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# GUIDANCE, SUPERVISORY EXPECTATIONS, AND THE RULE OF LAW: HOW DO THE BANKING AGENCIES REGULATE AND SUPERVISE INSTITUTIONS?

## HEARING

BEFORE THE

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

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING HOW BANKING AGENCIES SUPERVISE AND REGULATE FINANCIAL INSTITUTIONS, HOW REGULATED INSTITUTIONS INTERACT WITH THEIR REGULATORS, AND THE CONGRESSIONAL REVIEW ACT AND THE SCOPE OF ITS APPLICABILITY TO AGENCY STATEMENTS OF POLICY

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# GUIDANCE, SUPERVISORY EXPECTATIONS, AND THE RULE OF LAW: HOW DO THE BANKING AGENCIES REGULATE AND SUPERVISE INSTITUTIONS?

**TUESDAY, APRIL 30, 2019**

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

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

## OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. The Committee will come to order.

Today the Committee will turn its focus to guidance, supervisory expectations, the rule of law, and how banking agencies regulate and supervise institutions.

Banks receive significant forms of Government support and benefits, including deposit insurance and access to the Fed's discount window.

In exchange for these benefits, which ensure that American consumers have stable access to their deposits, banking agencies supervise banks and in return expect them to operate in a safe and sound manner.

The nature of the supervisory process and the need for trust between the supervisor and the supervised institution means that sometimes supervisory expectations are communicated in an informal and confidential manner between the supervisor and the supervised institution, which can be appropriate in certain circumstances, especially when protecting confidential supervisory information.

With that being said, there appears to be a number of situations where the banking agencies have enacted guidance or other policy statements that are being enforced as rules and therefore do not comply with notice-and-comment rulemaking processes and do not comply with the Congressional Review Act.

In addition, there are a number of situations where supervisors make verbal "recommendations" to banks that are inappropriate given the tremendous power supervisors have over banks.

All rulemaking authority at the banking agencies derives from authority delegated to the banking agencies by Congress, which means Congress has the authority to disapprove any rule a banking agency enacts.

In addition to the absolute authority Congress has to disapprove any agency action, Congress enacted the CRA in 1996 to provide Congress with an expedited process to disapprove agency rules.

Under the CRA, before a rule can take effect, agencies must submit it to Congress for review.

Congress then has 60 days to disapprove the rule with a majority vote.

A rule is defined, with a few exceptions, as "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.

The CRA applies to more than just notice-and-comment rules. It encompasses a wide range of other regulatory actions, including, among others, guidance documents, general statements of policy, and interpretive rules.

Even though the text itself is clear about the broad scope of what constitutes a rule, during the floor debates leading up to the passage of the CRA, then-Senator Reid reinforced this point and said: "[t]he authors are concerned that some agencies have attempted to circumvent notice-and-comment requirements by trying to give legal effect to general statements of policy, guidelines,' and agency policy and procedure manuals. The authors admonish the agencies that the APA's broad definition of rule' was adopted by the authors of this legislation to discourage circumvention of the requirements" of it.

Too often we see banking regulators implementing policy through guidance and other informal means without following the requirements in the CRA.

For instance, some in the agencies may argue that guidance is not binding, but as a practical matter, supervised institutions and supervisors know that informal guidance and other communications between supervised institutions and supervisors change behaviors within institutions.

Legal departments at the banking agencies often assert that guidance is nonbinding, but the language the supervisors at the agencies use often suggest that supervisors treat guidance as binding and expect supervised institutions to treat it as binding.

Actions like this within agencies are problematic and require congressional oversight, including by ensuring banking agencies comply with the CRA.

Recognizing the importance of agencies complying with the CRA, Acting Director of the Office of Management and Budget Russell Vought issued a memorandum recently, which "reinforces the obligations of Federal agencies under the CRA in order to ensure more consistent compliance with its requirements across the executive branch and sets forth guidelines for analysis that the Office of Information and Regulatory Affairs will use to properly classify regulatory actions for purposes of the CRA."

This memorandum is a step in the right direction.

The abuse of Government and agency power should not be a partisan issue, and no Administration or agency should be able to use their powers to influence the private market wrongly.

I continue to encourage the regulators to follow the CRA and to submit all rules to Congress, even if they have not gone through a formal notice-and-comment rulemaking.

In addition, I encourage the banking regulators to provide more clarity about the applicability of guidance and ensure that supervisors throughout the agencies—especially outside of Washington, DC—know about how guidance should be treated and do not inappropriately use their significant discretion.

As a final note, during the Obama administration, I fought against Operation Choke Point, an initiative in which Federal agencies pressured banks to "choke off" politically disfavored industries' access to payment systems and banking services.

Operation Choke Point initially began in the supervisory process. Operation Choke Point was inappropriate and demonstrates why supervisory staff at the agencies need to be transparent and accountable.

I look forward to hearing from each of our witnesses on their views as to what can be done to ensure that there is greater transparency and accountability in the supervisory process.

Senator Brown.

**OPENING STATEMENT OF SENATOR SHERROD BROWN**

Senator BROWN. Thank you, Mr. Chairman.

This is a hearing to talk about guidance, the nonbinding advice from Federal agencies that is supposed to make it easier for the banking industry to follow the rules.

There is a reason we have lots of banking laws. It is a complicated industry that affects everyone's lives with a great deal of potential for special interests to do a whole lot of harm. It takes a lot of oversight to prevent terrorist financing and to protect consumers and to stop discrimination in lending and to keep Wall Street from taking down the economy again.

Banks need guidance to help them comply with those laws. In fact, industry begs for guidance all the time, so why this hearing? Why hold this hearing at all? The same reason we always seem to have hearings in this town: to make things a little bit easier for Wall Street.

We know that this hearing is not actually about making it easier for big banks to follow the rules, that it is really about making it easier for big banks to get around the rules. It is about what kind of guidance the industry wants and the kind of guidance it does not want.

Big banks love guidance that makes it easier to trade derivatives with big foreign banks. Big banks love guidance that tells them how to track their capital or how to prepare for stress tests. I hear that all the time. Big banks love guidance that makes sure they can keep lending when a town is hit by floods or wildfires.

The guidance that big banks hate, though, the guidance we are actually talking about at this hearing today, is the kind that makes it easier for them to skirt the laws or take advantage of their consumers. And as usual, Wall Street has plenty of Senators lining up to help them every single time. Big banks hate guidance that explains how regulators are going to enforce the laws, the laws that say you cannot discriminate against people of color. They hated

that one so much they persuaded darn near every Republican to help them repeal it. Guidance had never been repealed before, as we know, but Republicans used the Congressional Review Act to repeal instructions from the consumer protection agency that would have made it harder for auto dealers to charge people of color more for car loans.

Big banks also hate guidance that says they should be cautious about risky leveraged loans that might crash the economy. They hate it because it cuts into the huge fees they were getting for making these types of loans to corporations. And they really hate guidance that explains how the regulators are going to keep tabs on Wall Street.

Last week, Senator Tillis, a Member of this Committee, sent a letter to the GAO to start the process of having Congress step in and tell regulators to take it easy on the largest banks in the country.

Two weeks ago, the Office of Management and Budget announced they want the President to have direct influence over the guidance that independent banking agencies put out. That means the President can lean over to his Acting—or maybe he is not acting anymore—Chief of Staff Mick Mulvaney, who is also the head of the OMB, who also, as we know, is head of the CFPB, and in some sense still is, and tell independent agencies—the President can lean over and tell Mulvaney and tell independent agencies what we do—what they should do, and they saw how Mick Mulvaney ran the CFPB.

These agencies are supposed to be independent for a reason. We know how corporate special interests spread their influence around in this town. The agencies policing Wall Street are supposed to be independent to guard against that influence. But now the same President, whose Cabinet looks like a Wall Street executive retreat, wants to meddle—although "meddle" is probably an understatement. Remember S. 2155, the bill that gutted many of the rules for the biggest banks in the country and the foreign megabanks. Right in that bill, in Section 109, the bill that Chairman Crapo wrote and skillfully shepherded to the floor, that President Trump signed into law, Congress instructed the CFPB to give guidance on filling out mortgage forms. Republicans demanded, they insisted, they fought for language instructing agencies to give more guidance. This is the kind of guidance they pretend to be opposed to today. This hearing is not about guidance. It is about getting rid of the rules that Wall Street does not want to follow, and as everyone knows, everyone except Republicans on the Senate Banking Committee, as everyone knows, the whole country will end up paying for it.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Brown.

Today our witnesses are Greg Baer, president and CEO of the Bank Policy Institute; Margaret Tahyar, partner at Davis Polk and Wardwell; and Patricia McCoy, professor of law at Boston College Law School.

I would like to inform our witnesses that their written testimony has been included in the record. I encourage you to follow the 5-minute guideline so we can have time for our questions and your

oral remarks, and we will proceed in the order I introduced you. Mr. Baer, you may proceed.

**STATEMENT OF GREG BAER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANK POLICY INSTITUTE**

Mr. BAER. Chairman Crapo, Ranking Member Brown, my name is Greg Baer, and I am CEO of the Bank Policy Institute. I am here to testify today about how legal process has broken down in the regulation and examination of banks. I will not focus on the substance of postcrisis requirements but, rather, on a process that has prevented the public—not only banks but also their customers, academics, and even Members of Congress—from learning what many of those requirements are and having a say in their content.

The breakdown has three parts:

First, examination reports have effectively turned into enforcement actions, as their mandates—specifically, Matters Requiring Attention, or MRAs—are treated as binding orders. By law, an examination report is not binding. Make no mistake, however. The banking agencies take the position that MRAs must be remediated. So, too, do bank compliance teams. This is significant because the volume of MRAs is extreme. Between the OCC and the Fed, at any given time over the past 10 years, there have been between 8,000 and 20,000 MRAs outstanding. Each could be viewed as a quasi-enforcement order. Each under agency rules is also secret, and bankers are subject to criminal penalties for discussing or complaining about them publicly. Notably, many of these, if not most of these MRAs, have not focused on capital and liquidity, the core rules that protect taxpayers. They are, rather, on matters such as how banks manage their vendors, update models or spread sheets, structure reporting lines, or monitor transactions.

Second, the basis for those MRAs frequently has not been a violation of law but, rather, of guidance or unwritten rules. Postcrisis the agencies have generally avoided notice-and-comment rulemaking in favor of a massive volume of guidance in the form of supervisory letters, bulletins, and circulars. Guidance also includes examination handbooks and even enforcement actions, which are read to bind all banks.

In other cases, MRAs are not even based on guidance but simply examiner preference. Asked for the legal basis for such actions, examiners generally cite "safety and soundness." Indeed, they do so increasingly, as the law has recently become clearer that guidance is, in fact, not binding.

But "safety and soundness" must be shorthand for an "unsafe and unsound banking practice," which is defined in the case law as referring only to "practices that threaten the financial integrity of the institution." That is a high bar. The vast majority of MRAs likely fail to meet that standard.

Third, these examination mandates must nonetheless be obeyed because a shadow enforcement regime has grown up postcrisis whereby a firm with unresolved MRAs is potentially subject to limitations on its growth, limitations never authorized by Congress. That is why banks have diverted extraordinary resources to comply with mandates that are often immaterial to their safety and soundness and against their better judgment.

For a perspective on how odd this new enforcement regime is, consider that we routinely see compliance violations across American industries. Those companies are appropriately required to pay fines and remediate their practices, but no one suggests that they should be stopped from opening new franchises, building new plants, developing new drugs, designing new cars, or launching new apps. Yet in banking, regulators often prohibit any type of expansion by the bank as a reaction to a compliance failure.

How could this be improved?

First, the banking agencies should grant the petition filed by the Bank Policy Institute and the ABA and confirm what they have already said in a recent statement: that guidance is not binding and that only a violation of law (including an unsafe and unsound practice) can be the basis for an MRA. This step is necessary because by numerous accounts their earlier statement has been ineffective.

Second, more broadly, the agencies should seek public comment on what an MRA is.

Third, a zero-based review of the application process should be undertaken to clarify what factors are relevant.

Fourth, the CAMELS rating system should be rethought entirely. The Federal Reserve has recently adopted a thoughtful revision of holding company ratings which could serve as a model.

In closing, Congress did not enact the Administrative Procedure Act as a sop to regulated entities or a blow to the independence of agencies but, rather, out of a genuine and well-founded belief that rules are better made when they are informed by an open process and not as well made when they are made in secret, without fear of public scrutiny or challenge. That spirit should be reinjected into the bank examination process.

Many thanks for the opportunity today.

Chairman CRAPO. Thank you, Mr. Baer.

Ms. Tahyar.

**STATEMENT OF MARGARET E. TAHYAR, PARTNER, DAVIS POLK AND WARDWELL LLP**

Ms. TAHYAR. Thank you very much for inviting me here today.

Many sectors of the economy today are regulated, but only the banking sector is also supervised. The legal framework governing the banking sector is open and public. You might agree or disagree with the policy choices, but they are open to all. Supervision happens behind closed doors and involves discretionary actions. The secrecy has traditionally been justified by financial stability or safety and soundness. There has long been an uneasy truce between the transparency required by the rule of law and the secrecy of supervision.

That uneasy truce has become untenable. One canary in the coal mine is the increase in leaks of confidential supervisory information. The canary is warning us about changed social expectations around transparency.

I know that the supervisory staff is made up of men and women of good faith doing a tough job, but it matters that confidential supervision can be a shield that makes it more difficult to hold the supervisors accountable. The public, congressional oversight committees, scholars, and others have limited information about the

work of the supervisors. Should they be praised or criticized? Nobody knows. The public debate and academic scholarship is critically underinformed.

As Minsky noted, "Perfection is out of the question, but better is possible." So I have three suggestions. I hope, I dare to hope, they might be bipartisan.

First, the regulations governing confidential supervisory information should be updated. They were put in place in the 1960s. That is a long time ago. They are not fit for the digital age. It should be narrowed to the minimum necessary for financial stability. There should be a serious reexamination from first principles of the relationship between the zone of secrecy and the securities laws.

One thing is certain. Whatever changes are made should be done on a systemic basis. Right now the practical reality is we have a system where some banks sometimes are subject to leaks and disclosures and others are not.

Second, there has been an expansion, a vast expansion in the zone of secrecy and discretion. Social and economic policy choices that affect jobs and credit are being made in a shadow regulatory system. These include moral suasion, MRAs, and horizontal reviews. The concept of secret law in a democracy is on shaky ground. We have recently seen strong steps in the right direction from Vice Chair Quarles and Chairman McWilliams. These steps should be supported.

Third, Congress and the banking agencies should rethink the training of supervisory staff. The rise in compliance with law exams, the focus on governance, and the increase in violation of law MRAs all mean that staff are making more judgments that are legally infused. And yet as the zone of secrecy and discretion has widened, it has increasingly become delinked from the legal framework. I recommend that training for the supervisory staff should be expanded to include core modules on the Constitution, the separation of powers, congressional oversight, the rule of law, and due process—essentially the legal framework that governs the regulatory State.

I believe that the time has come for a rebalancing in favor of more transparency, accountability, and observance of the rule of law, and I believe that regardless of the policy choice, regardless of whether you are thinking about Wall Street banks or consumers. I believe it content neutral.

We need to get this balance right now because we are moving to a digital age, and if the legal framework, due process, and the rule of law are not in the supervisory culture, they won't make it into the technology and the algorithms. Cultural change is hard. I suspect that both banks and supervisors might be a little uncomfortable with what I am saying today, but if, however, the changes I recommend are made and there is a little discomfort on both sides, I think the balance might be moving in the right direction.

We should not jettison confidential supervision, but we ought to reform it for the 21st century digital age. Thank you very much.

Chairman CRAPO. Thank you, Ms. Tahyar.

Ms. McCoy.

**STATEMENT OF PATRICIA A. MCCOY, PROFESSOR OF LAW, BOSTON COLLEGE LAW SCHOOL**

Ms. MCCOY. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for inviting me here today to talk about guidances and supervision.

My colleagues have argued that banking regulation needs more transparency. They have singled out guidances as an offender in that regard. In the interest of transparency, proposals are on the table to put guidance through notice and comment and routine congressional act review. Today I argue that that would backfire and result in less transparency, not more.

In fact, Federal bank regulators issue guidances because they want to provide transparency, not because they have to. Guidances help financial institutions navigate the thicket of Federal banking statutes and rules. Firms find guidances valuable because they shed light on agencies' supervisory perspectives, priorities, and concerns. Guidances make agency decisions more predictable and reduce compliance risk. For these reasons, financial providers want guidance, and they vocally request it. I have cited in my testimony quotations from financial trade associations to that effect.

Despite the benefits of guidances, agencies are sometimes criticized for penalizing third parties for failure to comply with them. How often this occurs is unclear. Normally, agencies base adverse actions on violations of statutes, notice-and-comment rules, unsafe or unsound practices, or UDAP laws, not on guidances. However, if financial institutions are ever penalized for violating guidances, they already have ample recourse. They can sue to invalidate binding guidances for failure to provide notice and comment under the APA. They can and do meet privately with Federal bank regulators to lodge complaints. They can ask the agency ombudsman to help resolve any problem. They can formally appeal adverse examination findings. And they have the right to judicial review to contest enforcement actions based on guidance violations.

The question is, more specifically, should agency guidance go through notice and comment and Congressional Review Act oversight? Let me cut to the chase. Imposing higher hurdles on the adoption of agency guidance would badly hurt financial institutions and the financial system. Normally, fast-track notice and comment takes 2 years, and many rulemakings take longer. CRA review prolongs this process further.

Agencies might respond by turning nonbinding guidances into binding rules. That would just increase companies' legal risk. Alternatively, agencies might stop issuing guidances altogether. They would be under strong internal pressure to do so given the daunting staffing and budgetary challenges of a vast increase in notice-and-comment requirements.

Is this what companies really want? Federal bank regulators have statutory responsibility to enforce the statutes and rules under their jurisdiction. If agencies stopped issuing guidances, they would still be responsible for enforcing those statutes and rules, and firms would still have to comply with them. But in the meantime, companies would lack guidance about agency interpretations or about how to comply. This would result in less transparency, not more. This would leave financial firms to fend for themselves and

might well produce the "regulation by enforcement" that they intensely dislike.

Moreover, companies would not be able to get quick responses to their implementation questions due to onerous notice-and-comment requirements. The result, unfortunately, might be less compliance with banking laws. We went down this road before pre-2008. It is not a risk that we can ever take again. Moreover, GAO has repeatedly criticized Federal bank regulators for not citing violations and for failing to require their remediation.

Thank you.

Chairman CRAPO. Thank you very much, Ms. McCoy.

I will start my questioning with you, Mr. Baer. Your association, along with the ABA, recently petitioned the banking agencies to engage in a rulemaking clarifying the role of supervisory guidance, to codify, to ask the agencies to codify their recent interagency statement clarifying the role of supervisory guidance, and in that process to clarify that MRAs, MRIAs, and other supervisory action should be based on a violation of statute or regulation, not on a failure to comply with a supervisory guidance.

Can you explain why a rulemaking will help provide clarity in the regulated institutions?

Mr. BAER. Yes, Mr. Chairman. We commend the banking agency for the statement that they did issue. They stated in their statement that guidance was not binding, could not form the basis for an MRA, and, furthermore, that an MRA needs to be—well, that a citation by an examiner needs to be based on a violation of law. I think that was all very good.

It turns out, though, that I think there has been a lot of confusion about that statement. Some have read citation to mean MRA; some have not. There are, I think, numerous reports that it is not really being observed in the field. And so really all we have asked the agencies to do is to formalize in regulation what we believe they have already said in a statement, which, of course, is guidance and, therefore, nonbinding itself. But all we have asked them to do is put into regulation what they have already said through guidance.

Chairman CRAPO. All right. Thank you. And for Ms. Tahyar, picking up on the topic of transparency, there is concern that the use of guidance is really just a substitute or a work-around for the notice-and-comment rulemaking standard set in statute. The lack of transparency around regulators' supervisory activities makes it difficult to decipher when regulators use the threat of supervisory actions that constitute confidential supervisory information against institutions punitively and when they use it for legitimate safety and soundness purposes.

For instance, as I mentioned in my introductory comments, in Operation Choke Point Federal regulators used informal communications to express concerns about services to industries engaged in what they called "high-risk activities" to pressure banks to cutoff services to lawful businesses engaged in politically disfavored industries, and they openly admitted that that was exactly what they were doing.

The question I have is: In this regard, can you discuss your concern around the concept of reputational risk and the use of this

concept to deter financial institutions from lending to certain markets as displayed during Operation Choke Point?

Ms. TAHYAR. Reputational risk, like supervision, isn't in any statute anywhere. I think the concerns that arise when supervisors within the confidential exam process express examiner preferences either around banking services to a sector or their own concerns—and these concerns may be done in the field and not in Washington, so there may not be consistency—around how supposed violations of law or other economic choices take place. All of this is happening behind closed doors, and all of it is happening—you know, some guidance is subject to notice and comment. Much guidance is public. Some guidance is major and some isn't. And, of course, the banking sector likes guidance. But it is the closed-door aspect of the economic choices that are being made, and in my view, these need to come out into the open.

I hope I have answered your question.

Chairman CRAPO. Thank you.

Ms. McCoy, could you respond to the same question? The general issue is the utilization of non-rulemaking or non-statutory standards for enforcement actions or supervisory actions.

Ms. MCCOY. Yes, in my experience, there are multiple layers of review of enforcement decisions; for example, at the CFPB, enforcement decisions are reviewed all the way up to the Director's office. And I have information that enforcement decisions similarly at the prudential banking regulators undergo many layers of review.

The agencies are very careful—many of these enforcement actions are public, and that is a very good thing. I encourage that. They are very careful to ground those enforcement actions on violations of statutes, legislative rules, unsafe or unsound practices, or in the case of the CFPB, UDAP violations. And so I am not seeing the evidence that enforcement is being brought based on guidances in isolation.

