerly S. 2155 (the "Act").

Given the recent 10th anniversary of the collapse of Lehman Brothers on September 15, 2018, many are reflecting on the 2008 financial crash and the onset of the worst financial crash since 1929, which caused the worst economy since the Great Depression of the 1930s.[4] As is

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[1] *See, e.g.,* Annual Report, available at https://bettermarkets.com/sites/default/files/2016%20Annual%20Report%20%28Better%20Markets%29.pdf.

[2] *See, e.g.,* "FSOC Accountability: Nonbank Designations," March 25, 2015 hearing, Committee on Banking, Housing, and Urban Affairs, available at https://www.banking.senate.gov/hearings/fsoc-accountability-nonbank-designations.

[3] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies-including many in finance-to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[4] *See* Better Markets, "The Cost of Crisis, $20 Trillion and Counting", July, 2015, available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis-2.pdf and Federal Reserve Bank of San Francisco, "The Financial Crisis at 10: Will We Ever Recover," August 13, 2018, available at https://www.frbsf.org/economic-research/publications/economic-letter/2018/august/financial-crisis-at-10-years-will-we-ever-recover/.

too well known, much of that economic devastation is ongoing for tens of millions of Americans, and the economic, social and political upheavals it caused are continuing as well.[5]

However, too many are forgetting or ignoring some of the most important and basic lessons of that financial crisis. In particular, without vigilant and independent oversight and regulation, financial institutions of various sizes, activities and complexity, often deeply interconnected and highly leveraged, can build up so much risk, often unseen and poorly understood, that they eventually threaten the economic stability of the financial system and the entire country. That is what happened in the years before the last crash and, unfortunately, that is what is happening again as memories fade and as the private sector rebounds and pursues its narrow interests in maximizing profits, as is their right if not duty. That's why vigilant and independent oversight and regulation are so critically important to protect the public interest and avoid future crashes, taxpayer bailouts and economic catastrophes.

Importantly, none of this requires evil actors in or motives by the private sector. It's the nature of markets and financial firms, individually and, ultimately, collectively. That is the unsettling, but undeniable truth behind former Citigroup CEO Chuck Prince's infamous and much misunderstood quote in July 2007:[6]

> "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you're got to get up and dance. We're still dancing."[7]

Translation: when a financial institution and its peer group are making lots of money doing roughly the same thing and their stock is going up (i.e., the market "music" is playing), they have to keep doing the same thing ("dancing") or their revenues, profits, bonuses and stock will go down ***relative*** to their peer group. While doing otherwise may be tolerated by a board, the executives and stockholders for a short time, it won't last long as revenues, profits and stock drop relative to their peers, which is why Mr. Prince was right: "as long as the music is playing, you've got to get up and dance."

That is why regulators, supervisors and public officials must be vigilant and independent in their oversight, regulation and enforcement. Put differently, they have to step in and slow the tune if not change the song or stop the "music" altogether, regardless of how much "dancing" the private sector is doing or wants to do. Without taking such independent and, at

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[5] *See, e.g.,* "Crashed: How a Decade of Financial Crises Changed the World," Adam Tooze (2018).

[6] It is telling that this statement was just a month after Bear Stearns had to bail out one of its hedge funds and just days before the collapse of two of its hedge funds, which had been unsuccessfully shopping their positions since the first quarter of 2007. That is to say, in July 2007 there were clear, strong and concrete indications of a coming crash visible to the major financial institutions on Wall Street, but the "music" continued to play. See "2 Bear Stearns funds Are Almost Worthless," Reuters, July 17, 2007, available at https://www.nytimes.com/2007/07/17/business/17cnd-bond.html.

[7] "Citigroup chief stays bullish on buy-outs," Michiyo Nakamoto and David Wighton, July 9, 2007, The Financial Times, available at https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac.

times, unpopular actions, the public interest is subordinated and exposed to the erratic and volatile dynamics of the marketplace, with devastating crashes the inevitable result.

Regulatory Implementation of the Act

It is with those baseline understandings in mind that we think about the implementation of the Act. No one disputes that the Act requires regulators to undertake certain, specific actions. However, it also appropriately and wisely provided regulators with ample discretion to use their best judgment and expertise to ensure the safety, soundness and stability of the financial system. Put differently, as you know, the legislation does not mandate unwise, mechanical or blind deregulation that would undermine financial stability, increase the likelihood of future bailouts, and once again harm hardworking Americans who are still paying the bill for the last crash that they did not cause.

The challenge and responsibility of getting this right cannot be understated. As former Senator Ted Kaufman said on the Senate floor during debate over the Dodd-Frank Act, wise regulators are critical bulwarks against the future crashes:

> The [Dodd-Frank] financial reform bill places enormous responsibilities and discretion into the hands of the regulators. Its ultimate success or failure will depend on the actions and follow-through of these regulators for many years to come. One of my main concerns is, if we elected another President who believed we should not have regulators and regulation, they would again have the ability to do what they did to cause a meltdown.[8]

Of course, no one wants that to happen or another crash, but those are the stakes as elected officials, policymakers and regulators make decisions regarding financial regulation, including how to best implement the Act.

First, that means that those financial institutions with assets of more than $100 billion but less than $250 billion must be ***considered*** for enhanced prudential regulation based on an individualized, multifactor risk analysis that includes sizes, activities, complexity, interconnectedness, leverage and other risk factors – as was the case previously for institutions with more than $50 billion in assets.[9] It is simply baseless to claim, as some have,[10] that financial firms with less than $250 billion in assets do not pose any systematic risk. One need

[8] Congressional Record Volume 156, Number 105 (Thursday, July 15, 2010) Available at https://www.gpo.gov/fdsys/pkg/CREC-2010-07-15/html/CREC-2010-07-15-pt1-PgS5870-2.htm.

[9] *See* Better Markets "Fact Sheet: Everything You Need to Know About the $50 Billion Threshold" (November 28, 2016), available at https://bettermarkets.com/sites/default/files/50b%20Fact%20Sheet%20Updated%20Long%20Version%2011.28.16_0.pdf

[10] *See, e.g.,* August 17, 2018 letter to Federal Reserve Board Vice Chairman Randal Quarles from several Senators, available at https://www.perdue.senate.gov/imo/media/doc/Letter%20to%20VC%20Quarles%20re%20401-%20Final.pdf.

only glance at the list of hundreds of banks receiving TARP money in 2008-2009[11] to quickly see that systemic risks are not limited to only the top dozen banks in the United States. Indeed, banks of all sizes also availed themselves of the Fed's many emergency rescue programs from 2007 through 2012, proving that systemic and contagion risk was significantly broader than those few banks with more than $250 billion in assets. Finally, regarding the 26 specific banks that will benefit the most from the Act, a Better Markets analysis reveals that they received more than $2.5 trillion in emergency bailouts during the financial crisis.[12]

Second, some proponents of weakening or eliminating the financial protection rules that were enacted after the financial crisis have urged the Fed to discontinue the use of Comprehensive Capital Analysis and Review (CCAR) stress tests. Such an action would be as unwarranted as it would be unwise. As has been detailed and well-recognized in the United States and around the world (including by the Fed[13]), stress tests are one of the Fed's most significant and successful post-crash actions. We will not burden you here with the mountain of proof of that other than to refer you to scholar Morris Goldstein's amply detailed book "Banking's Final Exam: Stress Testing and Bank-Capital Reform."[14]

Third, after years of falsely claiming that Dodd-Frank and the Fed improperly regulate by size alone, supporters of the Act now often argue that financial firms with less than $250 billion in assets cannot possibly pose a systemic threat to the financial system. However, the notion that financial institutions with between $100 billion and $250 billion in assets are *by definition* incapable of posing a risk to the financial system is unsupported by evidence, and in fact is directly contradicted by the historical record, as discussed above.[15] Moreover, big banks in the $100 billion to $250 billion asset range provide critical credit to large parts of the economy and the failure of one or more of them would have devastating effects on their borrowers, which could well spill over into a larger crisis.

Indeed, an important lesson of the 2008 financial crisis is that the distress, failure or inability to satisfy the obligations of a mid-to-large size bank at an inopportune time can exacerbate a crisis, ignite contagion and plunge already troubled markets into chaos. Just one example is Countrywide Financial, which had approximately $117 billion in assets when acquired by Bank of America, but which generated $65.3 billion in losses, crippling the bank for years even after it received $45 billion in TARP funds.