Chairman CRAPO. Thank you.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Mr. Baer, the BPI, the Bank Policy Institute, represents some of the biggest, most powerful banks on Wall Street. You are its CEO, correct?

Mr. BAER. Correct.

Senator BROWN. Those banks talk a lot about their diversity initiatives and their antidiscrimination policies. I applaud that. I assume you do.

Mr. BAER. I do.

Senator BROWN. We have a President of the United States who said there are good people on both sides in Charlottesville, who has made disparaging comments about immigrants, who has publicly insulted my friend and colleague, the Chair of the House Financial Services Committee, Maxine Waters. The President's racism I assume is offensive to many of your executives and many of the employees of your member banks. Do you think the President is a racist?

Mr. BAER. Senator Brown, I do not know the President.

Senator BROWN. I do not know his heart either, but do you—well, I will ask it this way: Do you think his words and his actions are racist?

Mr. BAER. Again, I do not think it is my position to characterize at a hearing on bank process what is in the heart of our President.

Senator BROWN. Well, I think it is. I am disappointed, but let me shift to another question.

Has the BPI or the Clearing House Association of the Financial Services Roundtable, which merged to create you, I guess, ever asked regulators to provide guidance?

Mr. BAER. I would say that is unusual. Generally, we are in the position of asking them to engage in notice-and-comment rulemaking around things that really matter.

Senator BROWN. But you have supported some guidance as BPI, correct?

Mr. BAER. I am actually trying to recall an occasion when we have done so, and I do not recall——

Senator BROWN. Well, let me give you a larger historical context, a wider time period. So as either the Financial Services Roundtable, the Clearing House Association, either of them, or you as the BPI now, you have asked regulators to provide guidance in the past?

Mr. BAER. Senator, we may well have. I just cannot recall an instance. In every recollection that I have, we have been asking them to use notice-and-comment rulemaking more, not less.

Senator BROWN. Did you have a position on Congress' repeal of the CFPB guidance, either you or your two predecessors that merged, that instructed banks on how to avoid making discriminatory car loans? Did you have a position on that repeal?

Mr. BAER. I do not think we engaged on that issue—of the two initiatives on the CRA. We were more focused on the leveraged lending one.

Senator BROWN. So you did not take a position or do any lobbying on that guidance, that rule?

Mr. BAER. I know we strongly supported review of—well, submission of the leveraged lending guidance and congressional review of that. I do not recall our taking a position on the CFPB auto.

Senator BROWN. Professor McCoy, Congress repealed—we have talked about a number of times now the CFPB's guidance on discriminatory auto lending.

Ms. MCCOY. Yes.

Senator BROWN. Did that make CFPB's plans for enforcing the Equal Credit Opportunity Act more or less clear for industry?

Ms. MCCOY. It certainly made it murkier. I want to stress here that before the CFPB was ever enacted, there is substantial Federal case law that established that disparate impact theory applies to auto lending by indirect auto lenders. The CFPB in that guidance was observing decided Federal case law that predated its existence. The CFPB remains statutorily responsible for enforcing ECOA, and firms have to comply with that.

What it means then to disapprove that guidance in the face of the still existing statute, which has not been repealed or amended, and the decided case law is really unclear. What does disapproval mean? If I were industry, I would not know.

Senator BROWN. That is helpful. This is for you again, Professor McCoy. The financial crisis took many Wall Street insiders by surprise. Consumer advocates and community activists were less surprised, were sounding the alarm about a foreclosure crisis, urging regulators to take action before the crisis. I wonder about the collective amnesia in this body about what happened a decade ago, but I am still hopeful that we have learned something.

If OIRA has the ability to block independent regulators' actions, do you think our financial system will be more or less safe?

Ms. MCCOY. I am very concerned about what I view as a power grab by OIRA. It is a direct attempt to abridge Federal banking regulators' statutory independence. Congress clothed the Federal banking regulators with independence for a very important reason. It is for the stability of the banking system. It is to make sure that the executive branch and the White House do not improperly interfere with neutral expert bank regulatory decisions for short-term political advantage.

The result of Federal bank regulator independence is to reside oversight of Federal banking regulators where it belongs, which is here in Congress. So I view OIRA's memo as actually not only a power grab vis-a-vis the Federal bank regulators, but an attempt to wrest control away from Congress and consolidate it in the White House.

Senator BROWN. Thank you.

Chairman CRAPO. Senator Toomey.

Senator TOOMEY. Thank you very much, Mr. Chairman.

Two years ago, I sent two letters to the GAO. I asked the GAO to review the CFPB's indirect auto lending bulletin, their indirect auto bulletin, and let me be clear, this was an ill-considered bulletin. It was really aimed at auto dealers despite the fact that that industry was explicitly excluded from the CFPB's jurisdiction. It was based on extremely dubious and speculative statistical analysis, and it ultimately would have made offering dealer discounts more difficult. In other words, it would have raised the cost of buying cars.

If Congress intended for dealers to have a harder time providing discounts and to raise the cost of buying cars for our constituents, in my view, we should pass a law to do that.

In any case, the second letter was regarding leveraged lending, and I specifically asked the GAO to determine if these two guidances, bulletins, met the CRA's definition of a rule, which the CRA defines in part as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."

In both cases, GAO concluded that the agency actions did meet the definition of a rule, despite the fact that they did not go through the Administrative Procedures Act. This is not a surprise. It is not unheard of for agencies to intentionally circumvent the transparent rulemaking process and instead implement its will through these tools such as guidance. In fact, the authors of CRA, including Senator Reid, acknowledged this reality, and the Chairman quoted from his remarks.

So I want to say I am glad to see the Committee is taking this up. I appreciate that, Mr. Chairman, and I would remind agencies of their obligations under the Congressional Review Act.

Now, the banking regulators have published a statement making it clear that they understand the law and that they do not believe that their guidance has the binding force of law or of a rule. I think that is widely acknowledged, at least at a theoretical level. My question for you, Mr. Baer: In your experience with banks as they interact with the regulators and supervisors, do supervisors treat guidance as binding even though the heads of the regulatory agencies have said that they are not supposed to be?

Mr. BAER. Thank you, Senator. I have to start with an important caveat. As noted, and I think as Meg Tahyar noted, the examination process is secret, and the communications between the examiners and the banks, therefore, are considered confidential supervisory information, and it is actually a crime for them to discuss that with me or you. So I think my knowledge here is quite limited. I think the Committee may have a better opportunity to find out what is really going on than I. But I can certainly tell you that I have heard from multiple banks, and I think in some cases even from supervisors, that there is confusion about what that statement means, particularly whether a citation means a MRA, whether guidance that was previously the basis of an MRA is somehow grandfathered. And so, again, it seems to us to be a very low cost and quite potentially beneficial move for the agencies to clarify and formalize that in a regulation.

Senator TOOMEY. What about the argument that if a bank feels that their examination or their rating is not accurate or is not done properly or is not fair or somehow is inconsistent with the rules, they can just appeal it? Is that an effective mechanism for regulated institutions?

Mr. BAER. Sure, Senator, I will confess, I think as a young man at the Federal Reserve, I actually at one point drafted the appeal rule there and did so in all sincerity and with the hopes that it would be used. There has been some terrific academic work on this by Professor Julie Anderson Hill who actually has documented the effectiveness of that regime. Again, consider as backdrop that we are talking about tens of thousands of MRAs. I think interagency appeals, the OCC has been averaging about nine per year, and——

Senator TOOMEY. Can I interrupt for a quick clarification? With respect to the MRAs, if I as a Member of this Committee wished to examine the MRAs so that I could determine whether or not the enforcement—whether they were being used properly in accordance with the law, how many would I be able to read through?

Mr. BAER. I think it would depend on the law and your relationship with the relevant agency. Certainly I am not allowed to read any of them.

Senator TOOMEY. You are not allowed to read any of them?

Mr. BAER. No.

Senator TOOMEY. They are not public?

Mr. BAER. Correct. And, again, given the numbers involved, the fact that you are only seeing between two and nine appeals per year is an indication that that is not really a live option for institutions.

Senator TOOMEY. Ms. Tahyar, are you aware of the extent to which these MRAs are available to Members of Congress for review?

Ms. TAHYAR. Well, the confidential supervisory privilege belongs to the agencies, and they could waive it if they chose to do so.

Senator TOOMEY. And if they chose not to?

Ms. TAHYAR. That is also totally in their discretion.

Senator TOOMEY. And there are thousands of these each year.

Ms. TAHYAR. There are thousands of these each year.

Senator TOOMEY. There is a lot happening that never sees the light of day.

Ms. TAHYAR. That is exactly right, Senator. My recommendation would be on MRAs that the agencies continue the process that the Fed did in its supervisory report. Let's get more information out, more in the aggregate, more granular, taking out the names of banks. Let's see what the trends are. Scholarship is critically uninformed, and the congressional oversight committees are critically underinformed.

Senator TOOMEY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you.

Let me just get some clarification because I am kind of confused with what I am hearing. Are you telling me that the banks want these confidential supervisory examinations to be public, Mr. Baer.

Mr. BAER. I think that is certainly something to be considered. I do not——

Senator CORTEZ MASTO. So the banks are not concerned about information that may become public, so the banks are open to any type of examination, a supervisory examination, being public and people being aware? That is what I am hearing you say.

Mr. BAER. I have not surveyed our members, and I do not know that there is one consensus view among the banks.

Senator CORTEZ MASTO. I would be curious to know that because I would think just the opposite. I think from what I am seeing, and somebody who has enforced the laws and has dealt with regulation, that sometimes there is a need for secrecy for purposes of the banking industry, and they request that.

Now, let me ask you this: With respect to matters requiring attention, are you here telling me today that there are some enforcement actions taken against banks that were enforced because of a violation of an MRA that is not based in a violation of law?

Mr. BAER. I think we can say with great confidence, given the numbers and some background knowledge, that most MRAs are not based on a violation of law.

Senator CORTEZ MASTO. So you are telling me that what I heard you say is that there is some violations that have been implemented that were violations just based on an MRA and that MRA was not based in law?

Mr. BAER. The way I would put it is MRAs frequently, I believe, are not based on a violation of law or an unsafe and unsound banking practice.

Senator CORTEZ MASTO. But what I heard you just say is that there were some violations based on an MRA. Is that correct?

Mr. BAER. I do not think that is correct.

Senator CORTEZ MASTO. So no MRA—what I am understanding is that there are MRAs have been out there and that no bank has been issued a violation based on an MRA?

Mr. BAER. Well, an unremediated MRA would probably lead to an MRIA, immediate attention, and then if it were unremediated, the agency would take formal enforcement action.

Senator CORTEZ MASTO. Action based on a violation of law, correct?

Mr. BAER. At that point they would need a violation of law to take a formal enforcement action, for example, an order——

Senator CORTEZ MASTO. So any enforcement action is based on a violation of law?

Mr. BAER. Correct.

Senator CORTEZ MASTO. OK. So there is not a misuse of the MRAs or MRIAs from what I heard you say earlier. So I am just trying to clarify. Let me jump, because I only have so much—so many minutes to ask a question here. And, Ms. McCoy, let me ask you this: I am concerned from what I am seeing and what I have just heard that OMB's decision that they have authority to review independent bank regulatory—or regulators' actions, in essence what you have put in your writings, you basically say the OMB memo improperly treads on Federal bank regulators' independence and violates Executive Order 12866, particularly when it comes to the cost-benefit analysis. Can you talk a little bit about that and why you think that is a violation?

Ms. MCCOY. Yes. The Congressional Review Act only requires Congressional Review Act review in Congress of major rules. So somebody has to decide what is a major rule. Congress entrusted OIRA with that decision.

Agencies submit financial information about the effect of proposed rules, of final rules, to OIRA. What OIRA is doing in the memo is specifying the methodology that the agencies must use when they submit this financial information assessing the impact. That is totally improper under Executive Order 12866.

OMB and OIRA have no statutory authority to tell the Federal bank regulators how to conduct their cost-benefit analysis. In fact, they are barred from doing so.

Senator CORTEZ MASTO. Because that treads on the independence and the province of the banking regulators, correct, under the law.

Ms. MCCOY. Exactly.

Senator CORTEZ MASTO. And that is the whole intent why there is that independence, so the White House cannot come in and try to usurp that for their own short-term gain or long-term gain, whatever that is, correct?

Ms. MCCOY. Totally.

Senator CORTEZ MASTO. OK. Thank you.

Let me just say one thing. I get that we have to find balance, and I think, Ms. Tahyar, you are trying to find a balance between the two. And I get that that needs to be there. What I heard earlier, that to the extent that my colleagues have issued requests to the GAO to determine whether there is a rule or not and action is taken, at least we still have that authority to take that action and

the process was followed. But with this new guidance, that changes the game. This is the White House now coming in and making a determination and usurping the independence of the financial regulators for their own short-term gain over the banking industry. That concerns me. We should all be concerned about that. I get that bank examiners have discretion, and sometimes that discretion—they overstep their discretion. And I think what we are trying to do is find a balance here.

But let me ask you this, Mr. Baer: Are you saying that there should be no supervision?

Mr. BAER. To the contrary, Senator.

Senator CORTEZ MASTO. So let me ask you this: Are you saying there should be no guidance with that supervision?

Mr. BAER. What I am saying, Senator, is that if the agencies are going to treat guidance as a binding requirement, which is effectively what MRAs have become, even without resort to consent orders or an order——

Senator CORTEZ MASTO. So I guess I am still trying to understand that. Maybe I need to see some of these, and I know they are confidential. But if I am an enforcement agency and I am trying to give you the benefit of the doubt without taking enforcement to guide you, to give you that opportunity to clean it up, clear it up, before enforcement action is taken, and you have not done it, then I am going to enforce it based on a violation of the law. So the only time enforcement is going to happen is if there is a violation of law. But I am going to give you the benefit of the doubt, and I am going to let you try to take—cure it before you do.

Mr. BAER. Right.

Senator CORTEZ MASTO. So what I am hearing is that is not happening?

Mr. BAER. Here is, I think, the crucial distinction. The situation you are describing I think describes agencies that use only enforcement as a way to impose their wishes, so basically anybody but banking agencies. Banking agencies are unique in that they are resident at these institutions. They are always with them, and they are telling them a lot of things that would never rise to the level of an enforcement action, you know, how to minute your meetings, how to structure your reporting lines, how to review your models. Those are things that would never end up becoming a violation of law or even an unsafe and unsound banking practice.

So really the question is—there has always been an informal give-and-take between bank and regulator about, you know, "We would like your report line to look like this," "No, we like it the way it is," and you have that discussion. That has gone on for a century.

What has changed over the last 10 years is that that has become a much more one-sided conversation, and the notion is that if the agency wants you to do something and you do not do it, well, then you are subject to, you know, nonpublic sanctions, particularly around your growth. "You do not want to do it our way, we are going to give you a 3 for management, we are not going to let you open any branches for a year."

And all of that, to the extent it is happening behind the scenes, I think that is what you hear us objecting to.

Senator CORTEZ MASTO. Thank you. I appreciate that.

I know I went over my time. Thank you for the indulgence, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Moran.

Senator MORAN. Chairman Crapo, thank you.

Before we turn to the specific topic of today's hearing, we are on the topic of accountability, and I want to restate, once again indicate my concern with the lack of accountability at Financial Accounting Standards Board and its requiring banks to forecast and book current and expected losses over the life of loans at the time the loan is made. Those actions are not subject to review, and I do not think we ought to be allowing a self-governing body to, in effect, set national economic policy without congressional input and Federal regulators should acknowledge.

On the topic of today's accountability, let me start with Mr. Baer, but I am fine to have comments from any of you. Effective supervision and regulation of financial institutions require accountability of the regulators. That is what some of you—maybe all of you—have been saying. One of the most important components of accountability is the thread of legitimate appeal process, and Senator Toomey raised this topic a moment ago.

As mentioned in the testimony, the ultimate arbitrator of an examination appeal is made by the same agency that made the original decision. I think it is a difficult argument to make that this does not have an effect on the impartiality of the appeals.

In addition to reining in the shadow enforcement regime that was discussed in the testimony, would establishing an independent ombudsman within the regulators be one of the most effective legislative items this Committee could take up to address the examination appeals process that is currently in effect? Mr. Baer.

Mr. BAER. Senator, thank you. I think that would certainly be of help. I think there are really two things that drive the fact that banks generally do not appeal supervisory ratings or loan classifications. The first, as you note, is they are effectively appealing to the agency that made the decision, so you are unlikely to succeed.

I think the bigger factor, though, is really—and this gets to my conversation with Senator Cortez Masto, which was that you have to continue to live with those examiners.

Senator MORAN. All the other things they regulate or can do.

Mr. BAER. Right. I liken it to you can file for divorce and continue to live with your spouse, but you need to sleep with one eye open. And I think the notion that you can be contesting an appeal with regard to the examiner you are seeing every day and maintain the relationship you have—and this is not of recent vintage. This goes back forever. Examiners have long memories, and they will tell you that. And so, you know, I think it is very difficult, even to the extent that the agencies are well meaning—and I think they are. They recently actually just put out a request for how can we do more to prevent retaliation and make the system work better. I think they genuinely wish to make the system work better. But I think just as it is structured currently, it is very difficult to make progress on that.

Senator MORAN. I was surprised a number of years ago at the number of bankers in Kansas who had a particular complaint about a particular regulator, and I invited the regulator to my office and invited my Kansas bankers to come meet with the regulator. Not one was interested in doing that. Instead, they sent the president of the Bankers Association on their behalf, again, highlighting what I was surprised to learn was the fear of retaliation if they were complaining about something at least they thought was legitimate enough to complain to me over a long period of time in numerous occasions.

Either of you have a thought about an ombudsman?

Ms. TAHYAR. I think an ombudsman with real power, acting independently, would be a helpful step. But, ultimately, the appeals process from examinations is a limited way forward because I think ultimately the balance of power is such that, as you experienced in Kansas, banks will be reluctant to come forward. That is why some system of more transparency is needed. I am not necessarily suggesting that suddenly everything comes out. I think change is hard, and it would have to be done in an appropriate and systemic way. But more information, trends in aggregate of MRAs, MRIAs, more information coming out I think would make a lot of difference.

Senator MORAN. Thank you.

Professor.

Ms. MCCOY. Yes, and, Senator, I am a fellow Kansan. It is wonderful to meet you finally in person.

Senator MORAN. Thank you so much.

Ms. MCCOY. Yes. I think it is really important that we focus on improving the MRA and MRIA process. The current regulators are really starting to focus on that to reduce the number. I totally agree with Ms. Tahyar that it is imperative to do a better job of training examiners—we have a lot; we have over 10,000 examiners in the United States—on the proper use of MRAs and MRIAs. But if I can look at Mr. Baer's proposal, let us say that a particular regulator wants to adopt an MRA with respect to one bank on a particular safety and soundness issue. Do I understand him to say that the agency would be required to publish that in the *Federal Register*, naming the bank, naming the alleged unsafe and unsound practice, seek public comment, and then decide whether to make it final? Putting aside the time that that would take, I very much doubt that banks want to be put through that ordeal. So that suggestion does not seem to be at all practical to me. But an empowered ombudsman is a very good idea.

Ms. TAHYAR. I think there is no suggestion that individual MRAs be put through notice and comment. I will turn to Greg to see where he is.

Mr. BAER. No. Again, it depends on what an MRA is. It would never be a notice-and-comment rulemaking would be de facto in order, which under the rules, if you are issuing a capital directive or an order, there is a notice and process appeal right to the institution. And if it is going to have an effect on your ability to establish branches and grow, then perhaps you should have a formal appeal process akin to what you would have with an order or capital directive or a prompt corrective action directive. But, you know, again, most MRAs are not anywhere near that level, and if they

were truly treated as nonbinding orders, there would be no need for that appeal process.

Senator MORAN. Thank you all three.

Thank you, Mr. Chairman.

Chairman CRAPO. Senator Tillis.

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

I think it was said by the Ranking Member that I dislike guidance. What I dislike—it has nothing to do with guidance. Guidance has a place in the regulatory process. What I dislike is the inappropriate use of guidance for things that should give rise to a rule, which is why we have already utilized the CRA and the GAO process on three, and we have got a long, long list of other actions that regulatory agencies have taken that we are saying, look, maybe this does relate to safety and soundness of the banking industry. Just do your homework and go through the rulemaking process and then determine whether or not you have got a rule that is sustainable, that regulates the risk, that gives appropriate insight into the risk, but not so burdensome that we just layer more and more and more on the banking industry. And I believe based on some of the actions they just want to de facto nationalize the industry through a combination of rules that sometimes overreach and guidances and speeches and policy memos and a number of agency actions that I think are inappropriate.

Look, that would be like the Congress deciding, well, you know, we are going to pass laws when we think we can and when we have, you know, the time to do it. But, otherwise, we are going to start passing guidances that, unless the President vetoes them, they are just in place. That is an absurd concept, and I think it is also equally absurd for administrative agencies to go down the same path.

I want to go back to the MRA. Why couldn't we, instead of all-or-nothing scenario that Senator Cortez Masto is suggesting, why couldn't we simply say that for financial institutions who simply want to have the MRA review, they can actually have a redacted version of it reviewed so that people like me and other third parties, an IG, could take a look at it and see if it was an appropriate supervisory examination process? Why wouldn't that work? I do not know necessarily the rules, if that runs afoul of the rules, but why couldn't they do that, almost like a whistleblower, like this was an inappropriate set of behaviors and instructions between a supervisor and an examiner, and we actually want this to see the light of day? What would be wrong with a concept like that, Mr. Baer?

Mr. BAER. I think this gets to sort of what Senator Moran was saying. You could certainly envision an appeals process around MRAs where you could have a more neutral arbiter and perhaps better assurance that there would not be future retaliation. Again, I am a little dubious on that second point. I think, you know, institutions that were in the habit of appealing their MRAs would, again, if that is a public appeal—and we have not even talked about this component—you would have the reputation as someone who could not get along with your regulator, which from an investor relations perspective is not a good thing. And I think that is also a factor here.