[11] *See, e.g.,* "Tracking the $700 Billion Bailout," New York Times, available at http://archive.nytimes.com/www.nytimes.com/packages/html/national/200904_CREDITCRISIS/recipients.html?scp=5&sq=tarp&st=cse.

[12] https://bettermarkets.com/resources/who-does-s-2155-benefit-recidivist-giant-banks-received-trillions-taxpayer-bailouts

[13] *See infra* n. 19 and accompanying text.

[14] Bankings Final Exam, Columbia University Press (2017), available at https://cup.columbia.edu/book/bankings-final-exam/9780881327052.

[15] *See*, *supra*, n. 11 and accompanying text.

As Stanford's Anat Admati, Paul Pfleiderer, and Amit Seru have noted, policymaking based on this flawed assumption "is potentially quite dangerous."[16] Firms with between $50 billion and $250 billion in assets, they note, "are not community banks. The failure of one or more of them will cause significant disruption and collateral harm, particularly in the context of overall market turmoil."[17] Whether or not they "will cause" deleterious consequences, they may and that alone requires the Fed to undertake an individualized risk assessment rather than blindly exempting all such banks due to an uninformative asset size number.

Indeed, history shows the speed with which turmoil among these sub-$250 billion banks can spread through the financial system: "The Savings and Loan crisis along with some other banking crises have also shown that even small institutions that all take similar risks and tend to fail at the same time can be dangerous and costly."[18]

Fourth, while we agree with Federal Reserve Chairman Jerome Powell's testimony before Congress in March that "supervisory stress-testing is probably the most successful regulatory innovation of the post-crisis era,"[19] it is also important to note that the results of the stress tests are only as valid as the assumptions upon which they were based and the rigor with which they are conducted. Financial institutions - including those with hundreds of billions of dollars in assets that were the focus of the Act - face risks that are interlinked and complex. By their very nature, these risks are difficult to predict. For that reason, reliance solely on stress tests can provide regulators with false assurances about the stability of the financial system as a whole, as well as the individual firms operating within it.

For this reason, the Dodd-Frank Act relies on a set of interconnected financial stability rules to help reduce risky behavior by banks, make banks more resilient to financial shocks, help regulators detect threats on the distant horizon, and give regulators tools to unwind failing firms quickly. But the interlocking system of financial stability rules will lose their effectiveness if they are dismantled piece by piece, in whole or in part, as could happen with the implementation of the Act.

Fifth, a particularly dangerous suggestion is that implementing the Act should automatically include a number of foreign banks operating in the US, many of which received very significant bailouts during the financial crisis. As most recently detailed by Adam Tooze in his book "Crashed,"

> [T]he Fed, without public consultation of any kind, made itself into a lender of last resort for the world....providing a stopgap of liquidity that, all told, ran into the trillions of

[16] Letter to Chairman Crapo, March 6, 2018, available at https://www.gsb.stanford.edu/sites/gsb/files/admati-pfleiderer-seru-letter-s.2155-final.pdf
[17] *Id.*
[18] *Id.*
[19] https://www.bloomberg.com/news/articles/2018-03-20/fed-still-reigns-supreme-over-banks-despite-dodd-frank-rewrite

> dollars and was tailored to the needs of banks in the US, Europe and Asia. It was historically unprecedented, spectacular in scale and almost entirely unheralded.[20]

It is unfortunate that the many Fed facilities and actions, particularly regarding its assistance to foreign banks, have received so little substantive attention and review. This is undoubtedly due, in part, to "the Fed label[ing] its liquidity facilities in a bamboozling array of acronyms,"[21] which appear to have been a created complexity intended to prevent transparency, oversight and accountability.[22]

Nevertheless, the known facts starkly illustrate the risks posed to the US and US taxpayers from the operation of foreign banks, including most tellingly that nine of the top twenty largest users of the Fed's emergency lending facilities during the crisis were foreign banks.[23] This included Fed's "gigantic"[24] Term Auction Facility (TAF), which was one of the many programs created to bail out the asset backed commercial paper markets: "if TAF loans of varying duration are converted to a common twenty-eight day basis, the total sum loaned came to a staggering $6.18 trillion in twenty-eight day loans."[25] Remarkably, foreign banks were "over 50 percent of the borrowers"[26] of TAF. Another example was the Fed's $2 trillion Term Security Lending Facility (TSLF) where "51 percent was lent to non-American banks."[27] About 40 percent of its $737 billion Commercial Paper Funding Facility (CPFF) went to European banks.[28] Most of these programs were dwarfed by the staggering size of the swap lines, which, by September of 2011, amounted to $10 trillion.[29]

Deutsche Bank's U.S. subsidiary Taunus is a good illustration of the US bailouts not just of foreign banks, but of foreign banks' US operations. Leaving aside the bailout of the parent company Deutsche Bank, Taunus itself was bailed out with at least 354 billion American dollars, which prevented it from going bankrupt and requiring the emergency assistance of German

[20] *Supra* n. 5 at p. 202.
[21] *Id*. at p. 206.
[22] The inevitable result is, of course, "the scale of the Fed's liquidity actions was so large and varied that it poses problems of accounting," as Adam Tooze noted. *Id*. at p. 207. He asked the right questions, but also provided the answers: "How should one measure the Fed's huge programs? As a stock at a point of maximum exposure? As a rate of flow over a given period during the crisis? Or should one simply compile the sum total of all lending from the beginning to the end of the crisis? The first measure will tend to minimize the image of intervention. The last measure will yield the largest figure. Each measure has its uses. Thanks to records extracted from the Fed by legal action, we can compile all three numbers." *Ibid*. (citations omitted)
[23] https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again; *see also*, Tooze, *supra* n. 2 at p. 217 and accompanying text.
[24] *Supra* n. 5 at p. 207.
[25] *Ibid.*
[26] *Id*. at p. 208.
[27] *Ibid.*
[28] *Id*. at p. 209.
[29] *Id*. at p. 213.

taxpayers.[30] Put differently, the U.S. government substituted US taxpayers for German taxpayers to bail out a German bank and prevent it from failing: because Deutsche Bank itself was in such financial distress and on the verge of failure, it simply did not have the ability to bail out its US operations and, therefore, the German government would have had to first bail out Deutsche Bank so that it could bail out its US subsidiary.[31]

Making matters worse, notwithstanding the lifesaving generosity of the US bailouts, Deutsche Bank (along with another foreign bank with significant operations in the US) then reorganized its US operations in 2010 to avoid US capital requirements (applicable to all bank holding companies in the US), which resulted in its US operations having a Tier 1 risk-based capital of -6.37 percent.[32] This action, among others, necessitated the enactment of the FBO rule and the requirement of intermediate holding companies ("IHCs") for foreign banks in the US.[33]

This history is often omitted from the debate about how to implement the Act, even while the law's supporters call on the Fed to ensure that that IHCs of foreign banks are treated comparably to U.S. bank holding companies of similar size and risk profile.[34] However, such an action would make the U.S. financial system less resilient, and more susceptible to the importation of risk from foreign banks, as detailed in our letter to the Federal Reserve on the subject of enhanced prudential standards and early remediation requirements for foreign banking organizations and foreign nonbank financial companies. In that letter, we noted:

> Foreign banking organizations play an important role in the U.S. financial system. Their U.S. regulated subsidiaries, and their lightly regulated branch and agency networks, issue large amounts of short-term dollar liabilities, and use the proceeds to lend to U.S. and foreign firms and to buy dollar denominated assets. When these organizations are distressed and there are runs on their financing, as was witnessed in 2008-2009, the effects on U.S. financial markets can be significant.[35]

Proponents of an aggressive implementation of the Act fail to recognize the unique threat to the American financial system posed by IHCs that are tied to their foreign parent

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[30] https://bettermarkets.com/newsroom/senate-bank-deregulation-bill-will-put-us-taxpayers-hook-bailing-out-foreign-banks-again

[31] Adding insult to injury, Deutsche Bank bragged about not needing a bailout from the German government while never mentioning its lifesaving bailouts from the US government. As Adam Tooze put it, the "bullish" Deutsche Bank's CEOs "claimed exceptional status because they avoided taking aid from their national government[]. What the Fed data reveal is the hollowness of those boasts." *Supra* n. 5 at p. 218.