Senator TILLIS. That is a great point. What we are really trying to do, if you talk about 10,000 people in the mix on this, then obviously you know there are some number who, through their personality or personal preferences, are probably abusing their authority. So my goal is to try and figure out how you actually weed out the minority, significant minority of people doing this every single day, so that we are just not shifting our focus away from having a safe and sound financial services industry. That is all I care about.

And, incidentally, industries that are regulated to the appropriate level but not regulated to death have more resources to provide loans, to provide housing, to do the kinds of things they want to do ultimately for consumers. We talk about more and more regulation here, but we do not talk about at the end of the day that it has to be paid for. It is not paid for by the bank. It is paid for by the people who take loans, who get credit cards, and who need financial services to make ends meet.

I want to talk about maybe a couple of other ones that I should take a look at, Mr. Baer, in terms of my list of other actions that I may take through the GAO and the CRA. I think one—well, actually, I am not going to talk about this one. I had one on the list. Oh, yeah, the SR letter, 1402, bank expansion, are you familiar with that one?

Mr. BAER. Yes.

Senator TILLIS. What do you think? Is that something that I should take a look at and get a consultation with the GAO to see if that was something that should have been done through rulemaking?

Mr. BAER. Senator, I could certainly see that being appropriate. I would hope—and it is not really clear what the status of that is. I mean, I think the Federal Reserve recently, to their credit, has been indicating that they are more inclined to stick to the statutory factors for reviewing applications.

Senator TILLIS. That is awfully good of them.

Now, I would also say I think Chair McWilliams has done a good job of rescinding a number of guidances over in the FDIC. Do you think there is equal opportunities to do that in OCC and with the Federal Reserve?

Mr. BAER. Yes, Senator, again, this sort of gets to the core of what we are seeking through our petition for rulemaking, along with the ABA, which is simply, you know, a clarification that if you are going to have an MRA, it is going to be based on a violation of law or an unsafe and unsound practice, not guidance. And that cures a lot of ills because at that point guidance is, as I think some here have described it, nonbinding as an indication of the priorities or concerns of the agency but not a rule.

Senator TILLIS. Yeah, and when used in that spirit, it can be helpful. When abused, it can be harmful.

Mr. BAER. Absolutely.

Senator TILLIS. And people should do their jobs and go through the right processes.

I know I am over time. I almost never go over time, but the Chair and Ranking Member are talking, so I am going to try and get one more question in.

[Laughter.]

Senator TILLIS. I wanted to go back because I had one that was actually my—I have got two banking institutions who have decided that they are going through the merger process, SunTrust and BB&T. I personally think it would be good for the country. After we implemented S. 2155, I think those are two banks that are right in that middle ground that actually give them the scale to be able to deal with what larger banks have to do with respect to footprint and banking operations, regulatory burden.

Should I be worried as we go through this review process that we could get caught up in things that are not necessarily things that they should be subjected to to get approval for this bank merger?

Mr. BAER. Senator, I think——

Senator TILLIS. And do you think we will ever know the specifics of the negotiations that occur?

Mr. BAER. I would just say, I mean, fortunately, when evaluating bank mergers, the Federal Reserve looks at an objective measure of that, the Justice Department measure, the HHI, or Herfindahl–Hirschman Index, which I think shows—and we have looked at this particular merger and published on it—shows banking to be an unconcentrated industry, both as an absolute matter and relative to other industries. I think the numbers show that this merger would not materially add to the concentration of that industry.

Senator TILLIS. Just intuitively, can you imagine why it would take a year or more to review this and make a decision on this merger? It seems to me it should be something that should be done in a matter of months. I think that the Federal Reserve is trying to greatly compress the length of time for doing these reviews. But can you imagine any scenario why it should be next year before we get a decision on this merger in your professional opinion?

Mr. BAER. That is kind. I do not know if there are any complications around the merger of which I am unaware. I would think in the ordinary course it would not take that long.

Senator TILLIS. Well, I do not think that there are, so I am looking forward to a quick decision on the part of the regulators so that we can move forward. Thank you all.

This is the first time I have gone over my time, Mr. Chair, and I appreciate your indulgence.

Chairman CRAPO. Thank you. You are welcome.

Senator Brown.

Senator BROWN. First time Senator Tillis went over this week.

[Laughter.]

Senator BROWN. Thank you.

Chairman CRAPO. He has been really good.

Senator BROWN. Thanks. My staff—a question to Mr. Baer. We are going to follow up with written questions. We found several instances in which the Financial Services Roundtable took a position on indirect auto lending, so we would like to get some clarification. We will send you a letter, if you would respond as quickly as possible, Mr. Baer.

Mr. BAER. Thank you, Senator. As I said, my statement was based on my recollection. I actually never worked at the Financial Services Roundtable, so I take your word for that.

Senator BROWN. Thank you.

Chairman CRAPO. All right. Thank you, and that concludes our questioning for today's hearing. I again thank our witnesses for your time and for your expertise and for coming here and participating in this hearing.

For Senators who wish to submit questions for the record, those questions are due to the Committee by Tuesday, May 7th, and I ask the witnesses to respond to those questions as promptly as you can once you receive them.

Again, we thank you for being here, and this hearing is adjourned.

[Whereupon, at 11:06 a.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, the Committee will turn its focus to guidance, supervisory expectations, the rule of law, and how banking agencies regulate and supervise institutions.

Banks receive significant forms of Government support and benefits, including deposit insurance and access to the Fed's discount window.

In exchange for these benefits, which ensure that American consumers have stable access to their deposits, banking agencies supervise banks and in return expect them to operate in a safe and sound manner.

The nature of the supervisory process and the need for trust between supervisor and supervised institution means that sometimes supervisory expectations are communicated in an informal and confidential manner between supervisor and supervised institution, which can be appropriate in certain circumstances, especially when protecting Confidential Supervisory Information.

With that being said, there appears to be a number of situations where the banking agencies have enacted guidance or other policy statements that are being enforced as rules and therefore do not comply with notice-and-comment rulemaking processes and do not comply with the Congressional Review Act (CRA).

In addition, there are a number of situations where supervisors make verbal "recommendations" to banks that are inappropriate given the tremendous power supervisors have over banks.

All rulemaking authority at the banking agencies derives from authority delegated to the banking agencies by Congress, which means Congress has the authority to disapprove any rule a banking agency enacts.

In addition to the absolute authority Congress has to disapprove any agency action, Congress enacted the CRA in 1996 to provide Congress with an expedited process to disapprove agency rules.

Under the CRA, before a rule can take effect, agencies must submit it to Congress for review.

Congress then has 60 days to disapprove the rule with a majority vote.

A rule is defined, with a few exceptions, as "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.

The CRA applies to more than just notice-and-comment rules. It encompasses a wide range of other regulatory actions, including, among others, guidance documents, general statements of policy, and interpretative rules.

Even though the text itself is clear about the broad scope of what constitutes a rule, during the floor debates leading up to the passage of the CRA, then-Senator Reid reinforced this point and said: "[t]he authors are concerned that some agencies have attempted to circumvent notice-and-comment requirements by trying to give legal effect to general statements of policy, 'guidelines,' and agency policy and procedure manuals. The authors admonish the agencies that the APA's broad definition of 'rule' was adopted by the authors of this legislation to discourage circumvention of the requirements" of it.

Too often, we see banking regulators implementing policy through guidance and other informal means without following the requirements in the CRA.

For instance, some in the agencies may argue that guidance is not binding, but as a practical matter, supervised institutions and supervisors know that informal guidance and other communications between supervised institutions and supervisors change behaviors within institutions.

Legal departments at the banking agencies often assert that guidance is nonbinding, but the language the supervisors at the agencies use often suggest that supervisors treat guidance as binding and expect supervised institutions to treat it as binding.

Actions like this within agencies are problematic and require Congressional oversight, including by ensuring banking agencies comply with the CRA.

Recognizing the importance of agencies complying with the CRA, Acting Director of the Office of Management and Budget (OMB) Russell Vought issued a memorandum recently, which "reinforces the obligations of Federal agencies under the CRA in order to ensure more consistent compliance with its requirements across the Executive Branch and sets forth guidelines for analysis that the Office of Information and Regulatory Affairs (OIRA) will use to properly classify regulatory actions for purposes of the CRA."

This memorandum is a step in the right direction.

The abuse of Government and agency power should not be a partisan issue and no Administration or agency should be able to use their powers to influence the private market.

I continue to encourage the regulators to follow the CRA and submit all rules to Congress, even if they have not gone through a formal notice and comment rulemaking.

In addition, I encourage the banking regulators to provide more clarity about the applicability of guidance and ensure that supervisors throughout the agencies (especially outside of Washington, DC) know about how guidance should be treated and do not inappropriately use their significant discretion.

As a final note, during the Obama administration, I fought against Operation Choke Point, an initiative in which Federal agencies pressured banks to "choke-off" politically disfavored industries' access to payment systems and banking services.

Operation Choke Point initially began in the supervisory process.

Operation Choke Point was inappropriate, and demonstrates why supervisory staff at the agencies need to be transparent and accountable.

I look forward to hearing from each of you on your views of what can be done to ensure that there is greater transparency and accountability in the regulatory and supervisory process.

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## PREPARED STATEMENT OF SENATOR SHERROD BROWN

This is a hearing to talk about guidance—the nonbinding advice from Federal agencies that's supposed to make it easier for the banking industry to follow the rules.

There's a reason we have a lot of banking laws—it's a complicated industry that affects everyone's lives, and with a great deal of potential for special interests to do a whole lot of harm. It takes a lot of oversight to prevent terrorist financing and protect consumers and stop discrimination in lending and keep Wall Street from taking down the economy again.

And banks need guidance to help them comply with those laws.

In fact, industry begs for guidance all the time.

So why hold this hearing at all?

The same reason we always seem to have hearings in this town—to make life a little easier for Wall Street.

Chair Crapo, I am concerned this hearing isn't actually about making it easier for big banks to follow the rules—that it's really about making it easier for big banks to get around them.

It's about what kind of guidance the industry wants, and the kind of guidance it doesn't.

Big banks love guidance that makes it easier to trade derivatives with big foreign banks. They love guidance that tells them how to track their capital or how to prepare for the stress tests. They love guidance that makes sure they can keep lending when a town is hit by floods or wildfires.

The guidance big banks hate—the guidance we're actually talking about at this hearing today—is the kind that makes it harder for them to skirt the laws or take advantage of their consumers.

And as usual, Wall Street has plenty of senators lining up to help them.

Big banks hate guidance that explains how regulators are going to enforce the laws that say you can't discriminate against people of color. They hated that one so much they persuaded Republicans to repeal it.

Guidance had never been repealed before. But Congress used the Congressional Review Act to repeal instructions from the Consumer Protection agency that would have made it harder for auto dealers to charge people of color more for car loans.

Big banks also hate guidance that says they should be cautious about risky leveraged loans that might crash the economy. They hate it because it cut into the huge fees they were getting for making these types of loans to corporations.

And they hate guidance that explains how the regulators are going to keep tabs on Wall Street. Last week Senator Tillis sent a letter to the GAO to start the process of having Congress step in, and tell regulators to take it easy on the very largest banks in this country.

And 2 weeks ago, the Office of Management and Budget announced they want the President to have direct influence over the guidance that independent banking agencies put out.

That means the President can lean over to his Chief of Staff Mick Mulvaney, who is also the head of OMB, and tell independent agencies what to do. And we saw how Mick Mulvaney ran the CFPB.

These agencies are supposed to be independent for a reason. We know how corporate special interests spread their influence around Washington.

The agencies policing Wall Street are supposed to be independent to guard against that influence. But now the same president whose cabinet looks like a Wall Street executive retreat wants to meddle.

And remember 2155—the bill that gutted many of the rules for the biggest banks in the country, and for foreign megabanks?

Right in that bill, in section 109 to be exact, the bill that Chairman Crapo wrote and skillfully shepherded to the floor and that President Trump signed into law, Congress instructed the CFPB to give guidance on filling out mortgage forms. Republicans demanded, insisted, and fought for language instructing agencies to give more guidance. This is the kind of guidance they pretend to be opposed to today.

This isn't about guidance—it's about getting rid of the rules that Wall Street doesn't want to follow.

And everyone else will end up paying for it.

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## PREPARED STATEMENT OF GREG BAER

PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANK POLICY INSTITUTE

APRIL 30, 2019

My name is Greg Baer, and I am president and CEO of the Bank Policy Institute.[1] I am here to testify about how legal process has broken down in the regulation and examination of banks. I will not today generally discuss the substance of postcrisis requirements imposed by the Federal banking agencies; instead, my focus will be on a process that has prevented stakeholders in banking policy—not only banks but also their customers, academics, and even Members of Congress—from learning what many of those requirements are, and having a say in their content.

In so doing, I bring to bear not only my perspective as CEO of the Bank Policy Institute, a trade association representing America's leading banks, but also that of a lawyer and sometime law professor. Over time, the laws and regulations I learned, teach, and in some cases wrote have become decreasingly relevant in practice. The procedural rights and protections that those laws provide are generally obsolescent, as regulation and examination have become increasingly subjective, opaque, and unappealable.

So, this hearing is a welcome development, and I thank the Committee for devoting its valuable time to these issues.

In my testimony, I will describe the laws enacted by Congress to govern the regulatory, examination and enforcement process. I will then describe the actual status quo, and how it diverges significantly from the laws as written. Finally, I will describe recent actions by the Government Accountability Office and some of the financial regulators that hold the potential for reform in this area, and some additional steps that could be taken to restore the rule of law as enacted by Congress.

My testimony today describes how examination reports have been effectively turned into enforcement actions, as their mandates—Matters Requiring Attention and Matters Requiring Immediate Attention, or MRAs and MRIAs—are treated as binding regulations or orders. Furthermore, the basis of those MRAs frequently is not a violation of law but rather a "violation" of guidance that under the law is actually nonbinding, or of other standards that also have neither a legal basis nor an evidentiary foundation. Finally, the reason these examination mandates are treated as binding regulations or orders is because a shadow enforcement regime has grown up postcrisis whereby firms with any unresolved MRA are subject to limitations on their growth—limitations never authorized by Congress.

I should note that my testimony generally does not focus on capital and liquidity rules. Clearly, these are the most important components of banking regulation and universally regarded as the core protection for taxpayers and financial stability. And they generally have been adopted in accordance with the Administrative Procedure Act, and are enforced in a transparent, objective way.[2] Rather, ironically, it is the

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[1] The Bank Policy Institute (BPI) is a nonpartisan public policy, research and advocacy group, representing the Nation's leading banks. Our members include universal banks, regional banks, and the major foreign banks doing business in the United States. Collectively, they employ nearly 2 million Americans, make 72 percent of all loans and nearly half of the Nation's small business loans and serve as an engine for financial innovation and economic growth.

[2] One notable exception, however, is the Federal Reserve's stress testing regime. See, e.g., Jeremy Newell, The Fed's "2018 CCAR Scenarios: A Look at Process", *Underwritings: The BPI Blog* (March 2, 2018), *https://bpi.com/the-feds-2018-ccar-scenarios-a-look-at-process/*.

regulatory requirements that matter the least that are the most opaque and come with the fewest checks and balances—requirements about how banks manage their vendors, minute their meetings, update spreadsheets, structure reporting lines, or monitor transactions. Those requirements, not the core capital and liquidity requirements, are what have built a vast compliance bureaucracy, and it is those requirements that frequently have prevented banks from branching, investing and otherwise serving new customers and offering new products postcrisis. Over the past few years, many banks that met all of the dozens of capital and liquidity requirements to which they are subject have been unable to open a branch because of perceived failures in areas that are immaterial to their safety and soundness.

If I could stress one theme, though, it would be this: the erosion of the rule of law in banking should not be a concern just to lawyers and bankers. Decisions made behind the examination curtain significantly affect the ability of consumers and businesses to access credit and other financial services, and the terms and price of credit and services. They have every right to comment on the currently nonpublic and sometimes unwritten rules that affect them. So, too, do academics and other policy experts whose views would be helpful in making those rules better. This, of course, is precisely why Congress enacted the Administrative Procedure Act: not as a sop to regulated entities, but rather out of a genuine and well-founded belief that rules are better made when they are informed by an open and public comment process than when they are made in secret, without fear of public scrutiny or challenge.

**The Law as Written**

Under the law, banks are examined by the Federal banking agencies.[3] By law, an examination report is not an enforcement action, and is in no way legally binding. Rather, it is a statement of an examiner's views, and the beginning of a dialogue between examiner and banker. To be sure, bankers generally accept examiner criticisms, and strive to resolve any problems identified. But they sometimes disagree.

In that case, the law is clear. If the agency wishes the bank to conform to its prescriptions, it must initiate an enforcement action. Congress has provided multiple legal mechanisms for doing so. For example:

- Under section 8 of the Federal Deposit Insurance Act, a Federal banking agency may issue an order to halt, remediate, or penalize a violation of a law, rule, regulation, or final agency order, an "unsafe or unsound practice," or a breach of fiduciary duty.[4]
- Under section 39 of the FDI Act, each Federal banking authority has prescribed safety and soundness standards relating to internal controls, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, and other topics. If an institution fails to meet the applicable standards, the regulator may issue an order compelling remediation.[5]
- If the issue relates to capital, under section 38 of the FDI Act, the banking agencies may impose sanctions on a banking institution whose capital levels fall below predefined levels. Alternatively, a Federal banking agency may issue a capital directive to require a bank to maintain a level of capital deemed reasonable by the regulator.[6]
- For individual employees and directors who engage in misconduct, the Federal banking regulators have the authority to bar them from a firm (or the industry) and assess monetary penalties.[7]

In each of the above cases, the affected bank or individual has clearly delineated procedural rights, which generally include the right to be notified of the basis of the order, respond on the merits, and ultimately contest it before an Article III court.[8] Notably, these procedural rights incentivize both regulator and regulated to negotiate an agreement in lieu of litigation.

Another important procedural right was provided by Congress when it required each banking agency to establish a process for administrative appeal of any material adverse supervisory determination—that is, actions for which there was no formal

[3] See 12 U.S.C. §248(a)(1) (Federal Reserve); 12 U.S.C. §481 (OCC—national banks); 12 U.S.C. §1463, 1464 (OCC—Federal savings associations); and 12 U.S.C. §1820(b) and (c) (FDIC). State-chartered banks are also subject to examination by the relevant State banking agency.

[4] 12 U.S.C. §1818.

[5] 12 U.S.C. §1831p-1.

[6] 12 U.S.C. §3907(b); see also 12 CFR 3.601 et seq. (OCC); 12 CFR 263.83 (Federal Reserve); and 12 CFR 324.5 (FDIC).

[7] 12 U.S.C. §1818.

[8] See 12 U.S.C. §1818(h).

appeal under the law.[9] This might include a CAMELS rating or a loan classification.

Finally, all of these procedural rights are supplemented by section 706 of the Administrative Procedure Act, which governs the rulewriting process for all Federal agencies and gives any affected person the right to seek judicial review of any final agency action.[10] It serves as the ultimate guarantee that the regulations against which banks are being examined are adopted and administered with due process of law.

**The System in Practice**

Unfortunately, the laws that I have just described, and the procedural rights that Congress provided in them, have become increasingly irrelevant in practice, supplanted by an alternative, nonpublic examination and enforcement regime where they are unavailable.

*The Shift From Regulation to MRAs Based on Guidance and Ad Hoc Mandates*

First, the banking agencies have increasingly avoided notice and comment rulemaking, which under the APA requires the agencies to give prior notice of the rule they propose to issue, seek public comment on that proposal, and explain in any final rule why they have disregarded any comment. Instead, they have (i) issued guidance generally without opportunity for public comment or Congressional review or (ii) imposed mandates through the examination process, and then proceeded to treat each examination mandate as binding as a regulation, contrary to law.

*MRAs and MRIAs*

A Matter Requiring Attention, or MRA, is the vernacular by which bank examiners communicate criticisms to a bank's management or (increasingly) to the board of directors. MRAs and MRIAs have no basis in law—there is no reference to them in any statute—and they are unenforceable as a legal matter (in contrast to agency orders, which are enforceable and subject to due process). In essence, MRAs create a to-do list for the bank that comes at the end of examination report.

Make no mistake, however: the banking agencies take the position that MRAs must be remediated.[11] And ask any banker whether remediation of MRAs or MRIAs is optional, and the answer will be no.[12] But you really can't ask any banker, because MRAs and MRIAs are included in an examination report, which the banking agencies consider Confidential Supervisory Information; therefore, it is a Federal crime for a banker to complain publicly about an MRA.

Consider the number of MRAs they are prohibited from talking about:

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[9] 12 U.S.C. §4806.

[10] 5 U.S.C. §706.

[11] The bank enforcement section of the OCC's "Policies and Procedures Manual" states that an examination report may contain "concerns," which are expressed in an MRA. It then states: "The actions that the board and management take or agree to take in response to violations and concerns are factors in the OCC's decision to pursue a bank enforcement action . . . A bank's board and management *must* correct deficiencies in a timely manner." See Office of the Comptroller of the Currency, "Policies and Procedures Manual", PPM 5310-3 (Nov. 13, 2018) at 3 (emphasis added), available at *https://www.occ.treas.gov/news-issuances/bulletins/2017/ppm-5310-3.pdf*. Similarly, in its *Supervision and Regulation Report*, the Fed states: "In the event that holding companies do not address MRAs in a timely or complete manner, examiners may determine that the related weaknesses represent a significant threat to the safety and soundness of the company or its ability to operate in compliance with the law and may recommend further action." Federal Reserve, *Supervision and Examination Report* (Nov. 9, 2018) at 16, available at *https://www.federalreserve.gov/publications/supervision-and-regulation-report.htm*. The Federal Reserve also states, "MRIAs are matters of significant importance and urgency that the Federal Reserve *requires* banking organizations to address *immediately*." Id. at Appendix A (emphasis added).

[12] Greg Baer and Jeremy Newell, "The MRA Is the Core of Supervision, But Common Standards and Practices Are MIA", *Underwritings: The BPI Blog* (Feb. 8, 2018), *https://bpi.com/the-mra-is-the-core-of-supervision-but-common-standards-and-practices-are-mia/*.

**Approximate Number of Open MRAs at the Federal Reserve and OCC**

| Year | OCC | Federal Reserve |
|---|---|---|
| 2008 | 6,100 | |
| 2009 | 7,900 | |
| 2010 | 8,200 | |
| 2011 | 8,400 | |
| 2012 | 9,500 | |
| 2013 | 7,900 | 9,120 |
| 2014 | 4,900 | 7,400 |
| 2015 | 4,600 | 6,700 |
| 2016 | 4,100 | 5,890 |
| 2017 | 3,900 | 5,850 |
| 2018 | 3,700 | 5,400 |

Note: All figures are approximate as they were sourced from publicly available graphs released by the agencies.[13]

Consider, in contrast, the use of the enforcement mandates actually prescribed by statute and described above. For the Federal Reserve and the OCC over the past 10 years:

- The Federal Reserve has issued 34 safety and soundness orders; the OCC has issued zero.
- The Federal Reserve has issued only 20 prompt corrective action orders; the OCC has issued 34.
- The Federal Reserve has issued 211 capital directives; the OCC issued 9.
- The Federal Reserve has issued 75 removal actions against individuals; the OCC issued 246.

The case of safety and soundness orders is particularly telling. These are orders that specifically relate not to capital or liquidity levels but rather exactly to the sorts of issues examiners consider during an examination—risk management, credit underwriting, etc. Over the past 10 years, the OCC has not issued a single such order, but it has issued tens of thousands of MRAs.

What, then, are the bases for the thousands of MRAs and MRIAs being issued to banks?

*"Guidance"*

Postcrisis, there has been issuance of a massive volume of "guidance" in the form of supervisory letters, bulletins, and circulars. Guidance also includes examination handbooks (which previously were designed for examiners, not banks) and even enforcement actions (where the standards enforced on one bank through a consent order have at times been treated as binding on all banks).[14]

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[13] Data taken from the Federal Reserve's "Supervision and Regulation Report" dated November 2018, available at *https://www.federalreserve.gov/publications/files/201811-supervision-and-regulation-report.pdf* and OCC's 2018 Annual Report, available at *https://www.occ.gov/annual-report/download-the-full-report/2018-annual-report.pdf*. Federal Reserve data includes MRAs for BHCs, SLHCs, and FBOs. Figures for 2018 are as of the end of Q2 2018. OCC data includes MRAs for national banks and Federal savings associations. Figures for 2018 are as of the end of Q3 2018.

[14] This stance is contrary to Supreme Court precedent. United States v. Armour and Co., 402 U.S. 673 (1971); Local No. 93, Int'l Ass'n of Firefighters v. City of Cleveland, 478 U.S. 501 (1986) (holding that settled cases have no precedential effect).

The volume of guidance is in some ways inestimable, as it takes so many forms. By one estimate, since 2013, the OCC has issued 330 pieces of OCC-only or interagency guidance in the form of bulletins; the Federal Reserve has issued 103 pieces of Federal Reserve-only or interagency guidance in the form of Supervision and Regulation (SR) letters.[15] But this dramatically understates the volume, because the agencies (and therefore bank compliance teams) treat numerous other agency statements as binding.

Consider, as an example, vendor management. The OCC in 2013 issued a voluminous bulletin, which itself referenced and reinforced over 50 previous bulletins, advisory letters, and banking circulars, that describes how federally chartered banks should deal with their vendors and contractors.[16] It applies to a wide range of vendor—and many other types of business relationships (other than customer relationships)—everything from key IT vendors to corporate wellness vendors—and its expectations are granular and prescriptive. The result has been a cottage industry, requiring the retention of large teams of people, both internal and consultants, to act as gatekeepers to any contract with a third party and to draft policies and procedures for practically any interaction with a third party, and to document compliance with those policies on an ongoing basis.[17] (Unfortunately, but not surprisingly, one effective means to compliance is to concentrate one's most critical vendor relationships with fewer, larger firms that are able to handle the associated compliance burdens, at the expense of small businesses who cannot.)[18]

Banks generally treat all of those utterances as legally binding because a "violation" of any of them can form the basis for an MRA. And these guidance documents not only impose meaningful restrictions on banks internal operations but also proscribe or circumscribe specific products and offerings (e.g., small-dollar credit or leveraged lending).

To be sure, recent pronouncements by the GAO and statements by the agencies have sent a message that guidance is not to be treated as binding. One could read a recent interagency statement as stating as much, though it does not include a specific reference to MRAs and rather refers to agency "citations," which has prompted confusion. This area therefore appears to be one where, as suggested later in my testimony, clarity is required.

*"Safety and Soundness"*

In some cases, MRAs are based not on any law, regulation or even written guidance, but simply on examiner preference. In some cases, they take the form of "industry MRAs," which are identical examination mandates issued to multiple banks—basically, an ultra vires regulation without the process required by the APA. Increasingly those preferences derive from "horizontal reviews," where examiners review practices across a variety of banks, decide which one they prefer, and then require the remainder to adopt what examiners have determined to be best practice. A primary source of many such reviews is the Federal Reserve's Large Institution Supervision Coordinating Committee (LISCC), a supervisory committee it uses to oversee the supervision of large banks. Notwithstanding the LISCC's significance, the Federal Reserve has never established a process or meaningful criteria for how firms become subject to (or exit from) LISCC designation and its requirements. Yet LISCC designation triggers a wide range of heightened requirements related to capital adequacy and capital planning, liquidity sufficiency, corporate governance, and recovery and resolution. (In turn, these significant requirements generally flow from guidance, not law or regulation.)

Asked for the legal basis for such actions, examiners often cite "safety and soundness." Indeed, they are doing so increasingly, as the law has become clearer that guidance is nonbinding and cannot serve as the basis for an MRA.

But "safety and soundness" is not a magical phrase. Rather, it is shorthand for an "unsafe and unsound banking practice" that the banking agencies are authorized (after appropriate procedural process) to prohibit under 12 U.S.C. 1818. And that phrase has a well-defined legal meaning. As explained by the DC Circuit Court of Appeals, an unsafe or unsound practice for purposes of section 1818 "refers only to practices that threaten the financial integrity of the institution." Johnson v. OTS, 81 F.3d 195, 204 (DC Cir. 1996); see also Gulf Federal Savings and Loan Association

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[15] The Federal Reserve Bank of St. Louis maintains a public compendium of these and other agency issues at *https://www.stlouisfed.org/federal-banking-regulations/*.

[16] OCC Bulletin 2013-29.

[17] This consultant-industrial complex frequently includes retention of former regulators.

[18] In a 2017 "Semi-Annual Risk Report", the OCC itself observed that "[c]onsolidation among service providers has increased third-party concentration risk, where a limited number of providers service large segments of the banking industry for certain products and services." See *https://www.occ.gov/publications/publications-by-type/semiannual-risk-perspective/pub-semi-annual-risk-perspective-spring-2017.pdf*.

v. Federal Home Loan Bank Board, 651 F.2d 259 (5th Cir. 1981) ("The breadth of the 'unsafe or unsound practice' formula is restricted by its limitation to practices with a reasonably direct effect on an association's financial soundness."); Seidman v. Office of Thrift Supervision, 37 F.3d 911 (3d Cir. 1994) ("The imprudent act must pose an abnormal risk to the financial stability of the banking institution . . . . Contingent, remote harms that could ultimately result in 'minor financial loss' to the institution are insufficient to pose the danger that warrants cease and desist proceedings."); Hoffman v. FDIC, 912 F.2d 1172, 1174 (9th Cir. 1990) (requiring "abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds").[19]

Clearly, given the sheer number of MRAs it seems highly unlikely that all or even most of them meet that standard. The fact that they come at a time when the vast majority of banks are in compliance with all relevant capital and liquidity requirements makes it still more unlikely. Indeed, I wish that I could provide the Committee examples of MRAs that deal with matters that are beyond immateriality to the point of irrelevancy. Again, however, the banking agencies take the position that doing so is a criminal violation, so I cannot. The Committee itself would need to investigate the extent to which banking agency MRAs meet this standard—perhaps by requesting a sample of anonymized MRAs from exam reports issued over the past 5 years. Furthermore, it is deeply unfortunate that, other than reporting the total number, the agencies report no aggregate or anonymized data on the subject of those MRAs—reporting that no reading of the law would prohibit.

*Examination Versus Supervision*

The breakdown in legal process goes hand in hand with a broader trend. By law, the job of the regulatory agencies is to establish ex ante regulations, and then to examine the books and records of banks to ensure that they are operating in accordance with those regulations and that they are not engaged in practices that pose the risk of a substantial loss to the firm—that is, losses that could materially erode their capital and liquidity position. It is a system of regulation and examination.

Notably, the word supervision does not appear in the authorizing statues for the examination process. There is a large difference between examining a firm and supervising it. Congress authorized the former, but the current system is all about the latter. It is less and less about protecting taxpayers—that goal is primarily served through capital and liquidity requirements—and more about protecting shareholders by attempting to comanage the firm. Thus, we see constant references to "reputational risk"—another term that does not appear in law or regulation, but which has become shorthand for a practice that is legal and creates no material financial risk but which is disfavored by examiners. And as I will now describe, there is now a shadow enforcement regime that allows regulators to "supervise" without due process.

*The Shadow Enforcement Regime*

At this point, one should wonder: if all the MRAs are legally unenforceable and, moreover, based on unenforceable guidance and vague references to safety and soundness, why are they treated as binding rules by banks, and particularly their compliance teams? Why are they diverting extraordinary resources to comply with mandates that are often immaterial to their safety and soundness and in many cases against their better judgment?

The answer is: because a new, shadow enforcement regime has grown up postcrisis. It relies on growth and investment restrictions never authorized by Congress in place of written agreements, formal orders, and capital directives that were so authorized. Those restrictions are immediately effective, effectively unreviewable and therefore practically uncontestable by the bank. It is why those tens of thousands of MRAs should not be viewed as examination findings but rather as de facto enforcement actions.

*Shadow Growth Restrictions*

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[19] There is a minority of circuits that has a somewhat lower standard for what constitutes an unsafe and unsound practice, but even there the bar is still extremely high. These circuits primarily endorse the so-called Horne standard—named after the Federal Home Loan Bank Board Chairman who, in material provided to Congress in 1966 in support of the legislation that employed the term, described it as: "any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds." See, e.g., First National Bank of Eden v. Department of the Treasury, 568 F.2d 610 (8th Cir. 1978). That said, the law of the DC Circuit is effectively dispositive, given that the defendant in any action under 12 U.S.C. 1818 has the option of appealing to the DC Circuit, in addition to the relevant circuit for traditional venue purposes. Thus, a bank seeking to challenge an action can do no worse than the law of the DC Circuit.

Thus, the Federal Reserve's Supervisory Letter 14-02, issued in 2014, describes factors the Federal Reserve will consider in acting upon bank applications to engage in a wide range of proposed transactions, including mergers, acquisitions, asset purchases, investments, new activities, and branching.[20] SR 14-2 states that banking organizations that are rated below "satisfactory", that are subject to any enforcement action, or that have any significant consumer compliance issues or other "outstanding supervisory issues" should not even file an application until they resolve their supervisory issues. Although the literal terms of SR 14-2 suggest that various of these prohibitory conditions can be overcome, the general prohibitions have been virtually absolute in practice. Yet none of them is articulated in the relevant governing statutes. And, for good measure, SR 14-02 itself was never published for notice and comment or submitted for Congressional review under the Congressional Review Act. By all accounts, the practices at the other Federal banking agencies have generally been similar, though generally not codified in writing.[21]

For perspective on how odd this new enforcement regime is, consider that we routinely see serious compliance violations across a wide range of American industries. Those companies are subjected to enforcement proceedings and are required to pay fines and remediate their practices, but no one ever suggests that while those proceedings are pending they should be stopped from opening new franchises, building new plants, developing new drugs, designing new cars, or launching new apps. Yet in banking, regulators often prohibit any type of expansion by the bank as a reaction to any compliance failure.

Thus, SR 14-02 states that covered banks seeking to expand must "convincingly demonstrat[e] that the proposal would not distract management from addressing the existing problems of the organization or further exacerbate these problems." Again, it is very difficult to imagine how senior management could not simultaneously oversee, for example, one group of employees mailing reimbursement checks to consumers under a consumer compliance settlement and another group of employees opening a branch in Philadelphia or buying an asset manager in Los Angeles. In other industries, one presumes that a retailer with a data breach can still open new stores, or that an auto company with a fatal defect in its ignition switch can still open new dealerships. Yet over the past 10 years, a contrary illogic has significantly impaired the ability of banks to invest and expand to serve their customers better.

The unique reliance on growth restrictions in banking is even more remarkable when one realizes that banks already are subject to more potential penalties, imposed by more potential regulators, than practically any other industry. The inability to open a new branch is not necessary as a deterrent.

Thus, under agency practice, any unresolved consumer compliance issue or any unresolved supervisory issue can prevent a bank from expanding in any way. There are two results. First, obviously, bank expansion and investment in new technologies has been curtailed to an unhealthy extent. Second, and more importantly, this arrangement has given examiners powers never contemplated by Congress, without any procedural check or balance.

To be clear, Congress has authorized the banking agencies to restrict the growth of financial institutions under some circumstances, but those circumstances were intended to be quite limited. Under section 4(m) of the Bank Holding Company Act and implementing regulations, and the Board's Regulation Y, a financial holding company which receives either a rating of Deficient-1 or Deficient-2 on any component under the LFI rating system or whose subsidiary bank receives a CAMELS "3" composite or Management rating must receive Federal Reserve approval to conduct

[20] SR 14-2/CA14-1: "Enhancing Transparency in the Federal Reserve's Applications Process" (Feb. 24, 2014). Most large transactions involve a Federal Reserve review and therefore SR 14-2 may well directly affect many bank-level (in addition to bank holding company level) applications in that context.

[21] Applicable OCC and FDIC guidance—which like SR 14-2 have never been subject to public comment—differ from 14-2 in some respects and are less detailed. The OCC's Comptroller's Manual, Business Combinations (July 2018) states that in the context of MRAs and program deficiencies, the OCC assesses the nature and duration of the issues, the institution's progress in remediating identified program deficiencies, and whether the proposed combination would detract from the remediation, exacerbate existing problems, or create new problems for the resulting institutions. In the context of an enforcement action, the Manual simply states that in these circumstances the bank should consult with its supervisory office and Licensing Division before pursuing any plans for a transaction. See "Comptroller's Manual" at 7-8. The FDIC's 1998 "Statement of Policy on Bank Merger Transactions" simply provides that "[a]dverse finding may warrant correction of identified problems before consent is granted, or the imposition of conditions."

certain nonbanking activities.[22] A related provision requires the Board to consider a company's effectiveness in combatting money laundering activities in connection with applications to acquire bank shares or assets.[23] Similarly, under the law governing interstate mergers and branching, for a bank to open a branch in any State in which it does not already have a branch, the bank must satisfy certain statutory standards and requirements for the bank to be "well capitalized" and "well managed."[24]

These provisions have been extended far beyond their statutory intent and become part of the shadow enforcement regime. First, as noted above, the requirement to consider anti–money-laundering effectiveness in connection with some applications became a bar to any expansion by any institution with an outstanding AML consent order, regardless of whether the alleged problems were minor or major, or what their State of remediation was.[25] Second, in conditioning certain nonbanking activities on a "3" rating, Congress understood that rating to reflect the management of the overall organization. Indeed, by its own terms, the Management rating is intended to reflect "the capability of the board of directors and management, in their respective roles, 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."[26] Postcrisis, however, the Management rating has become less about the financial condition of the bank and more about compliance with banking agency rules, guidance, and examiner preference. This represents a fundamental change.

The direct result of this shift (lower ratings) was less important than its indirect result: adding an enforcement mechanism for MRAs that Congress never considered. Once the Management rating became subjective and untethered to financial condition, the threat of a downgrade to a "3" rating became as powerful an enforcement tool as any formal order. So, too, did an actual downgrade, with the need for Federal Reserve approval to continue conducting nonbanking activities unless the bank remediate exactly as instructed.

Again, though, section 4(m) relates only to nonbanking activities conducted by bank affiliates. It has nothing to do with the establishment of branches, or even the acquisition of or merger with other depository institutions or bank holding companies. Congress has never conditioned the opening of a branch on a particular management rating of the bank. Yet in practice, the agencies have done that themselves.[27]

*Examination Appeals*

As the banking agencies have avoided statutory enforcement mechanisms that come with congressionally established procedural rights in favor of informal but equally binding examination mandates, the importance of the examination appeals process, and the agency ombudsman, has grown significantly.

Sadly, for both structural and practical reasons, these tools are effectively dead letters for banks, and thus almost never used. Between 1995 and 2012, the OCC issued 157 decisions, and the Federal Reserve issued 25.[28] Consider that against a backdrop of tens of thousands of MRAs, and clearly something is very, very wrong.

The reasons for the paucity of appeals are not hard to divine. First, every banker and bank counsel is taught that "examiners have long memories," such that potential for retaliation is always a concern.[29] Second, appeals are made to the same agency that assigned the rating. For example, at the Federal Reserve, the ultimate arbiter in an appeal is a designated Federal Reserve Board Governor, while at the

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[22] 12 U.S.C. §1843(m)(3); 12 CFR 225.83(d)(2).

[23] 12 U.S.C. §1842(c)(6).

[24] 12 U.S.C. §1831u. A similar requirement exists for approval of interstate mergers.

[25] According to Federal Reserve SR 13-7, which addresses de novo branching by State member banks rated "3", "In all cases, the bank's Bank Secrecy Act/Anti–Money-Laundering program needs to be considered satisfactory."

[26] Uniform Financial Institutions Rating System, 61 FR 67021, 67027 (Dec. 19, 1996).

[27] See Louisiana Public Service Comm'n v. FCC, 476 U.S. 355, 375 (1986) ("[A]n agency literally has no power to act . . . unless and until Congress confers power upon it . . . . Thus, we simply cannot accept an argument that the FCC may nevertheless take action which it thinks will best effectuate a Federal policy. An agency may not confer power upon itself.")

[28] Julie Anderson Hill, "When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations", 92 *Wash. U. L. Rev.* 1101 (2015). The author notes that data from 1995–2000 was unavailable for the Federal Reserve.

[29] In recognition of this tendency to retaliate, the agencies have adopted internal policies criticizing examiner retaliation against institutions for pursuing supervisory appeals. One can question their effectiveness in practice, however.

FDIC, appeals are ultimately decided by the agency's Supervision Appeals Review Committee.

To their considerable credit, some of the agencies have recently sought public comment on their internal appeals processes. My suspicion, though, is that the problem cannot be solved without related reforms of the type discussed in this testimony.

*Attorney–Client Privilege*

A case study in the examination status quo concerns the attorney–client privilege. Examiners take the position that they can override attorney–client privilege, whether in the course of an ordinary examination of a bank or of an enforcement action. Thus, for example, in the latter case, the agencies take the position that they can begin their investigation by seeking the interview notes of inside and outside litigation counsel who have been defending the case. This is remarkable. So too is the fact that the SEC and the Department of Justice take the opposite position in the enforcement context.

What is more remarkable is that there is no legal basis for this position. Seven of the Nation's leading law firms have done a joint opinion that concludes "There is no valid legal basis for the Agencies to demand that supervised institutions disclose privileged material. As discussed, all the relevant case law and fundamental legal principles compel this conclusion."[30] The American Bar Association in a 2012 letter to the CFPB agreed that the examination powers of the agencies do not allow them to invade the privilege, finding "the ABA is not aware of any reported Federal appellate court case holding the Federal Banking regulators—or any other Federal agencies—can require production of privileged materials, nor do the Federal banking statutes contain such authority."

Of course, the agencies state that the privilege still holds with respect to all other third parties, and that providing privileged material to examiners or enforcement lawyers does not constitute a waiver of the privilege. While this is true, it is akin to saying that only the Government will be reading your email or searching your house, not other third parties. The fact that the Government is potentially accessing any and all privileged information absolutely vitiates the goal of the privilege, which is to "encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice."[31]

Notably, none of the banking agencies has contested the legal merits of the seven-firm memorandum in any venue at any time. Rather, they have continued their practice unabated. And banks have almost universally complied.

Why? This question really gets to the heart of the postcrisis hidden regime. First, it is unlikely that any bank (or trade association) would have standing to bring a declaratory judgment action against the agencies. A court's likely response would be that a case or controversy would exist only if a bank refused to provide privileged material and the agencies served a subpoena for it. But no bank is going to take that step, because of concerns about retaliation and reputational harm if labeled as uncooperative. For that reason, the Department of Justice and SEC affirmatively state that a bank's failure to provide a "voluntary" waiver will not be considered against it in assessing cooperation and penalties. Neither, importantly and conversely, will a company be rewarded for a waiver.[32]

As a result, banks (and indeed, banks alone) operate without the benefit of the candid legal advice that the attorney–client and work product privileges have ensured for centuries. Examiner pressure on keeping minutes of all management committee meetings and criticizing banks when the minutes are not specific enough are another means to chill candid conversations within the banking organization itself.