[32] See Better Markets comment letter on FBOs, April 15, 2013, available at https://bettermarkets.com/sites/default/files/documents/125-%20FRS-%20CL-%20Enhanced%20Prudential%20Standards-%204-15-13.pdf

[33] *See* "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies," December 12, 2012, available at https://www.gpo.gov/fdsys/pkg/FR-2012-12-28/pdf/2012-30734.pdf.

[34] *See, e.g., supra* n. 10.

[35] *See, supra*, n. 32; see also Crashed, supra n. 5 (detailing foreign distress, dollar demands and swap lines).

company, which may have a risk profile and contractual commitments to counterparties that are opaque to U.S. regulators. Consequently, "foreign institutions operating in the U.S.," write Admati, Pfleiderer and Seru, must be "regulated according to the risk they pose to the U.S. economy and citizens. The financial entanglement of foreign subsidiaries with their often very large parent institutions must be taken into account in determining the rules, and this means that regulations should be based on the size and systemic risk of the worldwide entity."[36]

Therefore, as with US institutions with \$100 billion to \$250 billion in assets, the Fed must do an individualized assessment of the unique risks each IHC poses to the US before making any determination to apply any of the provisions of the Act to any of them.

In conclusion, as your hearing reviews regulators' implementation of the Act, we urge you to carefully consider the importance of subjecting banks of all sizes and risk profiles to sensible and prudent financial protection measures, such as stress testing. And we urge you to encourage regulators to reject calls from some quarters to eliminate these measures, a step which may benefit the balance sheets of the banks involved, but also expose the U.S. taxpayer and our financial system to unnecessary risk.

Thank you for your consideration of this letter.

Sincerely,

Dennis M. Kelleher
President and CEO

CC: Members of the Senate Committee on Banking, Housing, and Urban Affairs
The Honorable Joseph M. Otting
The Honorable Randal K. Quarles
The Honorable Jelena McWilliams
The Honorable J. Mark McWatters

[36] *See supra* n. 16.

FACT SHEET: Regulatory Implementation of S. 2155[1]

S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, requires regulators to undertake certain, specific actions while providing them with ample discretion to implement other aspects of the law. However, in all aspects, regulators are required to use their best judgment and expertise to ensure the safety, soundness and stability of the financial system. After all, of the almost 6,000 banks in the U.S., S. 2155 applies to 26 of the 40 largest banks.

As regulators make decisions about how to best implement the law, they must keep foremost in mind that these decisions will impact financial stability, the likelihood of future bailouts and hardworking Americans who are still paying the bill for the last crash that they did not cause. Consequently, those implementing the law need to consider the following:

1. As was the case with the $50 billion threshold,[2] the law's new asset threshold of $100 billion is a trigger for consideration of enhance prudential regulation based on an individualized, multifactor risk analysis that includes sizes, activities, complexity, interconnectedness, leverage and other risk factors. It is not and was not intended to automatically dictate that all banks with less than $250 billion are not and cannot be systemic risks, leaving only the top dozen banks in the United States as systemically risky. Many banks with $100-$250 billion in assets availed themselves of the Fed's various emergency rescue programs from 2007 through 2012, proving that systemic and contagion risk was significantly broader than those few banks with more than $250 billion in assets.[3]

2. Comprehensive Capital Analysis and Review (CCAR) stress tests are one of the Fed's most significant and successful post-crash actions. Any effort to discontinue or dilute these critical tests would be as unwarranted as it would be unwise, particularly given the mountain of proof in favor of stress tests, much of it from the Fed itself.[4] Any effort to argue otherwise is unsupported by data or analysis, and the assertion that some financial institutions are non-

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[1] For greater detail, please see Better Markets' October 1, 2018 letter to Chairman Crapo and Ranking Member Brown, available at https://bettermarkets.com/resources/better-markets-letter-senate-banking-committee-implementation-s-2155.

[2] See Better Markets "Fact Sheet: Everything You Need to Know About the $50 Billion Threshold" (November 28, 2016), available at https://bettermarkets.com/sites/default/files/50b%20Fact%20Sheet%20Updated%20Long%20Version%2011.28.16_0.pdf

[3] See Better Markets "Who Does S. 2155 Benefit? Recidivist Giant Banks that Received Trillions in Taxpayer Bailouts" (February 28, 2018), available at https://bettermarkets.com/resources/who-does-s-2155-benefit-recidivist-giant-banks-received-trillions-taxpayer-bailouts

[4] See, e.g., https://www.bloomberg.com/news/articles/2018-03-20/fed-still-reigns-supreme-over-banks-despite-dodd-frank-rewrite

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systemic simply because of they are have less than $250 billion in assets should be given no weight by financial regulators.

3. The notion that financial institutions with between $100 billion and $250 billion in assets are *by definition* incapable of posing a risk to the financial system is unsupported by evidence, and in fact is directly contradicted by the historical record. As Stanford's Anat Admati and other experts note, firms of this size "are not community banks. The failure of one or more of them will cause significant disruption and collateral harm, particularly in the context of overall market turmoil."[5] That alone requires the Fed to undertake an individualized risk assessment rather than blindly exempting all such banks due to an uninformative asset size number.

4. Banks - including those with hundreds of billions of dollars in assets - face risks that are interlinked and complex. By their very nature, these risks are difficult to predict. For that reason, reliance solely on stress tests can provide regulators with false assurances about the stability of the financial system as a whole, as well as the individual firms operating within it. For this reason, the Dodd-Frank Act relies on a set of interconnected financial stability rules to help reduce risky behavior by banks, make banks more resilient to financial shocks, help regulators detect threats on the distant horizon, and give regulators tools to unwind failing firms quickly. But the interlocking system of financial stability rules will lose their effectiveness if they are improperly or incompletely applied, in whole or in part, as could happen if S. 2155 is implemented as a blunt instrument rather than a tailored application of appropriate measures.

5. A particularly dangerous suggestion is that the implementation of S. 2155 should automatically include the deregulation of most foreign banks operating in the US, many of which received very significant bailouts during the financial crisis. In fact, nine of the top twenty largest users of the Fed's emergency lending facilities during the crisis were foreign banks.[6] Foreign banks operating in the U.S. are tied to their foreign parent company, which may have a risk profile and contractual commitments to counterparties that are opaque to U.S. regulators. This makes these banks uniquely dangerous to our financial system, and therefore, the Fed must do an individualized assessment of the unique risks each such bank poses to the U.S. before making any determination to apply any of the provisions of S. 2155 to any of these banks.

As regulators consider the implementation of S. 2155, they must continue the prudently required policy of subjecting these banks to individualized risk assessments and robust stress testing. Having suffered so much already, the American people deserve no less.

[5] Letter to Chairman Crapo, March 6, 2018, available at https://www.gsb.stanford.edu/sites/gsb/files/admati-pfleiderer-seru-letter-s.2155-final.pdf

[6] https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again

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September 10, 2018

Honorable Michael Crapo	Honorable Sherrod Brown
Chairman	Ranking Member
Committee on Banking, Housing, and Urban Affairs	Committee on Banking, Housing, and Urban Affairs
United States Senate	United States Senate
Washington, D.C. 20510	Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown,

Thank you for the opportunity to comment on the hearing scheduled for September 13, 2018 on the implementation of S.2155. Three of us sent you a letter on March 6, 2018 when the proposed law was being discussed.[1] In that letter we expressed concerns that the "tailoring" that was proposed in S.2155 could and would be used to reduce safety by lowering equity requirements. We are now even more convinced these concerns are valid.

The financial crisis and recession of 2007-2009 revealed the failure of regulators to prevent the buildup of risk in the financial system, and showed that flawed rules and ineffective enforcement of financial regulations can cause significant harm to the rest of the economy, amounting to trillions of dollars in lost economic output.

[1] https://www.gsb.stanford.edu/sites/gsb/files/admati-pfleiderer-seru-letter-s.2155-final.pdf

We are alarmed by the push from some industry participants and policymakers to weaken capital regulation, which is the most essential, beneficial, and cost-effective part of banking regulation.

Effective capital regulation, in its most straightforward form, requires financial institutions to obtain a substantial part of their funding from equity, by issuing stock and retaining earnings, rather than by borrowing. By "substantial," we mean significantly more than current regulations require; at least 15 percent of a proper measure of unweighted total assets, and more still would be better.[2] Regulators have the tools to either require that banks maintain a certain ratio of equity to total assets and can direct banks to bolster their equity without shrinking by retaining their profits. Equity capital provides a cushion, which can absorb losses and reduce the chances of bankruptcy and a financial crisis and the need for bailouts. Equity capital makes the financial system resilient to losses.[3]

Abundant equity capital also insulates the financial system against the failure of regulators to spot risks, as happened on a grand scale in 2007-2008, and then again in the European sovereign debt crisis.

Requiring more equity capital has next to no social cost. You will hear many complaints from financial institutions that raising capital is costly. Capital can appear costly to individual institutions. They often do not realize however, that as they issue more equity its cost declines, because markets understand they are safer. The boom in bank stocks over the last few years as capital requirements have risen is consistent with this fact.

Equity funding is privately costly to the individual institution, because the institution and its creditors receive subsidies for debt, including deposit insurance and expected credit guarantees. But more equity capital is not more expensive to society as a whole, which pays

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[2] A 2010 letter from twenty finance and banking scholars whose signatories include Nobel-prize winners William F. Sharpe and Eugene F. Fama states that "if at least 15 percent of total, non-weighted assets were funded with equity, the social benefits would be substantial. And the social costs would be minimal, if any," https://www.gsb.stanford.edu/faculty-research/excessive-leverage/healthy-banking-system-goal

[3] One of the flaws in current regulations is that they use equity substitutes sometimes referred to as Tier 2 capital, "contingent capital" or "Total Loss Absorbing Capacity" (TLAC), which rely on certain triggers to impose losses on creditors. A pre-crisis version of such securities are Trust Preferred Securities or TruPS. Yet, in the financial crisis, holders of these supposedly loss-absorbing securities were paid in full even as the issuing banks were provided support and despite the securities having counted towards capital regulations. Regulators and policy makers were unwilling to let holders of these securities bear the losses. These investors thus gained by being rewarded upfront for their willingness to bear these risks through the payment of favorable interest or dividend rates, but in the end not having to suffer any consequences when the risk actually materialized. Equity is simpler and more reliant to serve as a loss absorbing security, since the losses happen automatically through share price declines, and not by the will (or failure thereof) of a government official. Shareholders, who receive upside gains if risks work out, are most appropriate investors to absorb losses should they occur. See, for example, https://www.americanbanker.com/opinion/too-much-equity-if-anything-brown-vitter-asks-too-little

those subsidies. That is why banks clamour for looser capital requirements, and why you must resist.

Indeed, capital requirements should be strengthened and improved. Regulations should be focused on straightforward transparent measures rather than obscure, convoluted measures which can be gamed by clever accounting and the manipulation of so-called risk weights. The proliferation of synthetic AAA securities before the crisis, which received low or zero risk weights and yet led to massive losses in some cases is an example of the problem. [4]

Regulators often assert that banks are "safe enough" on the basis of stress tests, which are necessarily based on many arbitrary assumptions. The risks faced by financial institutions that operate within a highly complex and interconnected system are inherently difficult to predict, describe, and quantify. The risks that bring down banks are always unexpected, both by the banks and by their regulators. Institutions are often unaware of their direct risk exposures and even less aware of those of their counterparties.

Placing trust in model-based calibrations and stress tests gives a false sense of safety. It is better to recognize our shared ignorance and the uncertainties we all face and take the most appropriate, prudent and cost-effective measure available to us[5] – more equity capital.

The plea that some institutions, especially smaller banks, should be exempted from capital regulation because they are not "systemic" is misguided. The failure of smaller institutions also causes significant disruption to third parties beyond their investors. Many crises, including the huge banking crisis of the Great Depression, and the savings and loan debacle of the 1980s, involved the simultaneous failure of many smaller institutions, not the big New York banks. Indeed, during the financial crisis, thousands of banks of all sizes, not just the largest, required support that was delivered through trillions in loans and investments by governments and central banks in US and Europe.[6] Many small banks making the same bets can fail just like a

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[4] Moreover, these models also bias against lending to private sector and favor loans to governments and traded securities over loans to people and businesses. As a result, regulations based on such models have been shown to increase the system fragility as banks over-invest in assets considered "safe" by regulators but which can in fact are risky, such as AAA-rated subprime mortgage securities or sovereign bonds by some European nations such as Greece. See, for example,
https://www.coll.mpg.de/pdf_dat/2010_31online.pdf,
https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1928.en.pdf,
http://www.econ.yale.edu/~shiller/behfin/2009_03/rajan.pdf
https://www.bis.org/review/r120905a.pdf.

[5] As former U.S. Defense Secretary Donald Rumsfeld said in a different context: *"There are known unknowns… things that we now know we don't know. But there are also unknown unknowns… things we do not know we don't know."* Financial and military risks have a lot in common.

[6] In fact, research has shown that implicit subsidies from the government flow to the entire banking sector See Kelly et al https://www.aeaweb.org/articles?id=10.1257/aer.20120389.

big bank making the same bet. And in a crisis we see runs in which creditors concerned that they might not be paid all rush at the same time to get their money out. Creditors can, and have, run on many small banks just as they can run on one big bank. The notion that only a small number of large institutions are "systemic" is false. Systemic danger comes from activities and behavior, and always involves too much short term borrowing, no matter the size.

We do not support all regulations. Many regulations are too complex and costly relative to their benefits, are not targeted at documented market failures, and are thus wasteful for society. Indeed, we argued above that much asset risk regulation is of this sort. Regulating the mix of funding to require more equity and less short-term debt, by contrast, goes to the heart of fragility in banking. It removes distortions caused by government subsidies and can be done simply and transparently. With more equity, banks can compete better with one another on the basis of their business model. Large compliance departments cease to be a drag on banks and cease to be a barrier to entry and competition. More equity also can free banks and regulators from the need for complex, expensive or counterproductive regulations. For example, as long as regulators insist on much higher equity levels, banks will be less likely to have liquidity problems. Costly regulations such as those about Liquidity Coverage Ratio would be unnecessary, and banks would less often need lender-of-last-resort support from the Federal Reserve.

You will hear that capital requirements are binding, so big banks are no longer trading as much as they used to do, and markets are becoming illiquid.[7] This consideration also argues for *more*, not less, equity capital. If banks issued much more equity, then their debt would be essentially risk free, and the "debt overhang" that discourages increasing equity capital at the margin for trading purposes would disappear.

We are deeply concerned that the safety of our financial system may be undermined and the risk of another crisis increased by this drive. As stated above, not all regulations are beneficial, and we agree that the intense, complex and costly effort to regulate bank risk taking is both burdensome to industry and counterproductive to financial stability.

The current high profitability of banks provides regulators with an opportunity to strengthen and improve equity capital requirements so the financial system can continue to function well in a downturn. Historically, regulators and the regulatory system have tended to relax in the boom, making the subsequent crisis worse. We must not repeat the same mistakes.

At this hearing, we urge you to press the banking regulators to answer the following question:

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[7] For a discussion of the mechanism, see Leif Andersen, Darrell Duffie, and Yang Song, https://www.darrellduffie.com/uploads/working/AndersenDuffieSongFeb2018.pdf.

Over the 10 years since the crisis, regulators have substantially increased capital requirements. The economy is booming, lending is up, bank profits are high. Now that we have all learned that the scare stories about capital are false, why would you not complete the job, raising capital requirements further so that the financial system can easily weather the next downturn? You need only to require firms to retain earnings rather than pay them out to shareholders. Why repeat the errors of the past by loosening capital requirements in the boom that always precedes a bust?