*The Results*

The results of this new supervisory regime are significant. Many banks of all sizes have been restricted from branching, investing in new businesses, or merging for reasons that are neither public nor assessable. (Indeed, the Committee might consider asking the banking agencies for a list of all banks that have been subject to

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[30] See "Banking Regulators' Examination Authority Does Not Override Attorney–Client Privilege", Opinion of Cleary Gottlieb Steen and Hamilton; Covington and Burling; Davis Polk; Debevoise and Plimpton; Simpson Thacher and Bartlett, Sullivan and Cromwell; and Wilmer Cutler Pickering Hale and Dorr, available at *https://www.sullcrom.com/siteFiles/Publications/SC-Publication-Banking-Regulators-Examination-Authority-Does-Not-Override-Attorney-Client-Privilege.pdf*.

[31] Upjohn Co. v. United States, 449 U.S. 383, at 389, citing Hunt v. Blackburn, 128 U.S. 464, 470 (1888).

[32] §28710-20; SEC Division of Enforcement Office of Chief Counsel, "Enforcement Manual" (Oct. 28, 2016).

a nonpublic growth restriction over the past 5 years, to be reviewed in camera.) Bank technology budgets often are devoted primarily not to innovation but to redressing frequently immaterial compliance concerns. Indeed, an underrated cause of the rise of FinTech companies over the past 10 years has been the fact that banks were spending their innovation budgets on compliance systems geared towards immaterial issues.

Board and management time has been diverted from strategy or real risk management and instead spent remediating frequently immaterial compliance concerns and engaging in frequent meetings with examiners to ensure that they are fully satisfied.

In effect, Congress has said that banks are free to develop different and competing practices, so long as they do not rise to the level of unsafe or unsound. But "unsafe and unsound" is a high bar from an evidentiary perspective, and due process can be a bother; thus, bank supervision has shifted away from this legal concept to a more malleable and supple one—"best practices" enforced by MRAs (Matters Requiring Attention) that are effectively unappealable.

*A Way Forward*

Notwithstanding the problems and concerns I have articulated, it is important to acknowledge several recent developments that suggest more attention is being paid to these issues:

- The General Accountability Office in a series of opinions requested by Members of Congress has ruled that various types of agency action self-described as "guidance" are in fact rules under the Congressional Review Act; they are therefore unenforceable until they are submitted for Congressional review and not invalidated. Furthermore, these decisions have served to highlight the fact that rules the agencies have clearly treated as binding[33] not only were not submitted to Congress but also were never published for public comment, in violation of the Administrative Procedure Act.
- Last September, the Federal banking agencies and CFPB issued an "Interagency Statement Clarifying the Role of Supervisory Guidance", which reaffirmed that supervisory guidance "does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance."[34] This represented an important step forward in ensuring that agency guidance is issued and applied in a manner consistent with the APA and the Congressional Review Act and, more broadly, that formal examination criticisms focus on matters material to the financial condition of a bank. Unfortunately, there are numerous reports that the statement (which is itself nonbinding guidance) is not being followed in practice.
- Also last year, the CFPB issued a bulletin that established two categories of examiner mandates—a step that could serve as a model for the Federal banking agencies. The bulletin notes that the CFPB would continue to use MRAs going forward, but only to address and correct issues that are "directly related to violations of Federal consumer financial law";[35] the bulletin then establishes a separate and distinct category of communication, the "Supervisory Recommendation" (SR), which will be used "to recommend actions for management to consider taking . . . when the Bureau has not identified a violation of Federal consumer financial law, but has observed weaknesses in CMS."[36] Thus, the CFPB statement allows for an important dialogue to continue between examiners and the institution with respect to nonmaterial matters, but without legal sanction. In other words, with respect to matters that do not involve a violation of law, a bank's management is free to design and innovate, while examiners remain free to identify best practices and provide input.
- Last November, the Federal Reserve finalized a new ratings system for large financial institutions that was substantially clearer, more objective, and better focused on core matters of financial condition than its predecessor. Although not perfect, this new framework not only represents a meaningful shift closer to transparency and the rule of law for those institutions.

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[33] See, e.g., Ryan Tracey, "Feds Win Fight Over Risky-Looking Loans", *Wall Street Journal* (Dec. 2, 2015), available at *https://www.wsj.com/articles/feds-win-fight-over-risky-looking-loans-1449110383*.

[34] See, e.g., Federal Reserve Supervisory Letter SR 18-5 / CA 18-7, Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 12, 2018).

[35] BCFP Bulletin 2018-01, "Changes to Types of Supervisory Communications" (Sept. 25, 2018) (emphasis added).

[36] Id.

- The FDIC has recently withdrawn hundreds of Financial Institution Letters, its version of regulatory guidance.
- In general, there has been a recent trend towards publishing more regulatory requirements for public comment. As the numbers show, the number of outstanding MRAs has reduced over the past few years. Still, the numbers remain extraordinarily high, particularly given that by every possible objective measure the banking industry is in good health. Furthermore, we cannot know whether those lower numbers reflect a greater focus on material safety and soundness matters by examiners, or simply the fact that banks have spent billions of dollars redressing every possible examiner concern for the past few years.

More broadly, some banks have reported that examinations have recently become more focused on material issues. Others, though, have not. But the primary concern remains: when the great majority of requirements are imposed in secret, with no process, they can vary across banks and across time because there simply are no checks or balances. So, this fundamentally is not an issue of tighter regulation or looser regulation (deregulation) but an issue of consistent and predictable regulation that is consistent with the law.

*Potential Next Steps*

How could matters be improved?

First, the banking agencies should grant the petition for rulemaking filed by the Bank Policy Institute and the American Bankers Association, follow the example set by the CFPB, and confirm what they have already said in a recent statement: that guidance is not binding and will not form the basis for an MRA, and that only violations of law (including an unsafe and unsound practice) will form the basis for an MRA. This step is necessary because by numerous accounts their earlier statement is being disregarded in practice.

Second, more broadly, the agencies should seek public comment on what an MRA is. If an MRA is an unenforceable suggestion, with no consequences for a company's ability to grow or invest, then they should make that clear. If it is a de facto order, then it should be issued only when there is a legal basis for it—a violation of law or an unsafe or unsound banking practice—and the bank should receive APA-prescribed process.

Third, a zero-based review of the application process should be undertaken by each banking agency. Pending such a review, the Federal Reserve should rescind its SR Letter 14-02 (establishing a series of ultra vires rules for bank expansion) and formally return to applying statutory standards for branching, merger, and investment applications. The OCC, which has acted similarly but without issuing public guidance to that effect, should do likewise. Any resulting application process should emphasize transparency and accountability. For example, the Governors of the Federal Reserve Board, the Comptroller of the Currency, and the Directors of the FDIC personally should receive regular reports on applications that have been pending for more than a given period—say, 75 days—along with the reason for the delay. The pendency of an investigation should not constitute grounds for delay absent extraordinary circumstances.

Fourth, the CAMELS rating system should be rethought entirely.[37] The Federal Reserve Board has recently adopted a significant rethinking of holding company ratings, and the banking agencies/FFIEC should do likewise. Such a review should emphasize the benefits of objective, transparent, consistent standards over subjective, opaque, and ad hoc standards. In particular, a management component, if retained, should not be a highly subjective wild card that can be used to deem a bank with solid capital, liquidity, and earnings to be unsafe and unsound, and thereby subject to an expansion ban. Any assessment of management should focus on financial management. A meaningful appeals process should be instituted.

**Conclusion**

Many thanks for the opportunity to appear before you today.

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[37] The expansion of bank supervision is having an impact on the economy. See Greg Baer and Jeremy Newell, "How Bank Supervision Lost Its Way", *Underwritings: The BPI Blog* (May 25, 2017), *https://bpi.com/how-bank-supervision-lost-its-way/*.

## PREPARED STATEMENT OF MARGARET E. TAHYAR

PARTNER, DAVIS POLK AND WARDWELL LLP

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Many sectors of the economy are regulated. Only the banking sector is also supervised. The legal framework that governs the banking sector and the banking agencies is written and public. Whether you agree or disagree with the policy choices, the legal framework is made in full sight of all. Supervision happens behind closed doors. It relies upon secrecy and involves a system of discretionary actions by supervisory staff. This zone of secrecy is traditionally justified for the sake of financial stability and bank safety and soundness. There has long been an uneasy truce between the transparency and accountability required by the rule of law and the secrecy and discretion of supervision.

That uneasy truce has become untenable. One canary in the coal mine is the increase in leaks of confidential supervisory information. The melody that canary is singing is changed societal mores about transparency. It also matters that confidential supervision can be a shield that makes it more difficult to hold the banking supervisors accountable. The public, including the Congressional oversight committees, scholars and others, has limited information about the work of the banking supervisors. Should they be praised or criticized?[1] Nobody knows. The public debate, and academic scholarship, is critically underinformed.

As Hyman Minsky has noted, "Perfection is out of the question, but better is possible."[2] Understanding that some secrecy is necessary for bank safety and soundness and candid conversations, I recommend beginning with three changes.

First, the regulations governing confidential supervisory information need to be modernized. Their core framework was put in place during the late 1960s and only lightly updated in the mid-1990s. They no longer match the reality of the digital age. The realm of confidential supervisory information should be narrowed to the core minimum necessary to protect financial stability or individual bank safety and soundness.

Second, we should recognize that one of the aftereffects of the Financial Crisis has been a vast expansion in the nature of supervision and its zone of secrecy and discretion. Social and economic policy choices are being made within a shadow regulatory system. From "moral suasion" to the matters requiring attention and matters requiring immediate attention that come out of the examination process, as well as horizontal reviews, banking organizations are subject to both a public and a nonpublic web of guidance and expectations. Sensible guardrails are needed so that supervision does not make economic and social policy choices that impact credit, jobs and growth in an ad hoc manner free from oversight. We should also recognize that secret lore[3] and guidance have a troublesome placement in the legal framework since the concept of secret law in a democracy is on shaky ground.

Third, Congress and the banking agencies need to think clearly about how to create an environment where the supervisory staff are given the training, resources and tools that would permit them to do their jobs in a way that is more transparent to the world, where there is more accountability and where there is more consistency with the rule of law. As the zone of secrecy and discretion has widened, it has increasingly become delinked from the legal framework of the regulatory State. One way to increase those tools and resources, in light of the increased complexity of both the legal framework and the banking sector, is that training for the supervisory staff should be expanded to include core modules on the rule of law in a Constitutional democracy and the legal framework that governs the regulatory State.

The time has come for a rebalancing of how the banking regulators supervise banking organizations. The extensive scope of the shadow regulatory system, which operates without transparency and with limited accountability, has become untenable in the digital age. The rebalancing should be in favor of more transparency, accountability and observance of the rule of law by the banking supervisors. We

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[1] Banking supervisors are highly professional men and women acting in good faith to carry out an important mission in monitoring the banking sector for safety and soundness and compliance with the law. The pressures on the supervisory staff during and since the Financial Crisis have been enormous. I am convinced that more openness will lead to as much praise as criticism.

[2] Hyman P. Minsky, "Financial Instability and APT Bank Supervision", Hyman P. Minsky Archive Paper 470, 24 (1992).

[3] I prefer the term "secret lore" to "secret law" even though many banking lawyers, myself included, will, in conversation refer to "secret law." We do well to remind ourselves that, in a democratic country, law cannot be secret. And, under the Administrative Procedure Act, it is not.

need to get this balance right as we move toward a more digital world with increasing reliance on algorithms. If the norms of the rule of law, transparency, and accountability are not part of supervisory culture, they will not find their way into new technology.

We should not jettison confidential supervision but we ought to reform it for the 21st Century digital era.

The need to rethink the theory of supervision and how we might go about it are inextricably linked to its history. I therefore begin in Part I by describing that history and suggesting principles for how to reform the regulators' approach to confidential supervisory information. In Part II, I set forth my view that supervisory staff have not been trained in the legal framework at a time when their jobs have grown tougher and the legal framework itself has become more complex.

**I. The Need To Reform Confidential Supervisory Information**

The Federal banking regulators have long operated under a cultural mindset different from other independent Federal agencies both in the financial sector and in the larger regulatory State.[4] History explains why the separate cultural tradition exists. This Part examines two regulatory traditions—a tradition of secrecy and discretion unique to banking supervision and a New Deal tradition of transparency in the regulatory State more broadly.

*A. The Tradition of Secrecy and Discretion*

In banking supervision, two regulatory traditions have lived in an uneasy truce since the New Deal. The central core and direct ancestor of Federal banking supervision is the confidential bank examination, which dates back to at least the mid-19th Century.[5] Many do not realize, however, that these traditions of secrecy and discretion developed at a time when there was limited Federal regulation of any sector, long before Federal deposit insurance, the creation of the Federal Reserve as the lender of last resort, the New Deal administrative State of the 1930s and the Administrative Procedure Act (APA) of 1946. The lack of a solid foundation in Federal law for many of the secrecy traditions of the banking regulators will surprise many who have accepted them as if they were contained in hallowed texts.

There is another, more recent policy tradition, dating from the New Deal, which created Federal securities disclosure laws and put in place a legal framework that favors transparency and accountability by administrative agencies. Both traditions must abide by the rule of law in our Constitutional democracy.

The truce remained workable when banks were engaged almost exclusively in taking demand deposits and making commercial loans. But, as market competition and technological change made the banking sector more complex, the uneasy and unexamined truce was, counterintuitively, sustained by the expansion of both the tradition of secrecy and discretion and that of transparency and the rule of law. In today's complex times, we have both more secrecy and discretion and more transparency. The problem is that we have them randomly and without serious thought about how the zone of secret supervision ought to work in the 21st Century digital era.

The bank examination, where an outside person appointed by the State examines the books and records of the bank, has a long history. The 19th Century bank examiner's job was to look closely at the loans and liabilities of each individual bank and to make sure that vault cash and reserves really existed.[6] He, and in the 19th Century it was always a he, performed his task in conditions of utmost secrecy.[7] His critically important job was to assess whether the bank was safe and sound in an

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[4] For the purposes of this testimony, the concept of a banking regulator is limited to the Federal Reserve, the OCC and the FDIC. The CFPB operates under newer, more transparent cultural norms.

[5] As Professor Conti-Brown has noted, "the Examination Report from the Comptroller of the Currency for each bank remained the same in general form from 1865 to 1953—an extraordinarily stable institutional arrangement across a long period of economic, political, legal, and financial tumult." Peter Conti-Brown, "Stress Tests and the End of Bank Supervision", *The Regulatory Review* (Apr. 21, 2016), available at link.

[6] Simpler times exemplified in "It's a Wonderful Life" by Mr. Carter, a diligent bank examiner checking whether the Bailey Building and Loan had cash in its vault.

[7] The first woman bank examiner was Adelia M. Stewart who officially become a bank examiner in 1921, after having gone to law school at night and having worked as a "clerk-stenographer" at the OCC since 1892. In 1922, the year after she was the first woman to pass the test for national bank examiners, she was promoted to head of the examination division. See Office of the Comptroller of the Currency, "The Changing Role of Women in the Workplace", available at link. I like to imagine that the first woman examiner understood the tight link between the legal framework and supervision.

era when rumors could lead to deposit runs and bank panics were frequent.[8] Thus developed the tradition of the secret bank examination, the crime of spreading false rumors about a bank[9] and the view that bank supervision was best done inside a cone of confidentiality to preserve the stability of the financial system and avoid triggering a bank panic.

Central to the concept of a confidential bank examination is the need for a free flow of communication in conditions of high trust between a bank's management, its board of directors and supervisory personnel. Bank examiners and the banking sector feel strongly about the need for this candid conversation, which has contributed to the creation of a common-law bank examiners' privilege that keeps reports out of the public domain and out of the hands of the plaintiff's bar.[10] The other justification for a confidential bank examination report has been that it contains private personal information about bank customers and unvarnished views about the creditworthiness of borrowers. The free flow of information, much of it deliberately and appropriately leaning toward the negative and critical, and the protection of personal information are policy goals to be taken seriously today.

The Federal banking regulators used the passage of FOIA in the mid-1960s, a statute meant to expand the scope of information available to the public, to expand their zone of confidentiality beyond the scope of the traditional bank examination. There is no Federal statute that explicitly prohibits anyone other than bank examiners from disclosing the bank examination or parts of it,[11] such as CAMELS or other ratings.[12] Soon after the passage of FOIA,[13] each of the Federal Reserve, the OCC and the FDIC promulgated stern but ambiguous regulations that contain additional constraints on the sharing of confidential supervisory information. These regulations also introduced the assertion of the Federal banking regulators that bank examinations and other supervisory communications are the property of the banking regulators.

The authority to treat confidential supervisory information as property is less solid than one might think, relying on a general Federal statute relating to Federal Government property. One suspects that the general Federal property law was pressed into service by the Federal banking regulators because no other statutory authority was available. The result of viewing bank examinations or other supervisory communications as the property of the State is that stealing them or misusing them becomes a crime. It is solely from this source that the criminal prohibitions on banking organizations revealing bank examinations or other supervisory communications derive. With the increased scope of confidential supervisory information along with the changes in technology and societal mores, it is increasingly uncomfortable for banking entities and their personnel to have to worry about criminal liability for the "property" of the banking regulators.[14]

The banking regulators have defined this type of "property" very broadly in their regulations, the plain text of which could be read to encompass a vast amount of information. Tracking the statute, the Federal Reserve's definition of confidential supervisory information includes any document prepared by a banking organization "for the use of" the Federal Reserve.[15] The FDIC's definition is similar.[16] The Federal Reserve's definition excludes documents prepared by the banking organization

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[8] Panics took hold of the American banking sector in 1819, 1837, 1857, 1873, 1893, 1901, 1907, 1929, and 1933, as well as in 2007–2008.

[9] N.Y. Banking Law §671 False Statements or Rumors as to Banking Institutions.

[10] The need for candid conversations in the supervisory context is hotly defended in the courts by banking regulators. By sharp contrast, banking regulators frequently take the view that the attorney–client privilege should be waived by the banks or limited in supervisory communications. So, sometimes candid conversations are encouraged and sometimes they are not.

[11] There is a Federal criminal statute that prohibits bank examiners from disclosing the results of an examination. See 18 U.S.C. §1906. Few are aware, however, that the Comptroller may, if he is not satisfied with the response of a national bank, disclose an examination. See 12 U.S.C. §481.

[12] CAMELS is used in this testimony for simplicity even though there are other ratings systems with their own acronyms.

[13] The precise words of the FOIA statute's exemption, which were originally drafted by the banking regulators, encompass matters "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions" from disclosure.

[14] One of the elements of the confidential supervisory information regulations that needs updating is the requirement that any "property" of the banking regulators be viewed on bank premises. This made sense in the late 1960s, but with the development of email and the cloud, it no longer does.

[15] 12 CFR §261.2(c)(1)(iii).

[16] See 12 CFR §309.5(g)(8).

"for its own business purposes and that are in its possession."[17] The FDIC does not have such an explicit exclusion. The OCC's definition of confidential supervisory information (in OCC parlance, "nonpublic OCC information") is broader and includes any "record" that is "obtained" by the OCC in connection with the OCC's performance of its duties, including "supervision."[18]

These regulations were put in place before a world of email, electronic files, the cloud and PowerPoint and at a time when the data and information flow was much smaller. The line between data prepared by the banking organization "for the use" of the agency or for its own "business purposes" is a troublesome one in the supervisory context today. It cannot be that, by some means of transubstantiation, every bit of data or every PowerPoint sent to the regulators becomes confidential supervisory information.[19]

The Federal Reserve, the FDIC and the OCC all permit sharing of confidential supervisory information within the banking organization. Under the OCC's regulation, sharing within the banking organization is permitted only "where necessary or appropriate for business purposes."[20] The OCC has not defined what would be necessary or appropriate for business purposes and criminal liability may hang on this ambiguous phrase. These ambiguities will get more intense as we enter into more technologically infused RegTech. There is a real question whether these vague standards, along with the changes in the world since the 1960s, ought to continue to contain the threat of criminal liability.

*B. The Other Tradition of Transparency*

The other regulatory tradition has as its central paradigm that of the disinfectant of disclosure.[21] Created in the New Deal or as an immediate reaction to it, the norms of the securities disclosure laws and the APA illustrate this cultural mode of transparency. These laws take a very different approach to the relationship between the Government and the governed.

The APA is properly viewed as a "bill of rights for the new regulatory State."[22] It demands that regulations be public and subject to notice and comment, and has transparency and accountability as its central core. The APA was the end product of a decade's worth of political wrangling between New Dealers, who fought for the expansion of a discretionary administrative State, and those concerned with the rule of law and transparency. A compromise was finally reached following Truman's assumption of the Presidency, in a post-WWII environment more sensitive to authoritarian tendencies.[23] Public choice scholarship since the New Deal has widely shown that the regulators also have their own stakeholder interests.

It was not immediately clear whether or to what extent this new approach would apply to banking regulators, at least from the perspective of the supervisors accustomed to secrecy and discretion. While for many readers the New Deal and the passage of the APA may seem like long ago developments, it is important to understand that, by the time of their passage, the cultural traditions and institutional path dependency of the banking supervisors had already been set. Early versions of the bill that became the APA excluded the Federal banking agencies from its scope.[24] The banking regulators might be forgiven, in the early years after the APA, for thinking that the APA only lightly applied to them. But we are now nearly 85 years since the passage of the Securities Exchange Act and 73 years since the passage of the APA. The impulse toward secrecy remains strong within the banking regulators,

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[17] 12 CFR §261.2(c)(2).

[18] 12 CFR §4.32(b).

[19] Even if such information were not considered confidential supervisory information, other exemptions from FOIA disclosure may apply, such as the exception for trade secrets, confidential commercial or financial information and personal information.

[20] 12 CFR §4.37(b)(2). The Federal Reserve does not have this limitation on sharing in the group. The FDIC's regulations require that there be an annual board resolution for a bank to share a report of examination with its parent, which must contain a number of archaic requirements. These requirements include that the resolution specifically name the parent holding company and state the snail mail address to which the reports are to be sent. See 12 CFR §309.6(b)(7)(iii)(B).