Sincerely,

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Paul Pfleiderer (pfleider@stanford.edu) Amit Seru (aseru@stanford.edu)

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The Honorable Bob Corker
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The Honorable Patrick J. Toomey
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The Honorable Dean Heller
The Honorable Mark R. Warner
The Honorable Tim Scott
The Honorable Elizabeth Warren
The Honorable Ben Sasse
The Honorable Heidi Heitkamp
The Honorable Tom Cotton
The Honorable Joe Donnelly
The Honorable Mike Rounds
The Honorable Brian Schatz
The Honorable David Perdue
The Honorable Chris Van Hollen
The Honorable Thom Tillis
The Honorable Catherine Cortez Masto
The Honorable John Kennedy
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October 2, 2018

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing
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Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of America's credit unions, I am writing to express our views ahead of the hearing entitled "Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act," which was enacted last May. The Credit Union National Association (CUNA) represents America's credit unions and their 110 million members. CUNA strongly supported the legislation during the Congressional process. CUNA is pleased that National Credit Union Administration (NCUA) Chairman Mark McWatters was invited to testify.

CUNA applauds NCUA's timely implementation of the provisions comprising S. 2155, most notably, the May 30 notation vote to remove one-to-four non-owner occupied residential multi-family housing loans from the category of member business loans, as filed on quarterly call reports. CUNA values NCUA's expedient execution of the law's provisions. Given the intent of the legislation to treat such loans as real estate-based products with parity to secondary market treatment, CUNA would support agency efforts to remediate this imbalance.

As provisions comprising what was the Making Online Banking Initiation Legal and Easy (MOBILE) Act, relating to data privacy and record retention, are implemented by the federal banking agencies, CUNA would expect some degree of guidance from NCUA with regard to how this may impact credit union examinations. CUNA also appreciates the NCUA hosting a budget transparency public hearing this Fall, as the agency has held for several of the preceding years with the current Board membership.

CUNA further awaits the consumer protection-related provisions to be fulfilled by the Bureau of Consumer Financial Protection, specifically relating to the Home Mortgage Disclosure Act, the Truth in Lending Act Qualified Mortgage requirements, and the Truth in Lending Act-Real Estate Settlement Procedures Act (TILA-RESPA) Integrated Disclosures (TRID). Guidance in these areas would be welcomed sooner rather than later.

CUNA continues to oppose NCUA's efforts to seek additional authority to examine and regulate credit union service organizations and third-party vendors. NCUA has effectively managed this risk within their current regulatory authority. Credit Unions are required to perform due diligence on their third party vendor relationships, and this due diligence is already subject to supervision by the NCUA.

On behalf of America's credit unions and their 110 million members, thank you for holding this important hearing. We look forward to further discussing the implementation of S. 2155 with you and the members of this committee.

Sincerely,

Jim Nussle
President & CEO

IMPLEMENTATION OF S. 2155

THE ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT

Section/Subject	Summary	Agency	Status
Sec. 101 – Minimum Standards for Residential Mortgage Loans	Certain mortgage loans originated and retained in portfolio deemed to be qualified mortgages.	BCFP	**In effect** (*but awaiting guidance*). Analysis indicates that banks can take advantage of the provision immediately, yet there are several ambiguities and details that ICBA expects the bureau to address in a forthcoming regulation. ICBA has met with bureau staff to discuss specific facts of the act. ICBA has also submitted comments, urging the bureau to promulgate a regulation soon.
Sec. 103 – Exemption from Appraisals of Real Property Located in Rural Areas	Exemption for rural mortgage portfolio loans of less than $400,000 if unable to find a state-certified/licensed appraiser to perform the appraisal in a timely manner.	FDIC, OCC, Fed	**In effect** (*but awaiting guidance*). The agencies are reviewing the statutory provisions to determine whether further action is necessary.
Sec. 104 – Home Mortgage Disclosure Act Adjustment and Study	Exemptions from collecting the new Dodd-Frank Act data fields for banks with "satisfactory" CRA ratings that originate fewer than 500 closed-end mortgage loans or fewer than 500 open-end lines of credit.	BCFP	**In effect**. The interpretive and procedural rule is available here. At a later date, the bureau anticipates that it will initiate a notice-and-comment rulemaking to incorporate these interpretations and procedures into Regulation C and further implement S. 2155.

Blue rows are already in effect. Last updated: Sep. 13, 2018

Section/Subject	Summary	Agency	Status
Sec. 108 – Escrow Requirements Relating to Certain Consumer Credit Transactions	Exemption from TILA escrow requirement for banks that make 1,000 or fewer first lien mortgages on principal dwellings.	BCFP	Banks will not be able to benefit from this provision until the bureau promulgates a regulation. ICBA has already submitted a comment letter to the bureau, asking that it quickly implement this change by issuing an interim final rule.
Sec. 109 – No Wait for Lower Mortgage Rates	Removes three-day waiting period required under TILA-RESPA mortgage disclosure when creditor extends a second offer of credit with lower APR.	BCFP	**In effect** (*but awaiting guidance*) Banks are already able to take advantage of this relief. The bureau issued guidance that incorporates this provision, which Congress codified in S. 2155.
Sec. 201 – Capital Simplification for Qualifying Community Banks	Agencies to establish a community bank leverage ratio (CBLR) between 8-10 percent; banks exceeding the ratio meet risk-based capital and leverage requirements and are "well-capitalized."	FDIC, OCC, Fed	**High-priority.** The agencies will establish the CLBR after notice and comment rulemaking and after consulting with the state bank supervisors. ICBA has met with the FDIC and is advocating for a CBLR that is close to 8 percent. The agencies also will establish procedures for the treatment of community banks that fall below the CBLR after exceeding the ratio.
Sec. 202 – Limited Exception for Reciprocal Deposits	Certain reciprocal deposits will not be considered brokered deposits.	FDIC	**In effect, proposed rule issued.** The FDIC has issued proposed conforming rules with a 30-day comment period. This is the first part of a two-part effort to revisit the brokered deposit rules. The FDIC plans later this year to seek comment on the brokered deposit regulations more generally.
Sec. 203 – Community Bank Relief from Volcker Rule	Banks under $10 billion in assets with total trading assets and liabilities not exceeding 5 percent of total assets exempt from the Volcker rule.	FDIC, OCC, Fed	**In effect** (*but awaiting guidance*). The agencies have indicated that they will not enforce the final Volcker Rule in a manner inconsistent with the statutory changes. However, the agencies intend to address the statutory changes through a separate rulemaking process.
Sec. 205 – Short-Form Call Reports	Agencies required to reduce reporting requirements for the first and third quarters for banks under $5 billion in assets and that meet other appropriate criteria.	FDIC, OCC, Fed	**High-priority.** The new short-form call report will be established after notice and comment rulemaking. ICBA is advocating a short-form call report consisting of: balance sheet, income statement and statement of stockholders' equity, without additional schedules.

Section/Subject	Summary	Agency	Status
Sec. 206 – Option for Federal Savings Associations to Operate as Covered Savings Associations	Institutions with assets of $20 billion or less can elect to operate with national bank powers.	OCC	**Proposal issued.** The OCC issued a proposed rule with a 60-day comment period.
Sec. 207 – Small Bank Holding Company Policy Statement	Raises the Federal Reserve's Small Bank Holding Company Policy Statement's asset limit from $1 billion to $3 billion.	Fed	**In effect**. The interim final rule is available here.
Sec. 210 – Examination Cycle	Well-managed, well-capitalized banks with assets of less than $3 billion qualify for 18-month exam cycle, up from $1 billion.	FDIC, OCC, Fed	**In effect**. The interim final rule is available here.
Sec. 214 – Promoting Construction and Development on Main Street	Acquisition, development and construction loans that meet certain criteria will not have higher risk-weights under risk-based capital rules.	FDIC, OCC, Fed	**In effect.** The agencies issued a statement that this is effective immediately and that banks only need to risk-weight at 150 percent those CRE exposures they believe meet the statutory definition of HVCRE ADC loan. Also, when reporting HVCRE exposures on the call report, banks may use available information to reasonably estimate and report only HVCRE ADC loans. Alternatively, banks may also continue to report and risk-weight HVCRE exposures consistent with the current instructions for the call report until the agencies take further action. The agencies have also proposed to revise the definition of an "HVCRE exposure" to conform to the new statutory definition of "HVCRE ADC loan."
Sec. 401 – Enhanced Supervision and Prudential Standards for Certain Bank Holding Companies	Increases the asset threshold at which certain enhanced prudential standards shall apply, from $50 billion to $250 billion, while allowing the Fed discretion in determining whether a financial institution with assets of $100 billion or more must be subject to such standards.	FDIC, OCC, Fed	To resolve a technical problem with the statute, the agencies are extending the deadlines for all regulatory requirements related to company-run stress testing for banks with average total consolidated assets of less than $100 billion until Nov. 25, 2019, at which time all banks and BHCs with total consolidated assets of less than $250 billion will be exempt. However, conforming regulations will be issued. Also, the

Section/Subject	Summary	Agency	Status
	It also increases the asset threshold at which company-run stress tests are required, from $10 billion to $250 billion, and increases the asset threshold for mandatory risk committees, from $10 billion to $50 billion.		agencies have indicated that while they will not take action to require company-run stress testing by banks with assets less than $100 billion – "the capital planning and risk management practices of these institutions would continue to be reviewed through the regular supervisory process."
Sec. 403 – Treatment of Certain Municipal Obligations	Agencies directed to classify investment-grade muni bonds as level 2B liquid assets under the liquidity coverage ratio rule.	FDIC, OCC, Fed	**In effect**. The interim final rule is available here.

ICBA
INDEPENDENT COMMUNITY BANKERS *of* AMERICA®

October 2, 2018

Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act: The Community Bank Perspective

On behalf of the nearly 5,700 community banks represented by ICBA, we thank Chairman Crapo, Ranking Member Brown, and members of the Senate Banking Committee for convening today's hearing on "Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act." ICBA is pleased to have the opportunity to submit this statement for the hearing record.

In the nearly four months since the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) was signed into law, the banking agencies represented at today's hearing have acted expeditiously in the issuance of key rules and guidance. (See attached ICBA matrix: "Implementation of S. 2155.") Five provisions of the new law are in effect today with accompanying rules or guidance. An additional five provisions are also in effect, though community bankers await guidance to clarify ambiguities in the statute. These important provisions are being used by community banks today and making a positive impact in local communities as Congress intended. ICBA thanks the agencies for their efforts to date.

The agencies continue their work on four community bank provisions which are not yet in effect. Of these, two in particular are eagerly awaited by community bankers.

Simplified Capital Rules

Once Section 201 of S. 2155 is implemented by the regulators, banks with assets of less than $10 billion that exceed the "community bank leverage ratio" will be considered "well capitalized" and effectively exempt from all risk-based capital requirements, including Basel III and its predecessors. For banks that qualify, most of Schedule RC-R – Regulatory Capital, of the call report will not apply. In addition, the punitive risk-based capital rules on high volatility commercial real estate lending (HVCRE), mortgage servicing rights, deferred tax assets, and trust preferred securities (TruPS) investments, will not apply to qualifying banks. Relief from international capital standards will allow qualifying banks to deploy more credit in their communities and promote local economic growth. ICBA has always believed that community banks should never have been subject to Basel III, and S. 2155 will provide highly capitalized community banks the opportunity to be exempted from those complex and onerous capital requirements.

For this provision to be effective, the banking agencies must establish the "community bank leverage ratio" (a ratio of tangible equity to average consolidated assets) between 8 percent and 10 percent. ICBA urges the agencies to establish an 8 percent leverage ratio since the regulators will likely insist that community banks hold a higher amount than the minimum to avoid inadvertently dropping below that level.

Furthermore, a majority of community banks would qualify if the community bank leverage ratio was 8 percent, allowing most community banks to take advantage of the simpler capital standard, thereby better fulfilling congressional intent. We urge the bank regulators to promptly provide needed rules and guidance on S. 2155's simplified capital rules. In particular, there should be a transition period if a bank drops below the community bank leverage ratio so that it does not suddenly and unexpectedly become subject to Basel III and risk-based capital standards.

Short Form Call Reports

Section 205 of S. 2155 requires the agencies to create a short form call report for banks with assets of less than $5 billion to be filed in the first and third quarters of each year. The agencies will continue to receive all of the data currently reported by community banks twice a year, in the second and fourth quarters.

Short form call reports will allow community banks to make better use of costly analytical and administrative resources to serve customers instead of providing granular and unnecessary data to their regulators. Banks that qualify for the short form call report pose no risk to the domestic or global financial system.

Community banks nationwide continue to be extremely frustrated by the regulators' inaction in implementing streamlined call reports. With S. 2155, Congress has put into statute a very clear mandate with respect to these call reports. Community banks cannot take advantage of this provision until the agencies issue regulations. ICBA strongly urges the agencies to honor the intent of Congress by creating a *true* short form call report for community banks that only requires the balance sheet, income statement, and statement of changes in shareholders' equity for the March 31st and September 30th call dates, with more detailed accompanying schedules to be completed for the June 30th and December 31st reporting dates.

As the agencies are aware, ICBA has been at the forefront in advocating for call report relief for community banks for many years. ICBA has continually worked to help the banking regulators better understand the difficulties facing community banks in providing the vast array of data reporting requirements that are reported to the agencies on a quarterly basis but are unnecessary to adequately monitor safety and soundness, especially considering the full array of information will be reported twice a year.

In 2014, nearly 15,000 community bankers nationwide submitted a petition to prudential banking regulators calling for short form call reports. ICBA strongly urges the agencies to create meaningful call report relief without further delay so that the benefits can be felt in the communities these institutions serve.

Closing

ICBA has been pleased with the provisions of S. 2155 that have been implemented to date. We look forward to working with Congress and the bank regulatory agencies to ensure all the remaining provisions of S. 2155 are implemented promptly and as intended by Congress.

Thank you for your consideration.

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Local Agents Serving Main Street America℠

STATEMENT BEFORE THE U.S. SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE ON
THE IMPLEMENTATION OF THE ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT
October 2, 2018

Founded in 1931, the National Association of Professional Insurance Agents (PIA) is a national trade association that represents independent insurance agencies and their employees who sell and service all kinds of insurance but specialize in coverage of automobiles, homes, and businesses. PIA represents independent insurance agents in all 50 states, Puerto Rico, and the District of Columbia. They operate cutting-edge agencies and treat their customers like neighbors, providing personal support and service.

Introduction

PIA appreciates the committee holding this hearing and thanks Chairman Mike Crapo and Ranking Member Sherrod Brown for their leadership in doing so. PIA is pleased that the subcommittee is providing this opportunity to address the implementation of S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act.

PIA's testimony today concerns section 211 of S. 2155, "International insurance capital standards accountability." For over 150 years, the state-based system of insurance regulation has successfully protected consumers and created a competitive and diverse U.S. insurance market. While states are the primary regulators of insurance in the United States, developments at the international level can heavily influence laws and regulations at the state level. If global standards are promulgated without appropriate consideration of the unique state-based system of U.S. insurance regulation, they may increase systemic risks and consumer costs by pushing small and midsize companies out of business, thereby reducing competition.

PIA opposes any federal or international effort, including the adoption of a one-size-fits-all approach to global insurance regulation, that would undermine the state-based system of insurance regulation. PIA is concerned that international efforts to increase capital standards imposed on insurance companies will lead to higher consumer costs, without corresponding consumer protections. PIA supports coordination and cooperation among state officials, federal officials, and international bodies to ensure that state insurance regulation is afforded appropriate deference in any federal or international decision-making process. The U.S. Department of

Treasury, the Federal Insurance Office (FIO), the Federal Reserve Board, the Securities and Exchange Commission, and the National Association of Insurance Commissioners (NAIC) all represent the U.S. in some capacity in important international insurance discussions with the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS).

Support for International Insurance Capital Standards Act

S. 2155 contains a PIA-supported provision (section 211) that would increase transparency at global insurance standard-setting regulatory forums and in any international insurance agreements. This provision is based on the International Insurance Capital Standards Accountability Act (S. 1360), sponsored by Sens. Dean Heller (R-NV) and Jon Tester (D-MT).

Specifically, the bill creates an advisory committee at the Board of Governors of the Federal Reserve System that will ensure that the insurance industry, including agents and brokers, are given the opportunity to offer their expertise and advice on international capital standards and other insurance issues. The bill would also mandate an annual report from the Treasury Department and the Federal Reserve concerning the activities at the IAIS and the FSB.