[21] As Justice Brandeis famously said just before his time on the court, "[s]unlight is said to be the best of disinfectants." Louis D. Brandeis, "Other People's Money and How the Bankers Use It" 93 (Frederick A. Stokes Company ed. 1914).

[22] George B. Shepherd, "Fierce Compromise: The Administrative Procedure Act Emerges From New Deal Politics", 90 *NW. U. L. Rev.* 1557, 1558 (1996).

[23] See id. at 1683.

[24] See id. at 1618.

even as transparency and accountability have become foundational tenets of administrative law.[25]

A key question is how both of these regulatory traditions—the long-standing secrecy of banking regulators and the 20th Century paradigm of a transparent administrative State more broadly—have managed to coexist in an uneasy truce for so long. One part of the answer is counterintuitive: as the banking sector has become more complex, both transparency and secrecy have expanded in scope.

For example, the scope of financial disclosure and its companion market discipline has been expanding over the last 50 years vis-a-vis banking organizations.[26] In addition to the constraints of the securities laws, Pillar 3 of Basel II, now in full implementation, also requires more disclosure. The existence of enhanced capital and liquidity requirements, subordinated debt, credit default swaps, and, more recently, TLAC debt that might be bailed in, all push towards market signaling functions.

The public nature of these disclosures has become so embedded in our consciousness that many have forgotten that the requirements to disclose hundreds of pages of information, whether in periodic reports under the securities laws, Pillar 3 or the many public reports filed by banking organizations, were once new and shocking in the banking sector. Banking-sector requirements for disclosure lagged the disclosure norms in other sectors by many years. Call reports were not made public by the FDIC until 1972 and even then, it was upon request, with a fee for search costs,[27] bank stocks were not subject to periodic reporting until 1964,[28] the requirements of Guide 3 date from 1976[29] and audited bank financial statements were not required under Federal law until 1991.[30] When CAMELS ratings were first created, they were not even disclosed to bank management.[31]

The formal and informal punitive actions of the banking regulators against banking organizations have also become increasingly more public. Banking regulators were not given formal enforcement powers until 1966. Before that, moral suasion and "jawboning" were the main powers of the banking supervisors, backed by the nuclear, and therefore not used, threat to revoke a charter or terminate deposit insurance. Even after the banking regulators were given the power to remove directors and officers, impose civil money penalties and enter into informal written memoranda or formal consent or cease and desist orders, the tendency was to favor informal—that is, nonpublic—board resolutions and memoranda of understanding (MOU). The long litany of very public post-Financial Crisis consent orders shows that the old custom has definitively changed to be more transparent. As a result, there is an increasing tendency to disclose informal and private MOUs in securities disclosure documents, with the express consent of the banking regulators, when their contents are deemed material to investors.[32]

Also on the side of transparency, the long-term trend has been toward a greater tendency to publish guidance, interpretations, and FAQs, and greater disclosure of informal and formal enforcement actions against banking organizations. Many interpretive positions, even in the form of written letters, were typically kept secret well into the 1990s. It was long a given that the only way to find out the interpretive

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[25] As stated by Professor Gillian Metzger, "Accountability is administrative law's central obsession, which it furthers through mechanisms for public participation, congressional oversight, centralized White House regulatory review, and judicial review. Fear of agency capture is a recurring theme, as is the concern that agencies will wield their delegated powers arbitrarily." Gillian E. Metzger, "Through the Looking Glass to a Shared Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation", 78 *Law and Contemp. Probs.* 129, 130 (2015).

[26] The long-standing spat between the banking regulators and the SEC on the calculation of allowances for loan losses is an example of the transparency and secrecy traditions clashing. See George J. Benston and Larry D. Wall, "How Should Banks Account for Loan Losses?", Federal Reserve Bank of Atlanta (2005), available at link. That clash was resolved by an administrative detente in the early 2000s. Nonetheless, so-called GAAP/RAAP debates sometimes show up in the footnotes to call reports. It remains to be seen how the implementation of CECL will impact this dynamic.

[27] See 37 FR 28607, 28608 (Dec. 28, 1972).

[28] See Alfred D. Mathewson, "From Confidential Supervision to Market Discipline: The Role of Disclosure in the Regulation of Commercial Banks", 11 *J. of Corp. L.* 139, 141 (1986).

[29] See id. at 161.

[30] See Eugene N. White, "Lessons From the History of Bank Examination and Supervision in the United States 1863–2008", in *Financial Market Regulation in the Wake of Financial Crisis: The Historical Experience Conference* 15, 34 (2009), available at link.

[31] See Ron Feldman, Julapa Jagtiani, and Jason Schmidt, "The Impact of Supervisory Disclosure on the Supervisory Process: Will Bank Supervisors Be Less Likely To Downgrade Banks?" in *Market Discipline in Banking: Theory and Evidence*, edited by G. Kaufman in *Research in Financial Services*, Elsevier, at 3 (2003), available at link.

[32] Requirements to raise capital and restrictions on dividends are the core examples. Other MOUs remain undisclosed.

views of the Federal Reserve was to file a FOIA request and hope for the best.[33] The development of the Internet, which brings with it increased expectations of transparency, has meant that many, but not all, interpretive positions now find their way onto the banking regulators' websites. There is more in the public domain than ever before. This trend started even before the Financial Crisis and the Dodd–Frank Act, which required 390 new rulemakings by the banking agencies.[34] A prominent pre- Dodd–Frank example is that the long history of semipublic interpretations under Section 23A of the Federal Reserve Act came to an end with the promulgation of Regulation W in 2002.

Yet, all of these advances in transparency and accountability are not enough, either for the rule of law or for the norms of the digital age. The disparate elements of increased use of the Congressional Review Act, the GAO ruling that guidance can be subject to the Congressional Review Act, an increased focus on cost-benefit analysis in financial regulation and increased attention by the OMB on major guidance issued by independent agencies each, in their own way, are attempts to answer the call for more transparency and accountability.

*C. The Increasing Scope of Secret Guidance and Lore*

Against this recent societal backdrop of increased transparency and accountability is the opposite tradition covered by confidential supervisory information, secret guidance and secret lore. As a noted administrative law scholar has argued:

> The banking agencies of the Federal Government have long maintained systems of secret evidence, secret law, and secret policy. The result has been a degree of unchecked and unstructured discretionary power that is far greater than it should be. Sound principle calls for openness, so that discretion may be checked and structured. To some extent the systems the agencies have been following violate existing legal requirements. The banking agencies can and should make procedural changes that will increase both efficiency and fairness.[35]

What may come as a surprise is that these statements were made in 1966. They remain fresh today.

Indeed, I would posit that as supervision and the banking sector have grown more complex, the amount of confidential supervisory information shielded from public view has increased vastly not only since 1966, but also at an accelerated pace after the Financial Crisis. One reason for the expansion of confidential supervisory information is that the traditional bank examination has morphed into something much wider in scale and scope than its 19th and early 20th Century ancestor. A regional banking organization will have up to 50 bank examinations on different topics a year; a G–SIB will have hundreds. The annual roll-up examination now covers multiple areas, and the number of matters requiring attention or immediate attention have expanded into hundreds for some banking organizations. It is a fair question, in a time of high capital and liquidity, what these matters requiring attention are covering and at what level of materiality. It goes without saying that there is no sense of cost-benefit or proportionality. The lack of public data is disturbing.

Economic and social policy, affecting financial stability, economic growth and jobs, is being fashioned in the shadows of the confidential supervisory arena. Some of these economic and social policy choices may reflect the right tradeoffs, but, as they are made, Congress and the public have no way of knowing. Before regulators act through matters requiring attention, horizontal reviews, guidance or lore, we should ask why a particular policy choice or regulatory interpretation is being made under the rule of discretion rather than the rule of law. In an era of increased transparency and accountability, policy choices that have an impact on access to deposit services, credit allocation, and investment in the banking sector—that is on jobs and growth—should be open, not secret.

Today's supervisory culture has moved far away from the core of examining the quality of a bank's loans or the amount of cash it has in its vault. It is easy to un-

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[33] As a young lawyer in the early 1990s, I was frequently given the task of crafting a FOIA request to capture a secret interpretive letter that was known by the bank regulatory bar to exist but that was not public. Letters received under FOIA were carefully tended in paper files and shared among banking lawyers. Contrast that cultural mode with that of the SEC, which began publishing no-action letters in 1970. See Donna M. Nagy, "Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework", 83 *Cornell L. Rev.* 921, 948–49 (1998).

[34] See Davis Polk and Wardwell LLP, "Dodd–Frank Progress Report" (July 19, 2016), available at link.

[35] Kenneth Culp Davis, "Administrative Procedure in the Regulation of Banking", 31 *Law and Contemp. Probs.* 713 (1966).

derstand how the supervisory theory of the traditional bank examination translates into supervision over capital and liquidity, including stress testing. The theory of supervision for the 21st Century becomes muddled, however, once one leaves the realm of qualitative judgements around a quantitative core. How should compliance with law examinations be fashioned? What is the purpose behind supervisors' focus on the internal governance structure of management, the review of the minutes of management's discussions and forced changes in reporting lines?[36] On what basis was the ideology of the three lines of defense imposed upon almost all banking organizations?[37] The word supervision, although longstanding, appears nowhere in the legal framework governing the banking sector. The only public source is the explanations published in agency reports and on agency websites. These explanations are not helpful to understanding the theory of banking supervision beyond logical extensions of the traditional banking examination.[38] Academic scholarship on supervision is almost nonexistent and hard to do given that what is happening is kept confidential. Congressional oversight is also made more difficult.

The bias, for important policy choices affecting economic and social conditions, should be toward the rule of law and transparency. The realm of lore or secret constraints on banking organizations should be narrowed to a core minimum of what is necessary to preserve financial stability or the safety and soundness of any one banking organization. Part of the challenge is that, a decade ago, the supervisory staff, like the rest of us, lived through the Financial Crisis and its aftermath on the economy. When the fire is raging, the firefighters appropriately use whatever tools are handy, whether it is by the stretching of legal texts or the need for tough supervisory actions. But, long after the fire, when the house has been rebuilt on a better foundation, it is time to leave behind the emergency culture of firefighting and think in terms of regular maintenance.

As those within banking organizations will know, it is only possible, because of the constraints of confidential supervisory information, to speak about those examples that have randomly become public. Those who are at banking organizations or the regulators will know that there are many additional examples. This informal nonpublic shadow system of regulation is neither transparent nor accountable.

For example, what became the leveraged lending guidelines, which are meant to guard against the next asset bubble, started in the bank examination. They were originally sent to banks as confidential letters, and banks were not permitted to disclose to their clients such letters' existence, or the reasons why banks were not making certain loans. From the perspective of the banking regulators, the leveraged lending guidelines were an advancement in transparency and disclosure. They were, after all, public and had been subject to notice and comment. From the perspective of those who have been thinking deeply about the administrative law and its march towards transparency and accountability, they did not go far enough. Similarly, there have been attempts to take legal interpretations on the Volcker Rule in the context of bank examinations.

As one more significant example of important policy being made in the shadows, the Federal Reserve's lore on what constitutes a "controlling influence" and the so-

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[36] Since the Financial Crisis, the banking agencies have required that compliance in larger institutions report to risk, not legal. These decisions were taken without any public comment or discussion, and the evidentiary basis for them was not developed. In most smaller and regional banking organizations, compliance remains within legal. The collateral consequences of two competing poles of legal interpretation and judgement within the organization were not considered.

[37] The three lines of defense appears in only one place in the legal framework in guidelines issued by the OCC in 2014. See 12 CFR pt. 30 app. D. It is otherwise not a part of the traditional bank supervision. There was no cost-benefit analysis around its adoption in the OCC's guidelines and it was imported from a position paper of The Institute of Internal Auditors. See generally The Institute of Internal Auditors, IIA Position Paper: "The Three Lines of Defense in Effective Risk Management and Control" (January 2013), available at link.

[38] The Federal Reserve describes supervision as follows: "Once the rules and regulations are established, supervision—which involves monitoring, inspecting, and examining financial institutions—seeks to ensure that an institution complies with those rules and regulations, and that it operates in a safe and sound manner." Board of Governors of the Federal Reserve System, The Federal Reserve System: Purposes and Functions, at 73 (10th ed., Oct. 2016), available at link. Until recently, however, the OCC included the promulgation of regulations in its concept of supervision. The OCC's 2017 annual report, for example, listed the power to issue regulations as one of its supervisory powers, but that was removed from the 2018 report. Compare Office of the Comptroller of the Currency, 2017 Annual Report, at 2, available at link, with Office of the Comptroller of the Currency, 2018 Annual Report, at 1, available at link. The FDIC's 2018 annual report does not explicitly distinguish between supervision and regulation under its "Supervision" section. Federal Deposit Insurance Corporation, 2018 Annual Report, at 14–20, available at link. Moreover, it contains a section titled "Supervision Policy" that groups together discussions of supervision programs, rulemaking, and supervisory guidance. Id. at 20–26.

called "tear-down rules" were mostly secret for a long time. These are not "rules" at all, but a series of oral principles, not made public nor written down, but which reflect the views of some legal staff at a moment in time. In a welcome development, the Federal Reserve last week announced a move from the "Delphic and hermetic process" for ordaining control to notice and comment rulemaking.[39] In announcing the proposed rulemaking, Vice Chair for Supervision Quarles acknowledged that divining whether the Board will find control under the existing framework requires "supplication to a small handful of people who have spent a long apprenticeship in the subtle hermeneutics of Federal Reserve lore, receiving the wisdom of their elders through oral tradition in the way that gnostic secrets are transmitted from shaman to novice in the culture of some tribes of the Orinoco."[40] As the Vice Chair for Supervision implies with his colorful metaphor, the oral tradition from shaman to novice is not good governance.

Another example arises because of the ability of the Federal Reserve to impose limitations on the conduct and activities of a financial holding company. To qualify as a financial holding company, an institution and all of its insured depository institution's subsidiaries must be both "well managed" and "well capitalized." Under Section 4(m) of the Bank Holding Company Act, the Federal Reserve may impose limitations on the conduct and activities of a financial holding company that fails to satisfy either condition, and the financial holding company is required to enter into a 4(m) agreement to comply with those limitations. Because the Federal Reserve treats the failure to be well managed as confidential supervisory information, the existence and scope of 4(m) limitations are confidential if based on the failure to satisfy the well managed condition. One study, which examined the securities disclosures of 60 financial holding companies (FHCs) between the years 2005 and 2017, noted that nearly all FHCs disclose that they are well capitalized but many do not disclose if they are well managed.[41]

Another example has come about due to the informal "penalty box" rules of thumb that the banking supervisors have applied to banking organizations as a result of CAMELS ratings, especially as to Management ratings, BSA/AML compliance reviews and consumer compliance reviews. Tacit principles in the evaluation of management include the fact that any compliance problem resulting in an enforcement action will result in a downgrade of the Management rating and that it is often hard for a bank to obtain a Composite rating better than "3" if it has a Management rating of "3".[42] Bank expansion is not possible as long as a consent order is pending, meaning banks of all sizes devote board and management time as well as technology resources toward even the most immaterial compliance concerns to ensure regulators are fully satisfied.[43] Appeals against adverse ratings are rare because appeals must be made to the same agency that issued the rating—part of evaluation is the readiness with which management responds to regulator criticisms, and banks are warned that "examiners have long memories."[44]

The evolution of the living wills guidance is also instructive. Resolution plans and their guidance started out as largely confidential, then morphed into a mix of confidential and public feedback—all of which applied—and finally, over the years, regulators nudged toward public guidance. The first set of public guidance was issued without advance warning or notice and comment and stated that all previous guidance, public and private continued to apply. For those working on living wills, figuring out which parts of which years' private guidance no longer applied—because it was not aligned with the public guidance—was a puzzle. More recently, and in a welcome move, the Federal Reserve and the FDIC have issued new guidance, subject to notice and comment, that makes it clear that all previous guidance has now been superseded. The point here is that banking organizations were subject to a mix

[39] Board of Governors of the Federal Reserve System, "Federal Reserve Board Invites Public Comment on Proposal To Simplify and Increase the Transparency of Rules for Determining Control of a Banking Organization", Press Release (Apr. 23, 2019), link (statement of Vice Chair for Supervision Quarles).

[40] Board of Governors of the Federal Reserve System, "Transcript Open Board Meeting on April 23, 2019", at 2–3, available at link.

[41] "Ethics Metrics, Analysis of Bank Holding Company Disclosures", comments submitted May 8, 2017, to the SEC on its Industry Guide 3, Statistical Disclosure by Bank Holding Companies, 8, link.

[42] See "Examination of the Federal Financial Regulatory System and Opportunities for Reform": Hearing before the U.S. H. Financial Services Subcomm. on Financial Institutions and Consumer Credit, 115th Cong. 10 (2017) (statement of Greg Baer, President, The Clearing House Association), available at link.

[43] See id. at 11.

[44] See id. at 12.

of private and public expectations, many of which were not clearly aligned and all of which were perceived as binding.

The long tradition of regulation by negotiation in the applications process is another type of shadow regulatory system.[45] Conditions, sometimes not linked to the pending application, are imposed. Regulators strategically use delays and silence to encourage silent, nonpublic withdrawals of applications. Some have called this regulation by negotiation but it is more akin to regulation by threat or intimidation.[46] An illustrative example, which can be used because it is one of the few to become public, comes from applications by Citicorp, J.P. Morgan, and Bankers Trust New York Corporation in 1987 to underwrite and deal in municipal revenue bonds, mortgage related securities and commercial paper.[47] During negotiations with agency staff, each applicant "voluntarily" consented to market share limitations while protesting that they saw no need for them. When considered for review by the Federal Reserve Board of Governors, the banks admitted that they agreed to the limitations only to "expedite the applications."[48] In this instance, the market share limitations were ultimately overturned by the Second Circuit but normally such "voluntary" commitments do not come up in final orders and are unlikely to be challenged in court or known to the public.[49] As a result, the staff conducting negotiations during the application process wield an immense policymaking power.

Many have debated whether confidential supervision and its secret lore are binding upon banking organizations. The recent "guidance on guidance" from the banking regulators seeks to settle that debate by stating that guidance is not binding unless it impacts safety and soundness. In a world where the supervisor can punish the banking organization and mold its behavior through these tools, from the perspective of those who receive it, the secret guidance and lore may as well be binding. Of course, banking organizations frequently seek and are happy to receive nonpublic guidance, on a written or oral basis, from the supervisory staff. The point is not to eliminate these communications but to put more guardrails around them, as the guidance on guidance begins to do.

*D. Uneasy Truce Is Now Untenable—Tilt Towards Accountability and Transparency*

The uneasy truce between the tradition of secrecy and the tradition of accountability has become untenable. The signal that the balance is askew is the increase in leaks of confidential supervisory information. By my count, there have been 7 leaks of confidential supervisory information that have made their way into the media since 2011, some but not all of which can be traced to regulators. In addition, in 2016 one judge released the CAMELS ratings of a bank[50] and, near the time of the Financial Crisis, two exam reports were released by the Financial Crisis Inquiry Commission. Before 2011, leaks of confidential supervisory information into the public square were virtually unknown. So far, each of these releases has been treated as a one-off situation. It is time to consider, however, whether they are a signal of the pressures felt by humans living in a digital society where there is a strong tilt towards transparency.

There is also an increase in the officially sanctioned publication of confidential supervisory information by the banking supervisors themselves. Confidential supervisory information belongs to the supervisors who can choose, when they so desire, to disclose it. Although the Comptroller has not used his power to disclose examination results to the public, that power exists. The New York Department of Financial Services in 2017 used its power to release information in the public interest to release its otherwise confidential ratings of Bank of Tokyo-Mitsubishi as part of its ongoing spat with the bank and the Comptroller over who should be the primary regulator of the bank's New York branch.[51] The decision about what is in the public interest and its timing is entirely in the hands of the supervisors.

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[45] See Culp Davis, "Administrative Procedure in the Regulation of Banking", supra n. 35, at 713 (arguing the OCC practice of making decisions regarding charter applications without providing reasoned opinions or findings of fact lends itself toward arbitrariness).

[46] Daniel Schwarz and David T. Zaring, "Regulation by Threat: Dodd–Frank and the Non-Bank Problem", 84 *U. Chic. L. Rev*. 1813, 1817 (2017).

[47] See Alfred C. Aman, Jr., "Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board", 74 *Iowa L. Rev.* 837, 894–95 (1989).

[48] See id. at 895.

[49] See id.

[50] See Memorandum Opinion and Order, Builders Bank v. FDIC., No. 15-cv-06033 (N.D. Ill Apr. 25, 2016), ECF No. 26.

[51] Letter from Shirin Emami, Executive Deputy Superintendent-Banking, N.Y. State Dept. of Fin. Servs., to Marva V. Cummings, Director for District Licensing, OCC (Nov. 13, 2017), available at link.

Banking organizations, however, are silenced in the public arena when the media or Congress make statements that might otherwise be corrected but for the rebuttal being considered confidential supervisory information, even when that information has been made public by the regulatory staff. As one example of the potential chilling effect, the OCC issued a bulletin reminding banking organizations of their confidentiality responsibilities and potential criminal liability just 2 weeks before the CEOs of the Nation's largest banks were scheduled to testify before the House Financial Services Committee.[52]

*E. What Policy Purpose Is Served by Confidential Supervision and Discretionary Actions?*

The question then becomes how to improve the existing situation by narrowing the scope of confidential supervisory information. Following in the footsteps of Minsky, we should aim for better, not perfect. We are moving into an era where policy making will increasingly be driven by data analytics and evidence in a technological environment. Going forward, three key questions ought to be asked about confidential supervision. Each one of these questions would involve a new way of thinking.