Importantly, the provision requires that the Director of the FIO and the Chairman of the Board of Governors of the Federal Reserve jointly produce a report on the effects of any final international insurance capital standard on consumers and markets in the U.S. before supporting or consenting to its adoption. It also allows public comment on the report.

In signing S. 2155, President Trump issued a signing statement in which he was critical of the provision on international insurance regulations, saying it was an encroachment on presidential authority and that the administration may disregard the portions of the bill that require federal negotiators to reach a consensus with state regulators when at the bargaining table discussing international regulatory measures.

PIA finds this concerning, given the primary role that state regulation plays in the insurance industry in the United States. International insurance standard-setting bodies must be required to maintain the dominance of our domestic insurance regulatory system. U.S. consumers must never take a back seat to what may be in the best interests of other countries. It is vital that all aspects of the law are implemented, particularly the provision that calls for consensus with U.S. state insurance regulators. Ignoring this section would render many of the rest of the important insurance provisions meaningless. This provision is essential to the maintenance of the existing relationship between state regulators and consumers, a dynamic that could never be duplicated by the most well-meaning federal government employees. It will give these consumers a voice in international insurance negotiations that will ultimately affect their lives. Without this provision, consumers and state insurance regulators will continue to have little or no influence over the international insurance agreements that will have a significant impact on the U.S. insurance market.

Conclusion

PIA urges Congress to ensure that the insurance provisions of S. 2155 are appropriately implemented. It is important that state insurance regulators have a say when it comes to international insurance negotiations.

MILLIMAN WHITE PAPER

What could private flood insurance look like in New Jersey and New York?

Across each state, over 90% of homes could see cheaper premiums in a private market

Nancy Watkins, FCAS, MAAA
John Rollins, FCAS, MAAA

Milliman

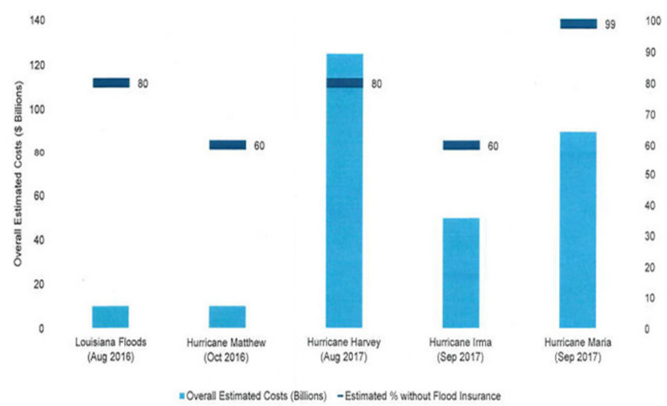
With the deadline to reauthorize the National Flood Insurance Program (NFIP) approaching on July 31, Congress is once again debating the future of flood insurance in the U.S. The NFIP, which insures approximately 5 million homes nationwide, has been operating on a temporary extension since March 23, 2018. As part of the reauthorization discussion, specific legislation has been proposed to lower entry barriers for private flood insurers. But the role of a private flood insurance market remains a key question for some policymakers.

An emotional backdrop to the debate is the widespread devastation experienced last year from a trio of costly and destructive hurricanes. The successive impacts in 2017 of hurricanes Harvey, Irma, and Maria generated over $9 billion of new NFIP claims[1], and highlighted the fact that the majority of consumers affected by major floods in recent years did not have any form of flood insurance as shown below.

This mirrors the experience of consumers in New Jersey and New York after Superstorm Sandy. In New York City, for instance, data shows the NFIP's "take-up rate," or ratio of active flood insurance policies to properties eligible for flood insurance, was only 55% for one- to four-family homes in high-risk Special Flood Hazard Areas (SFHAs), even though approximately 75% faced a mandatory purchase requirement in order to get a federally backed mortgage. Outside the SFHA, the take-up rate among homes was only about 20%.[2] After catastrophic storms,

FIGURE 1: MAJORITY OF CONSUMERS UNINSURED DURING RECENT LOSS EVENTS

Between 60% and 99% of those affected by five recent catastrophes did not have flood insurance



Source: www.artemis.com, www.claimsjournal.com, www.usatoday.com, www.wsj.com, NOA National Centers for Environmental Information (NCEI) U.S. Billion-dollar Weather and Climate Disasters (2018). www.ncdc.noaa.gov/billions

[1] "Significant Flood Events." Retrieved on July 18, 2018, from https://www.fema.gov/significant-flood-events.

[2] Dixon, L. et al. "Flood Insurance in New York City Following Hurricane Sandy," RAND Corporation. (2013). Retrieved on July 18, 2018, from https://www.rand.org/pubs/research_reports/RR328.html.

many residents find out the hard way that floods can occur outside the lines of federal maps, which are designed to fulfill specific requirements of the NFIP but are insufficient to reflect all the complexities of flood risk.

To inform the debate, Milliman has recently collaborated with Risk Management Solutions, Inc. (RMS) to model a potential private flood insurance market in New Jersey and New York, with emphasis on investigating the issue of "cherry-picking." "Cherry-picking" in this context is the concern that private insurers would target only attractive risks for removal from the NFIP, which could leave the remaining NFIP population biased toward high-risk homes and therefore underfunded.

Our independent study–similar to Milliman research on Texas, Florida, and Louisiana released last year[3]–is based on an analysis of single-family homes in New Jersey and New York, supplemented with highly granular geographic data about flood risk, the latest inland flood and storm surge models from RMS, and our actuarial analysis of private flood insurance cost structures and policy terms. Our study represents the entire market of owner-occupied single-family homes, not only those currently insured by the NFIP, as the NFIP does not release detailed data on policy locations.

This paper compares potential private insurance premiums to our estimates of the current NFIP premiums, though we explain later that NFIP rates may change significantly in the next few years. We also include an analysis of the potential effects of a private market on consumers in New Jersey and New York.

How could premiums and take-up rates change?

Our analysis found that, across each state, approximately 94% of homes in New Jersey and 96% of homes in New York could see cheaper premiums with private insurance than with the current NFIP premium structure, given similar coverage to the NFIP. In fact, of the vast majority of homes that are located outside NFIP's high-risk areas, approximately 94% (New Jersey) and 95% (New York) could be offered a private flood insurance policy for a target premium of just $250. The $250 minimum value was selected by judgment, but it is consistent with minimum premiums used in some private flood programs in other states.

Even inside high-risk areas, where flood insurance is mandatory for homes with federally backed mortgages, our study found that more homes in New Jersey and New York could be offered lower premiums if private insurance were widely available. In New Jersey's high-risk zones, 85% of homes could see premium rates cheaper than those of the NFIP, while in New York, 72% of homes could see premium reductions.

[3] Watkins, N. "Could private flood insurance be cheaper than the NFIP?" (July 10, 2017). Retrieved on July 18, 2018, from http://us.milliman.com/insight/2017/Could-private-flood-insurance-be-cheaper-than-the-NFIP/.

When savings are possible, they tend to be big: in the high-risk areas, the estimated average annual savings among the homes seeing lower premiums is over $4,800 in New Jersey and $4,700 in New York.

FIGURE 2: POTENTIAL NEW PRIVATE MARKET POLICIES

	NEW POLICY CONVERSION	NEW POLICY COUNT	
		NEW JERSEY	NEW YORK
Inside SFHA	25%	9,000	5,000
Outside SFHA	10%	152,000	216,000
Total		161,000	221,000

Of New Jersey's approximately 1.8 million single-family homes, only about 125,000 have flood insurance policies through the NFIP; in New York, the figures are around 125,000 out of approximately 3 million homes. A private market could increase the take-up rate–or percentage of homes with flood insurance–in both low- and high-risk areas, improving the resilience, rebuilding, and recovery process of the affected communities after another storm like Sandy.

The majority of dwellings in both states are outside high-risk zones, and our analysis indicates that only 2% to 3% of these homes are insured by the NFIP. Even if only 10% of uninsured homes outside high-risk zones that were offered a cheaper private flood policy purchased it, approximately 152,000 additional homes would be covered for flood damage in New Jersey and 216,000 in New York, based on our demographic data.