1. *Why is this topic being treated confidentially?* Banking regulators and banking organization should begin to ask themselves why a given topic is being treated as confidential. There should be a tight link to financial stability and the need for candid conversations. There should be a serious reexamination, from first principles, of how the obligations of the securities laws and confidential supervision interact. It is fair to ask why shouldn't banks have the option to make their CAMELS ratings public. After all, since 1990, the results of CRA examinations have been made public.[53] Or, one could ask why the banking regulators don't publish examination findings and trends in matters requiring attention in anonymous aggregate but with granular detail.[54] One thing is certain, however, and that is that any reform of the confidential supervisory information regulations and culture needs to be done on a systemic basis that applies equally to all banking organizations. Right now, the practical reality is one where some institutions sometimes are subject to random leaks or disclosures and others are not. There is a deep unfairness in that situation.

2. *Who or what is being protected by the confidentiality?* Sometimes confidentiality shields the supervisors' actions from the public scrutiny. How is it that the confidential "penalty box" constraints on a banking organization's activities can exist for years?[55] Do CAMELS ratings really judge individual institutions or do they follow the trends of the business cycle? On what basis are matters requiring attention and matters requiring immediate attention issued and what patterns exist in them? Some of these examples are areas where the supervisor fears that its actions would be controversial to the public and so a confidential route is chosen, or sometimes the confidential route is traveled just because it is familiar and is done without much forethought. If confidentiality is chosen to protect the regulator from public scrutiny, it is not appropriate. If, however, it is chosen for financial stability, then it is appropriate.

3. *Why is this policy choice or regulatory interpretation being made under the confidential rule of discretion rather than the rule of law?* Why did the leveraged lending guidelines start as confidential letters? What is one to make, for example, of Henry Paulson admitting that he privately threatened to remove the management and board of Bank of America if it did not complete a merger with Merrill Lynch? He has since stated "[b]y referring to the Federal Reserve's supervisory powers, I intended to deliver a strong message."[56] This message was not disclosed at the time. The penalty box, and many nonpublic examples involve similar threats of confidential supervisory actions.[57] The increasing number of banks requesting to strengthen their ability to appeal examination results reflects the sense that con-

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[52] See OCC, Bulletin 2019-15: Statement on Confidentiality (Mar. 25, 2019), available at link; United States House Committee on Financial Services, Hearing: "Holding Megabanks Accountable: A Review of Global Systemically Important Banks 10 years after the Financial Crisis" (Apr. 10, 2019), available at link.

[53] See FFIEC Interagency CRA Rating File Specifications, Community Reinvestment Act, FFIEC, link (last visited Apr. 22, 2018).

[54] The Federal Reserve's recent "Supervision and Regulation Report" is an excellent start. Board of Governors of the Federal Reserve System, "Supervision and Regulation Report" (Nov. 2018), available at link.

[55] Transcript of Q&A with Federal Reserve's Randal Quarles, *WSJ* (Nov. 7, 2017), available at link (statement by Greg Baer) [hereinafter Quarles Transcript].

[56] Martin Kady II, "Paulson Admits To Threatening Lewis", *Politico* (July 17, 2009), link.

[57] Quarles Transcript, supra n. 55 (statement by Greg Baer).

fidential supervision can look like a weapon when it is shrouded in secrecy.[58] On what basis can new standards be imposed upon banking organizations through horizontal reviews by supervisors that are not made transparent to the organizations or the public?

We have recently seen helpful steps in the right direction toward transparency and accountability. Vice Chair for Supervision Quarles has stated that increases in transparency and a re-think of supervision are high on his agenda, noting that "one of the reasons for transparency . . . is just a basic view of the right relationship between the Government and the governed . . . I do think we can be much more transparent about the regulatory process generally."[59] Chairman McWilliams has also focused on increased transparency with her Trust through Transparency initiative at the FDIC.

## II. Training of Supervisory Staff in the Legal Framework of the Regulatory State

Congress and the banking agencies need to think clearly about how to create an environment where the supervisory staff are given the training, resources, and tools that would permit them to do their jobs in a way that is more transparent to the world, more accountable and more consistent with the rule of law.[60] Given that the legal framework governing the banking sector has become much more complex, the work of the examination staff has become more legally infused and yet the supervisory culture has become increasingly unmoored from the legal framework itself.[61] The rise in compliance with law examinations, the focus on risk and board governance and the increasing use of matters requiring attention and matters requiring immediate attention for violations of law mean that the examination staff are increasingly making judgments that are legally infused, either involving legal judgments or involving a mixture of facts and law.

At the same time, the legal departments and legal staff of the Federal banking agencies remain quite slim, especially as compared to other major agencies.[62] It is fair to ask whether there is a deep enough pool of lawyers at the agencies for the agency lawyers to be able to guide the supervisory staff on the more complex legal framework and to deal with all of the increased legally infused work that is occurring.[63] It is also fair to ask whether the budget, resources, and stature of the agency legal departments is sufficient for the increased legal complexity and the coming digital transformation. A study should be done on whether increases in the legal staff have kept pace with increases in supervisory staff and increases in legally infused work by the supervisory staff.[64]

Examples that I have seen in my practice, as well as examples that have been relayed to me, lead me to believe that the current generation of examination and supervisory staff, who are people of goodwill trying to do a complex job under dif-

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[58] Julia Anderson Hill, "When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations", 92 *Wash. U. L. Rev.* 1101, 1165–69 (2015).

[59] Quarles Transcript, supra n. 55 (statement by Vice Chair for Supervision Randal Quarles).

[60] One important resource, beyond the scope of this testimony, is equipping the supervisors with more advanced technology, known as RegTech or SupTech. See Jo Ann Barefoot, "Regulation Innovation: Using Digital Technology to Protect and Benefit Financial Consumers", Harvard Kennedy School Mossavar-Rahmani Center for Business and Government Working Paper Series No. 110, at 10–11 (Mar. 2019), available at link.

[61] Of course, major elements of bank supervision are related to credit, interest rate, liquidity, and other market driven elements rather than the legal framework.

[62] See Rory Van Loo, "Regulatory Monitors: Policing Firms in the Compliance Era", 119 *Columbia Law Review* 369, 436–40 (2019)

[63] The banking agencies have long been understood to be monitor- or examiner-dominated in their personnel. Based on research by an academic, some of which is estimated, the Federal Reserve is 95 percent monitor staff, the OCC is 93 percent monitor staff and the FDIC is 86 percent monitor staff. See id. at 438-39. The higher proportion of lawyers at the FDIC is likely linked to its work as the deposit insurer and bank failures. Just a comparison of the number of lawyers to the number of examination staff at each of the agencies tells us that deep training on the law, legal interpretation and the legal framework has not been possible. A memo published by two former Federal Reserve staffers has pointed out that training on the legal framework has been delegated to the regional Federal Reserve Banks. Richard K. Kim, Patricia A. Robinson, and Amanda K. Allexon, "Financial Institutions Developments: Revamping the Regulatory Examination Process", Wachtell, Lipton, Rosen, and Katz (Nov. 26, 2018). That fact alone brings into question the consistency of the training.

[64] In the private sector it is well understood that increases in the budget, resources and staffing of the in-house legal department have not kept pace with the rise of risk management and the separation of compliance from the legal function. See Thomas C. Baxter, Jr., "The Rise of Risk Management in Financial Institutions and a Potential Unintended Consequence—The Diminution of the Legal Function", *American Bar Association Business Law Today* (Apr. 2, 2019), link.

ficult circumstances, have not had in-depth training in the legal framework. Some examiners were confused about the fact that the First Amendment protects lobbying activity by banking organizations, and attempting to stop such activity or subject it to an examination is unconstitutional.[65] There is confusion about the fact that the Constitution and statutes are higher level authorities than a regulation, guidance, or handbook. Some supervisory staff mistakenly believe that guidance can override a statute. Some supervisory staff are confused about what is part of the legal framework and what is not. Some supervisory staff mistakenly believe that guidance is not governed by the statutes or regulations and that they can pick and choose among the applicable guidance or law. Some supervisory staff seek to exclude in-house lawyers from meetings or tasks.

I believe that the training of supervisory staff for compliance with law is heavily weighted towards the technical elements of individual banking regulations and guidance in areas of subject matter expertise. The training has been overfocused on compliance with the technical aspects on a regulation-by-regulation basis and has underweighted fundamental principles such as the rule of law in a Constitutional democracy and the legal framework that governs the regulatory State. The training has also not focused on basic grounding statutes such as the APA or the Congressional Review Act.[66] The supervisory staff are also not trained in major case law that affects their work. There is a large difference in what the supervisory staff believe to be their authority under safety and soundness and the case law that defines the term.

There is no need for 3 years of law school to understand these critical concepts. We also need not be purists worrying about the unauthorized practice of law. Instead, it should be possible, especially in light of the quality of the credentialed examination staff and the base of the past training, to add more of the following elements to the training of supervisory staff so that they are better able, in light of the shortage of lawyers at the agencies, to handle legally infused judgments:[67]

- The principle of the separation of powers and how the delegation of authority by Congress to agencies is based solely on written statutory authority with their being no such thing as "inherent authority";[68]
- Fundamental principles of due process, including the distinction between prospective and retroactive application of rules, regulations, and other standards;
- The legal hierarchy among the Constitution, statutes, regulations and guidance, including the distinction between binding law and nonbinding written public guidance;
- The statutes, regulations, other laws and guidance that are binding on the supervisory staff;
- The key major cases that impact the work of supervisory staff;
- Why reading the legal framework involves cannons of construction and deference, so that it is not like ordinary reading;[69] and
- Why adhering to the rule of law and fundamental principles of due process is fundamental in a representative democracy and binding upon agency staff.

The lack of training about the legal framework, the principles of how legal texts must be interpreted, the binding nature of court decisions, and the regulatory State has real world consequences. One real world consequence is the creation of matters requiring attention and matters requiring immediate attention, with all that implies, based on misunderstandings of the legal framework. Another consequence is

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[65] See Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System, 115 Cong. 86 (2018) (Statement of Randal K. Quarles, Vice Chairman for Supervision).

[66] It is safe to say that none of the banking regulators, and certainly not the banking bar, noticed or were aware of the passage of the Congressional Review Act in 1996. In hindsight, the GAO ruling that the leveraged lending guidelines are a "rule" under the APA is completely obvious. See 5 U.S.C. §551(4) (defining "rule"). Thinking of guidance as requiring a stop at OMB or notice to Congress has thrown a wrench into the traditional cultural mode.

[67] I began my life in the law by taking, as is common in the Midwest, a 6-week paralegal certification. I can attest that if a 22-year-old from a small town in Michigan could grasp the basics of these concepts in a paralegal certification course, then the much more highly educated and mature supervisory staff should be able to with ease.

[68] The safety and soundness statute, 12 U.S.C. §1831p-1, is broad and delegates discretion to the banking agencies. It is not, however, unlimited and does not create "inherent authority."

[69] See Margaret E. Tahyar, "Legal Interpretation Is Not Like Reading Poetry—How To Let Go of Ordinary Reading and Interpret the Legal Framework of the Regulatory State", at 9–11 (Dec. 4, 2018, Working Draft), available at link.

the historical failure to keep track of appeals from examinations[70] or not being sensitive to the fact that some examination judgments or matters requiring attention are legally infused.[71] One clue that there is not enough sensitivity to the role of the rule of law is that risk governance guidance on the role of risk and compliance did not mention in-house legal departments at banking organizations.[72] Another clue is the three lines of defense ideology, developed post-Financial Crisis, which was drafted and adopted by the auditing profession without consideration of the role of the rule of law or the in-house legal function.[73]

Increased training in the hierarchy of the legal framework, why legal interpretation is not like normal reading and a wider understanding of the separation of powers and the regulatory State would, I believe, also have positive knock-on effects in the private sector. Many in the growing professions of risk management and compliance had their initial training in the banking agencies. They take their confusion about the legal framework, the role of guidance and the limits of secret lore with them to the private sector.

**Conclusion**

Change is hard but, the longstanding uneasy truce is now untenable. I suspect that both banking organizations and supervisors might be made a little uncomfortable by what I am saying here today. If, however, the changes I recommend are made, and if both supervisors and banking organizations are a little bit uncomfortable, the balance is moving in the right direction.

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## PREPARED STATEMENT OF PATRICIA A. MCCOY

PROFESSOR OF LAW, BOSTON COLLEGE LAW SCHOOL

APRIL 30, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee: Thank you for inviting me here today to discuss nonbinding guidances by Federal bank regulators.[1]

Imagine a world in which Federal bank regulators did not provide guidances. They would still have statutory responsibility to administer and enforce the statutes and legislative rules under their jurisdiction. Regulated firms would still have to obey those statutes and rules. The only difference is, firms would not have insight into the agencies' interpretations, priorities, or positions in the form of guidances. In the process, financial providers would be deprived of an essential source of transparency that they vocally want and benefit from today.

Some are calling for changes that would require nonbinding agency guidances to undergo notice-and-comment proceedings and Congressional Review Act oversight. Such changes would be badly misguided. Agencies would either respond by converting flexible, nonbinding guidances into binding legislative rules or by continuing to discharge their supervisory and enforcement responsibilities without the illumination provided by guidances. In all likelihood, "regulation by enforcement" would become a self-fulfilling prophecy, for the reasons I explain.

### I. Guidances Provide Vital Transparency in Banking Regulation

Guidances are informal agency statements that advise the public of an agency's construction of its statutes or rules or the agency's prospective plans to exercise discretion. As such, guidances are "an essential instrument of [F]ederal administra-

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[70] See Hill, supra n. 58, at 1115–60 (describing appeals process at OCC, Federal Reserve, FDIC and NCUA, and noting data issues).

[71] See Davis Polk and Wardwell LLP, Comment Letter on Proposed Amendments to Guidelines on an Internal Appeals Process for Institutions Wishing to Appeal an Adverse Material Supervisory Determination, Docket No. OP-1597, at 4–5 (Apr. 30, 2018), available at link.

[72] See Davis Polk and Wardwell LLP, Comment Letter on the "Proposed Guidance on Supervisory Expectation for Boards of Directors", Docket No. OP-1570, at 9–11 (Feb. 15, 2018), available at link ("The Management Proposal is similarly silent on the importance of a firm having a sufficiently robust legal department with appropriate resources, budget and independence and a general counsel with sufficient stature and authority, instead addressing only risk management, internal audit and compliance functions.").

[73] See generally The Institute of Internal Auditors, supra n. 37.

[1] I use the term "Federal bank regulators" in this statement to refer to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau (CFPB).

tion" and "facilitate[] stakeholders' knowledge of agency positions and intentions ahead of enforcement or similar actions."[2]

The term "guidances", the topic of this hearing, refers broadly to a variety of nonbinding agency statements. Guidances encompass interpretive rules, policy statements, guidance, supervisory bulletins, opinion letters, frequently asked questions, and compliance guides, among other things.

The APA requires interpretive rules and policy statements of general applicability to be published in the *Federal Register* but expressly exempts them from the notice-and-comment requirements for legislative rules.[3] Nevertheless, sometimes Federal bank regulators solicit public comment on proposed guidances at their discretion in order to refine the final versions.[4] Guidances are nonpartisan in nature and are issued by Republican and Democratic appointees alike.[5]

Guidances are distinguishable from notice-and-comment legislative rulemakings under Section 553 of the Administrative Procedure Act (APA) in at least two important respects. First, unlike legislative rules, which can affect individual rights and obligations, guidances are nonbinding on third parties.[6] Second, guidances are highly flexible and allow agencies to more nimbly respond to changing market conditions because they can be amended without going through a time-consuming notice-and-comment process.[7]

Except in rare instances, Federal bank regulators are not required to issue guidances.[8] Instead, they do so to provide transparency for what might otherwise be an opaque regulatory process. Agencies increased their use of guidances before the 2008 financial crisis, in response to industry requests for a "principles-based approach" to regulation. Guidances have continued to be important post-2008.

Guidances serve an essential function, given the intricacy of Federal banking law. Federal bank regulators administer the Federal banking statutes and implement those statutes through binding, notice-and-comment legislative rules. This thicket of banking statutes and rules is voluminous and complex.

Against this backdrop of statutes and rules, regulated entities find guidances valuable because they shed light on agencies' supervisory perspectives and concerns. When they are issued as policy statements, guidances can advise the public prospectively on how an agency proposes to exercise one of its discretionary powers.[9] When issued as interpretive rules, guidances apprise the public of an agency's construction of the statutes and rules it administers.[10] Other types of guidances provide a useful possible roadmap for compliance, while leaving companies free to propose alternative models or interpretations or consideration of additional facts. In this way, guidances "can make agency decision making more predictable and shield regulated parties from unequal treatment, unnecessary costs, and unnecessary risk . . . ."[11] Finally, guidances can flag potential compliance issues for regulated entities' attention.

Guidances can emanate out of rulemaking or out of supervision. During the rulemaking process, for example, it is common for regulated firms to request guidance to help them comply with an agency's legislative rules (particularly new rules). This was especially important during the implementation of the Dodd–Frank Act, when

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[2] Bureau of Consumer Financial Protection, Request for Information Regarding Bureau Guidance and Implementation Support, 83 FR 13959, 13959 (Apr. 2, 2018) (citations omitted) (hereinafter CFPB Guidance RFI).

[3] 5 U.S.C. §§552(a)(1)(D), 553(b)(A); see CFPB Guidance RFI, supra n. 2, at 13960.

[4] CFPB Guidance RFI, supra n. 2, at 13960.

[5] See, e.g., Bureau of Consumer Financial Protection, "Changes to Types of Supervisory Communications", BCFP Bull. 2018-01 (Sept. 25, 2018) (issued by the CFPB under former Acting Director Mick Mulvaney), *https://files.consumerfinance.gov/f/documents/bcfp__bulletin-2018-01__changes-to-supervisory-communications.pdf*; Office of the Comptroller of the Currency, "Description: Cyber-Related Sanctions", OCC Bull. 2018-40 (Nov. 5, 2018) (guidance on the potential impact of Office of Foreign Assets Control sanctions on financial institutions' operations; issued under Comptroller Joseph M. Otting), *https://www.occ.treas.gov/news-issuances/bulletins/2018/bulletin-2018-40.html#*; Securities and Exchange Comm'n, TurnKey Jet, Inc., SEC No-Action Letter (Apr. 3, 2019), *https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm*.

[6] See, e.g., Administrative Conference of the United States, Agency Guidance Through Policy Statements, Recommendation 2017-5, at 1 (Dec. 14, 2017) (hereinafter Administrative Conference); CFPB Guidance RFI, supra n. 2, at 13960.

[7] Administrative Conference, supra n. 6, at 2.

[8] Recently, however, in the Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174 (2018), Congress urged or required Federal agencies to provide additional guidance. Id. §§109(b) (on integrated mortgage disclosures), 209(e) (on shared waiting lists for public housing facilities).

[9] Attorney General's Manual on the Administrative Procedure Act 30 n.3 (1947).

[10] Id.

[11] Administrative Conference, supra n. 6, at 2.

Congress instructed Federal bank regulators to adopt multiple complex rules. These industry requests for guidance are often time-sensitive, because firms are eager for guidance to be in place by a rule's effective date.

Other guidances come out of supervision. Bank supervision requires confidentiality, to protect regulated firms' sensitive proprietary information and to prevent bank runs. For this reason, bank examination reports and the findings of bank examinations are secret and may not be released to the public, on pain of criminal sanction.[12] Importantly, other financial institutions are not privy to the examination reports or findings of sister institutions. Against this backdrop, supervisory guidances provide a crucial sightline into the supervisory process by informing regulated companies of supervisors' viewpoints, priorities, and concerns.

For these reasons and more, regulated companies want guidance and they are vocal about asking for it. As the National Association of Realtors put it last year:[13]

> [I]t is imperative that necessary guidance, including interpretive rules and nonrule guidance, be provided to regulated entities to ensure compliance across the industry.

The American Financial Services Association (AFSA) has emphasized the importance of guidance to financial providers in similar terms:[14]

> There is undoubtedly a need for written, explanatory guidance. Written guidance can be a useful tool to help financial institutions obtain clarification on specific practices. With many regulations, particularly long and complex regulations, operational difficulties or unintended consequences arise. In these cases, clarifying guidance is need[ed] quickly.

As these industry statements stress, guidance serves important functions and we should be wary of jettisoning it.

## II. Regulated Entities Have Ample Recourse if Guidances Are Given Binding Effect

Despite the many benefits of guidances, agencies are sometimes criticized for penalizing third parties for failure to comply with guidances. Whether this is really a problem or its extent is unclear. Agencies are statutorily responsible for enforcing the statutes and legislative rules with which they are charged. The fact that those statutes and legislative rules may overlap with guidances does not relieve agencies of that statutory responsibility.

Criticisms of guidance often assert that examination reports downgrade companies for failure to follow guidance or that enforcement actions are based on guidance violations. This might raise concerns that guidances were being given binding effect against third parties without prior public input into their substance through the notice-and-comment process. In the more likely case, Federal banking regulators base negative exam ratings, exam citations, and enforcement actions on violations of statutes or rules, on unsafe or unsound practices (in the case of the prudential banking regulators), or on unfair, deceptive or abusive practices (in the case of the Consumer Financial Protection Bureau), and not on any guidances that happen to overlap.

At this juncture, it is critical to dispel the mistaken impression that financial institutions are helpless if they are penalized for violating guidances alone. To the contrary, if financial institutions are experiencing this problem, they already have ample recourse. Regulated entities have multiple avenues of review if agencies seek to penalize them for violating guidances:

- *Suits to invalidate guidances:* Affected parties can sue to invalidate guidances that are given binding effect for failure to comply with the notice-and-comment provisions of Section 553 of the APA.[15]
- *Informal meetings with regulators:* In addition, regulated entities can and do meet privately with Federal bank regulators to request guidance, propose changes, and contest its use.

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[12] See, e.g., 12 CFR §§4.32(b), 7.4000(d), 261.21(a), 309.6(b), 1070.42. There are narrow exceptions permitting public disclosure of the nonconfidential portion of Community Reinvestment Act examination reports, 12 U.S.C. §2906(a)–(b), and of summaries of capital adequacy stress test results, see, e.g., 12 CFR §§252.17, 252.46, 252.58.