A significant number of homes in high-risk areas of both states are also uninsured despite the mandatory purchase requirement. Among homes in high-risk areas, if say, 25% of uninsured homeowners opt for cheaper private insurance, our demographic data indicates that approximately 9,000 additional homes in New Jersey and 5,000 homes in New York would be insured for flood.

Our analysis indicates that expansion of private insurance outside and inside high-risk areas could more than double the number of homes insured for flood in New Jersey and almost triple the number in New York.

In addition to lower premiums for some and more consumers protected, private flood insurance may offer some coverage and convenience benefits over NFIP policies. Though not modeled in this analysis, typical benefits of private flood policies include higher coverage limits (greater than the $250,000 maximum offered by the NFIP), additional coverage options (such as compensation for temporary relocation expenses), and flexible deductibles that offer more choice. Moreover, if flood coverage is offered in conjunction with a homeowners policy, the insured can deal with one claims adjuster and one insurance company following an event causing wind and water losses. This can significantly reduce cost, conflict, and confusion. Finally, it's worth noting that increasing flood insurance take-up rates would also better protect home mortgage lenders, reducing collateral risk and perhaps stabilizing credit availability for recovery after a large storm.

Note that, for approximately 6% of homes in New Jersey and 4% in New York, the private market premiums based on our estimates would exceed those of the NFIP, sometimes by thousands of dollars. Private insurers may altogether avoid targeting areas where their cost structures are not competitive with the NFIP. Therefore, some property owners will continue to find that the only available or affordable flood insurance is from the NFIP.

A changing NFIP

When interpreting these findings, it is also important to consider that the NFIP is not standing still. In the wake of Hurricane Sandy, the Federal Insurance and Mitigation Administration (FIMA) conducted an assessment on the NFIP to ensure that the customer's experience aligns with FIMA's goals. Out of this assessment, FIMA identified the following service gaps within the NFIP's current risk rating approach: (1) policyholders do not understand their flood risk and (2) the relationship between risk and rate are often inconsistent between structures with similar risk. Therefore, FIMA is redesigning and modernizing its risk rating approach in order to address these service gaps and improve overall customer experience.

Through a program called Risk Rating Redesign, the NFIP is modernizing its rate structure and will be rolling out new rates over the next several years, beginning in 2020. These rates will be based on multiple catastrophe models, historical NFIP data, and advanced actuarial techniques, and they will be designed to be intuitive, transparent, continuous, and aligned with policyholder risk. Although there are statutory limits on premium increases which will protect homeowners with existing NFIP policies, the full-risk rates will be known and should be a better signal of the actual flood risk.

What would "cherry-picking" look like?

Given the changing NFIP rating structure, how could a robust private market affect both the highest risk properties and the NFIP itself?

Based on our analysis, a significant amount of premium could be removed from the NFIP via the private market, although it is difficult to predict which NFIP insureds would be likely to make a switch. However, removing a material number of policies from the NFIP could also significantly reduce the expected losses and reinsurance costs for the program. With a lower potential loss in any given event, the NFIP may be less likely to deplete its reserves. Further, increasing take-up rates by promoting flood insurance through the private market could result in a decreased need for direct financial assistance from FEMA after future disasters, corresponding to a reduction in risk for taxpayers and the Treasury. As a comparison point, FEMA recently reported over $8 billion in Individual Assistance obligations for Sandy, Harvey, Irma and Maria combined.[4]

The effect on remaining NFIP policyholders is unclear in large part because of the NFIP's changing rate structure. In general, as private insurers and the NFIP move to risk-based pricing, there is likely to be a large rate increase indicated for some properties which are currently heavily subsidized. The analytical tools used to identify the properties which are currently underpriced will also help identify what investments in resilience are most effective to reduce the risk. Legislators, communities, and consumers will be able to better understand which homes need subsidization due to affordability issues and have better information for future planning and risk reduction.

Based on our analysis of the available data in New Jersey and New York, coupled with our experience in states like Florida with significant residual markets, we believe that the potential benefits resulting from a combination of a private market and the NFIP outweighs the potential for extreme cherry-picking. For one thing, there are many more cherries in the tree than in the NFIP's basket; that is to say, some private insurers may target the homes in New Jersey and New York that are not yet insured for flood. FEMA leaders have publicly promoted a "moonshot goal" to double the number of insured homes in the U.S. to 10 million by 2023, and stated that achievement of this goal may depend on both the NFIP and an expanded private market. Given the NFIP rate redesign, more policyholders will be set on a path to market parity, potentially making cherry-picking by private insurers more difficult to achieve.

[4] "Disaster Relief Fund: Monthly Report as of June 30, 2018." Retrieved on July 19, 2018, from https://www.fema.gov/media-library-data

For policyholders who do remain in the NFIP, there may be an additional benefit to a private market: a more agile federal response to catastrophic events. Many consumers after Sandy have been vocal about difficulties they faced obtaining claim payments after the storm. If a significant percentage of consumers were to move to a private market, having fewer NFIP claimants may enable the federal program to more easily respond to claims after a big storm.

Conversely, a smaller NFIP policy base would reduce the number of policies available to financially support the mapping and mitigation efforts of the program. It is worth noting that private insurers are able to offer cheaper policies to such a high proportion of consumers in part because they are not required to charge specific fees dedicated to reserve funding and mapping and mitigation efforts, unlike the NFIP.

Conclusion

Sandy demonstrated the devastating financial effect floods can have on one of the country's most densely populated regions, especially for homeowners and businesses that have not purchased insurance and are yet at risk of significant flood damage. The NFIP was formed to fill a gap when private insurers felt that flood risk was uninsurable. Now, with advances in catastrophe modeling, granular data, and analytical techniques, both the NFIP and the private insurance industry can do a better job of communicating, managing, and insuring flood risk. The NFIP has already begun the process of modernizing, investing in the Risk Rating Redesign program to foster innovation and learning that should assist the private flood insurance market. If legislators and regulators want to close the insurance gap, they should consider the benefits of encouraging private insurers to step up and soak up some of the risk. This would help enable the NFIP to maintain its original role of providing essential protection to U.S. property owners who are underserved by traditional markets and leading the way for understanding and mitigating against future flood risk.

Critical assumptions

A number of critical assumptions were used to complete the analysis. To perform the study, Milliman built a "market basket" containing a representative spectrum of single-family properties available to the insurance industry. While the market basket does not contain the actual inventory of homes, it reflects a carefully balanced hypothetical sample that is useful for comparative and sensitivity analysis.

Milliman collaborated with RMS to simulate flood losses from the RMS U.S. Inland Flood and North Atlantic Hurricane Storm Surge Models for New Jersey and New York. The RMS models simulate thousands of years of potential weather activity to produce an "exceedance probability loss curve" of estimated insurable flood and surge losses for each property in the market basket. The average annual loss (AAL) generated from this curve becomes the core risk measure underlying the target private flood insurance annual premium generated by Milliman. The target premium is the AAL, grossed up based on actuarial assumptions about the typical cost of reinsurance, profit, and expenses for a catastrophic peril.

The market feasibility studies also assumed a $250,000 maximum policy limit and policy coverage consistent with the NFIP, a 35% target loss ratio, and a minimum premium of $250. Milliman also selected a 10% take-up rate for previously uninsured homes in low-risk areas and a 25% rate in high-risk areas to represent consumer response to being offered cheaper private policies, for discussion in the article and based on judgment. The findings reflect one set of reasonable assumptions for all single-family homes across the two states, but the use of different data sources, catastrophe models, and target expense assumptions would produce different results.

No proprietary data from the NFIP was used in this analysis. For each state, Milliman used Census data on the number of single-family dwellings and geographic information systems to estimate the number of dwellings inside and outside the SFHAs. Actual NFIP policy counts inside and outside SFHAs in each state were obtained from FEMA's website. Note that parts of 26 counties in New York, mostly upstate, have no existing NFIP digital flood insurance rate maps (DFIRMs). As a result, demographic and policy count data for these areas was excluded from the totals and estimates in the analysis. Milliman's proprietary NFIP rating engine was used to generate estimates of current NFIP premium; assumptions were required regarding grandfathering, claims history and other rating factors, so the estimates will not exactly match actual premiums charged.

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