[13] Letter from the National Association of Realtors to the CFPB on Docket No. CFPB-2018-0013, at 1 (July 2, 2018) (hereinafter NAR Comment Letter).

[14] Letter from AFSA to the CFPB on Docket No. CFPB-2018-0013, at 4 (July 2, 2018); see also id. at 3 ("There is a clear need for guidance that is responsive to operational difficulties or unintended consequences resulting from new regulations").

[15] 5 U.S.C. §§704, 706(2)(A), (2)(D); see, e.g., United States v. Gypsum Co. v. Muszynski, 209 F. Supp. 2d 308, 310 (S.D.N.Y. 2002).

- *Agency ombudsmen:* All Federal bank regulators maintain an ombudsman that provides an independent, impartial, and confidential resource to help firms resolve any problem they may have resulting from the regulatory activities of an agency. [16]
- *Supervisory appeals:* In the supervision context, proposed citations go through special scrutiny and multiple layers of agency review before they can be included in examination reports. Informally, this gives companies the opportunity to raise any concerns about the use of guidances with examiners' supervisors. In addition, all Federal bank regulators provide formal procedures in which companies can appeal examination findings. [17]
- *Judicial review of enforcement actions:* In the enforcement process, aggrieved respondents have the right to judicial review to contest sanctions based on guidance violations. [18]
- *Legislation:* Finally, financial providers can petition Congress to enact legislation overturning guidances.

In short, financial institutions already have ample recourse for any agency misuse of guidances. Proposals to make it more difficult to issue guidances would throw the baby out with the bath water, as I discuss.

**III. Recent Initiatives To Increase the Procedural Requirements for Guidances**

Recently, some have proposed stringent curbs on guidances issued by Federal bank regulators. The two leading initiatives in this regard involve Congressional reversal of agency guidances under the Congressional Review Act and mandatory notice-and-comment requirements for guidances akin to those for legislative rules in Section 553 of the APA. Above, I discussed the current APA requirements for guidances. In this section, I discuss the debate surrounding the Congressional Review Act's applicability to guidances.

*a. The Provisions of the Congressional Review Act*

The Congressional Review Act (CRA) [19] is a major vehicle for Congressional oversight of agency rulemaking. Under the CRA, before a rule can take effect, every Federal agency that promulgates a rule must submit a copy of the rule, "a concise general statement relating to the rule," and the proposed effective date of the rule to each House of Congress and the Comptroller General. [20] In the case of major rules, upon receipt, Congress has a statutorily specified time period to enact a joint resolution of disapproval of the rule. [21] If Congress allows the statutory time period to expire without enacting a joint resolution of disapproval, the rule will take effect. [22] If Congress enacts a joint resolution of disapproval and the joint resolution survives any veto, the rule will not take effect. [23]

Where Congress has struck down a major rule through a joint resolution of disapproval that has withstood any veto, the rule may not be reissued in substantially the same form unless it is specifically authorized by a law enacted after the date of the joint resolution. The same result holds for any new rule that is substantially the same as the original rule that Congress disapproved. [24]

The CRA's procedures for joint resolutions of disapproval only apply to major rules. For purposes of CRA review, a "major rule" is any rule that the Office of In-

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[16] See 12 U.S.C. §4806(d) (requiring every Federal bank regulator to establish an ombudsman); Consumer Financial Protection Bureau, "Appeals of Supervisory Matters" 5-6 (Oct. 28, 2015), *https://files.consumerfinance.gov/f/documents/201508_cfpb_ApprovedSupervisoryAppealsProcess.pdf* (CFPB Supervisory Appeals).

[17] 12 U.S.C. §4806 (requiring every Federal prudential banking regulator to establish a supervisory appeals process); CFPB Supervisory Appeals, supra n. 16.

[18] 12 U.S.C. §1818(h).

[19] 5 U.S.C. §§801-808.

[20] Id. §801(a)(1)(A). The CRA requires other accompanying materials as well. Id.

[21] Id. §§801(b)(1), 802; see also id. §801(a)(4).

[22] Id. §801(a)(3). The statute sets forth a timeframe for effective dates. Id. §§801(a)(3), (d)-(e), 808. The same result occurs if the President vetoes a joint resolution of disapproval and Congress does not override the veto. Id. A rule that Congress disapproved may also take effect where the President makes a written determination that the rule is necessary based on narrow statutory grounds or was issued pursuant to any statute implementing an international trade agreement. Id. §801(c).

[23] Id. §801(b)(1); see also id. §801(a)(3), (f).

[24] Id. §801(b)(2).

formation and Regulatory Affairs (OIRA) of the Office of Management and Budget (OMB) finds has resulted in or is likely to result in:[25]

1. An annual effect on the economy of $100,000,000 or more;
2. A major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or
3. Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.

The term "major rule" excludes any rule promulgated under the Telecommunications Act of 1996 and the amendments made by that Act.[26] In addition, nothing in the CRA applies to rules concerning monetary policy proposed or implemented by the Federal Reserve Board or the Federal Open Market Committee.[27]

No determination, finding, action, or omission under the CRA is subject to judicial review.[28]

On two recent occasions, Congress invalidated Federal banking pronouncements under the CRA. In late 2017, Congress issued a joint resolution disapproving the mandatory arbitration rule issued by the Consumer Financial Protection Bureau (CFPB or the Bureau).[29] Last year, Congress invoked the CRA to nullify the CFPB's 2013 bulletin on indirect auto lending.[30]

*b. The Recent OMB Memorandum Interpreting CRA*

Under the CRA, Congress tasked OIRA with determining whether agency rules are "major rules" for purposes of the statute.[31] The CRA is silent on the timing of that determination vis-a-vis agency publication of final rules.

On April 19, 2019, the Acting Director of OMB, Russell T. Vought, issued a memorandum that announced new, stricter procedures for Congressional Review Act compliance (OMB Memo).[32] OMB addressed the memorandum, which it termed a "guidance", to all executive departments and agencies, including all Federal bank regulators and other independent Federal agencies. According to OMB, the memorandum takes "full effect" on May 11, 2019.[33]

The OMB Memo took an aggressive position on CRA's compliance requirements in at least three respects. First, in the OMB Memo, Mr. Vought asserted that agencies "should not publish a rule—major or not major—in the *Federal Register*, on their websites, or in any other public manner before OIRA has made the final determination and the agency has complied with the requirements of the CRA."[34] Second, OMB required all independent Federal agencies, when providing ORA with their analyses whether a rule is a "major rule" under the CRA, to comply with OMB's cost-benefit analysis methodology and requirements in OMB Circular A-4 and Part IV of the OMB Memo.[35] Finally, OMB took the position that "guidance documents, general statements of policy, and interpretive rules" are subject to CRA review, in addition to notice-and-comment legislative rules.[36]

*c. The Congressional Review Act Does Not Apply to Guidances*

This last OMB pronouncement followed two separate opinions by the Government Accountability Office (GAO) in 2017 finding that a guidance document[37] and a su-

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[25] Id. §804(2).
[26] Id.
[27] Id. §807.
[28] Id. §805.
[29] Pub. L. No. 115-74, 131 Stat. 1243 (2017); see CFPB, Arbitration Agreements, 82 FR 55,500 (Nov. 22, 2017); CFPB, Arbitration Agreements, 82 FR 33,210 (July 19, 2017).
[30] Pub. L. No. 115-172, 132 Stat. 1290 (2018) (disapproving CFPB, Bulletin re: Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act (Mar. 21, 2013), *https://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf*).
[31] 5 U.S.C. §804(2).
[32] Memorandum from Russell T. Vought titled "Guidance on Compliance With the Congressional Review Act", OMB Memorandum M-19-14 (Apr. 11, 2019), *https://www.whitehouse.gov/wp-content/uploads/2019/04/M-19-14.pdf* (OMB Memo).
[33] Id. at 2.
[34] Id. at 4; see also id. at 5.
[35] Id. at 5.
[36] Id. at 3.
[37] GAO, Office of the Comptroller of the Currency, "Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation—Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending", GAO Opinion No. B-329272 (Oct. 19, 2017), *https://www.gao.gov/assets/690/687879.pdf.*

pervisory bulletin[38] by Federal bank regulators were "rules" and therefore had to undergo CRA review.

The CRA only applies to "rules." The statute defines the term "rule" as having the same meaning as in 5 U.S.C. §551.[39] In turn, 5 U.S.C. §551(4) of the APA defines a "rule" as: "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 . . . ."

Section 551(4) sets forth three requirements to satisfy the definition of a rule. First, there must be an "agency statement of general or particular applicability." Second, that statement must have "future effect." Finally, the agency statement must be "designed to implement, interpret, or prescribe law or policy . . . ."

That is not the end of the story, however. CRA goes on to expressly exclude any rule of particular applicability, any rule relating to agency management or personnel, and any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of nonagency parties from its definition of a "rule."[40] Consequently, nonbinding guidances are not rules under the CRA because they do not substantially affect the rights or obligations of nonagency parties.[41]

In an opinion letter last year, GAO affirmed that the Justice Department's zero-tolerance policy[42] was not subject to CRA review based on that exclusion.[43] According to GAO, "the rights and obligations in question [were] prescribed by existing immigration laws and remain unchanged by the agency's internal enforcement procedures at issue here."[44] In so concluding, GAO relied on Federal case law holding that "rules were 'procedural' . . . when the rules did not have a 'substantial impact' on nonagency parties."[45] GAO reasoned: "Although the memorandum changes previous policy, there is no underlying change in the legal rights of aliens who cross the border."[46]

If we change the phrase "aliens who cross the border" in GAO's letter to "regulated financial institutions," it is hard to understand how a nonbinding guidance by Federal bank regulators is a "rule" for purposes of the CRA when the Justice Department's zero-tolerance policy is not. For as the CFPB emphasized under then-Acting Director Mick Mulvaney last year, "neither an interpretive rule nor a general statement of policy can create new rights and obligations for regulated entities."[47]

Other provisions in the CRA highlight why it is advisable to exclude guidances from the definition of a "rule" for purposes of that statute. Rules that Congress disapproves under the CRA may not be reissued in substantially the same form unless they are specifically authorized by a law enacted after the date of the joint resolution. Nor may an agency issue a new rule that is substantially the same as the original rule that Congress disapproved unless a later statute specifically authorizes the new rule.[48]

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[38] GAO, "Bureau of Consumer Financial Protection: Applicability of the Congressional Review Act to Bulletin on Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act", GAO Opinion No. B-329129 (Dec. 5, 2017), *https://www.gao.gov/assets/690/688763.pdf.*

[39] 5 U.S.C. §804(3).

[40] 5 U.S.C. §804(3).

[41] There is another reason why guidances are not "rules" under the CRA. Because guidances are nonbinding by definition, they do not "take effect." As such, they lack "future effect" for purposes of Section 551(4) of the APA and the CRA. See Adam Levitin, "Congressional Review Act Confusion: Indirect Auto Lending Guidance Edition" (a/k/a "The Past and the Pointless"), *Credit Slips* (Apr. 17, 2018), *https://www.creditslips.org/creditslips/2018/04/congressional-review-act-confusion.html.* This distinction between binding rules that "take effect" and nonbinding guidances has real significance when it comes to the CRA. For the CRA states that a rule cannot "take effect" until the agency submits the rule and its "proposed effective date" to Congress and to GAO. 5 U.S.C. §801(a)(1)(A). It is impossible, however, for an agency to transmit a "proposed effective date" for a guidance that does not take "effect." Strikingly, GAO did not explain how guidances have "future effect" in its 2017 opinions.

[42] The policy instructed Federal prosecutors to give higher priority to certain immigration offenses with the goal of deterring first-time improper entrants along the southwest border. Department of Justice, Office of the Attorney General, Memorandum to Federal Prosecutors along the Southwest Border, Zero-Tolerance for Offenses Under 8 U.S.C. §1325(a) (Apr. 6, 2018).

[43] GAO, U.S. Department of Justice—Applicability of the Congressional Review Act to the Attorney General's April 2018 Memorandum, GAO Opinion No. B-330190, at 1 (Dec. 19, 2018), *https://www.gao.gov/assets/700/696164.pdf.*

[44] Id.

[45] Id. at 4 (citing Brown Express, Inc. v. United States, 607 F.2d 695, 702 (5th Cir. 1979)).

[46] Id. at 5.

[47] CFPB Guidance RFI, supra n. 2, at 13960.

[48] 5 U.S.C. §801(b)(2).

But what does it mean for Congress to disapprove a nonbinding guidance? The answer is murky, to say the least. Take disapproval of a policy statement that adopts Federal judicial decisions construing a statute that the agency is charged with enforcing. Nothing relieves the agency of its statutory duty to carry out the statute. Similarly, nothing prevents the agency from observing the case law discussed in the policy statement when enforcing the statute. This is doubly true when Congress does not amend the underlying statute or relieve the agency of its responsibility to enforce it. Under these circumstances, it is unclear what disapproval of the policy statement actually means.

For these reasons, the text and spirit of the CRA excludes guidances from the definition of "rules."[49] However, there is an even more important reason for not imposing added procedural hurdles such as CRA, which is the adverse effect that doing so would have on regulated parties and the larger financial system.

## IV. Imposing More Procedural Hurdles To Adopting Agency Guidances Is Unwise

Both of the initiatives to put guidances through notice-and-comment proceedings and CRA review are overkill because they would result in serious negative effects on regulated companies and the financial system. In this section, I discuss why it would be counterproductive to impose stiffer procedural requirements on guidances.

If nonbinding agency guidances had to undergo the notice-and-comment procedures in the APA plus CRA review, the negative effect on regulated persons would be palpable. Normally, a fast-track notice-and-comment procedure takes at least 2 years and many rulemakings take longer. Congressional Review Act transmission and review prolongs this process even further.

At a minimum, the new procedural requirements would result in protracted uncertainty and loss of transparency during the periods for notice and comment and CRA review. During the intervening 2-plus years, the public would be in the dark as to the content of the final guidance and the agency's current position. The OMB Memo would prolong that uncertainty and loss of transparency by prohibiting agencies from even publishing final guidances until receiving a go-ahead from OIRA.

The adverse consequences for industry could be even worse, depending on how Federal agencies respond. One way agencies might respond is by elevating nonbinding guidances into binding legislative rules. This would increase the number of binding rules on financial providers and with it, their attendant legal risk and regulatory burden.

Alternatively, agencies might respond by declining to formulate guidances at all. Agencies would have strong internal pressures to choose this path, given the daunting staffing and budgetary challenges of what otherwise would be a vast increase in notice-and-comment proceedings.

Is this what companies really want? Federal bank regulators have statutory responsibility to enforce the existing statutory authorities and binding rules under their jurisdiction. If agencies stopped issuing guidances, they would still be responsible for enforcing those statutes and rules. In the meantime, regulated persons would lack any guidance about agency interpretation of those statutes and rules or about ways to achieve compliance. This could result in precisely the type of "gotcha" enforcement actions that regulated entities complain about and that guidances are designed to avoid. Moreover, we would lose the constraints that guidances may practically place on agency enforcement. Ironically, subjecting guidances to notice-and-comment procedures and CRA review would result in less transparency, not more. Doing so might well leave regulated entities to fend for themselves and produce the "regulation by enforcement" that they intensely dislike.

Putting guidances through notice-and-comment proceedings and CRA scrutiny also is a slippery slope. Clearly, statements of policy and interpretive rules are guidance. Generally, so are official ex ante agency announcements that are labeled as "guidance." But how about individually tailored communications by regulators with specific regulated entities, such as no-action letters, which industry members find valuable?[50] Similarly, would concerns about issuing "guidance" cause examiners to clam up when companies ask them for compliance advice? The CFPB, under the leadership of Mr. Mulvaney, stated in 2018 that it "uses the term guidance . . . broadly to [also] refer to compliance guides and other materials and activities that

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[49] See Levitin, supra n. 41. GAO's and OMB's interpretations to the contrary are only opinions unless and until they are affirmed by the courts.

[50] Securities and Exchange Commissioner Hester Peirce recently described S.E.C. no-action letters as guidance. "SECret Garden: Remarks at SEC Speaks by Commissioner Hester M. Peirce" (Apr. 8, 2019), *https://www.sec.gov/news/speech/peirce-secret-garden-sec-speaks-040819*.

it does not believe are rules within the meaning of the APA . . . ."[51] A sweeping position that all such materials must undergo notice and comment and CRA review would have a severe chilling effect on those materials.

Undoubtedly for these reasons, the Mortgage Bankers Association (MBA) explained last year that "[t]here are times when the costs of public participation outweigh its benefits. . . . [T]he extent of public participation should vary on the nature of the guidance document."[52] The National Association of Realtors has pointed out that "time is of the essence" in certain regulatory situations and argued for "quick responses" in the form of agency guidances in those situations.[53] The MBA similarly called on agencies (and specifically the CFPB) to "frequently revise implementation and compliance support materials to ensure they remain relevant."[54]

Needless to say, companies cannot have it both ways. Imposing notice-and-comment requirements on agency guidance indiscriminately would make these types of quick responses and frequent revisions impossible.[55]

Furthermore, erecting stringent procedural barriers to guidance would pose enormous risks to the financial system and the public writ large. Regulators issue guidance to increase the level of compliance with the law. Losing this vital information source for the bulk of companies that want to comply with banking law would likely increase the level of unsafe and unsound practices and raise the aggregate risk in the financial system.

We cannot afford to take that risk, especially after the devastating losses from the 2008 financial crisis. Currently, leveraged loans pose one of the biggest threats to U.S. financial stability.[56] But after GAO classified the leveraged loan guidance as a "rule" under the CRA, the Comptroller of the Currency lifted that guidance for the biggest players in that market, which are national banks.[57] This is not good for anyone, be it national banks or the financial system at large.

Part of the controversy about guidances involves Matters Requiring Attention (MRAs) and Matters Requiring Immediate Attention (MRIAs) that examiners issue from time to time in individual companies' examinations. Concerns have been raised that some examiners at the Federal prudential banking agencies write up violations of guidance as MRAs and MRIAs.

In addressing this issue, it is important to stress the important role of MRAs and MRIAs in resolving safety and soundness problems and violations of statutes and rules short of initiating enforcement. Without those notices, problems could fester until sanctions were unavoidable or the institution flat-out failed. Requiring all MRAs and MRIAs to go through notice and comment—including those that address unsafe and unsound practices and violations of statutes and rules—would ban them for all intents and purposes. Instead, a better approach would be for senior bank regulators to carefully review proposed MRAs and MRIAs and to train examiners on their appropriate use. Supervised companies can also appeal MRAs and MRIAs through the supervisory appeals process.[58]

In sum, putting nonbinding guidances through notice and comment and CRA review would result in the worst of both worlds. Either agencies would issue even more binding legislative rules or they would enforce their statutes and rules without

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[51] CFPB Guidance RFI, supra n. 2, at 13960. These sorts of "nonrule guidances," to use the Bureau's term, include frequently asked questions, compliance guides, checklists, institutional and transactional coverage charts, webinars, staff manuals, and oral informal guidance in response to individual inquiries. Id.

[52] Letter from the Mortgage Bankers Association to the CFPB on Docket No. CFPB-2018-0013, at 4 (July 2, 2018) (hereinafter MBA Comment Letter).

[53] NAR Comment Letter, supra n. 13, at 1. See also id. at 2 ("compliance bulletins are often useful due to the expedited timeframe for issuance without formal notice and comment procedures . . . .").

[54] MBA Comment Letter, supra n. 52, at 6.

[55] Indeed, the Administrative Conference of the United States has advised that a "Government-wide requirement for inviting written input from the public on policy statements is not recommended, unless confined to the most extraordinary documents." Administrative Conference, supra n. 6, at 6.

[56] See "Financial Stability Oversight Council, 2018 Annual Report" 11-12 (2018), *https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf*; "Office of Financial Research, Annual Report to Congress" 18-20 (2018), *https://www.financialresearch.gov/annual-reports/files/office-of-financial-research-annual-report-2018.pdf.*

[57] "OCC Head Says Banks Need Not Comply With Leveraged Lending Guidance", *Ropes and Gray* (March 1, 2018), *https://www.ropesgray.com/en/newsroom/alerts/2018/03/OCC-Head-Says-Banks-Need-Not-Comply-with-Leveraged-Lending-Guidance.*

[58] See, e.g., CFPB Supervisory Appeals, supra n. 16, at 2; Comptroller of the Currency, OCC Banking Bull. 2013-15 (June 7, 2013), *https://www.occ.treas.gov/news-issuances/bulletins/2013/bulletin-2013-15.html.*

the benefit of guidance. Given these undesirable results, this is an area where Congress should tread carefully.

## V. The OMB Memo Improperly Seeks To Curtail Federal Bank Regulators' Independence

In this final section, I close by discussing other problems with the OMB Memo and specifically its attempt to infringe on the independence of Federal bank regulators.

In the OMB Memo, OMB purports to prohibit independent Federal bank regulators from publishing their final rules on their websites or in the *Federal Register* before OIRA has made its major determination under the CRA.[59] In addition, the memorandum also seeks to prescribe the methodology independent agencies are to use when conducting their cost-benefit (impact) analyses through the back door.[60]

In adopting this stance, the OMB Memo improperly treads on Federal bank regulators' independence and violates Executive Order No. 12,866. Historically, the courts and Federal law have guarded the independence of Federal bank regulators from the Executive Branch to shield the financial system from political intervention for short-term gain.[61] This is why Federal bank regulators are exempt from the requirement that agencies submit their rules to OIRA for review and cost-benefit analysis.[62] This results from the express exemption in Executive Order 12,866 for agencies designated as "independent regulatory agencies" under the Paperwork Reduction Act.[63] The Paperwork Reduction Act's list of independent regulatory agencies includes the CFPB and all other Federal bank regulators.[64]

Because OMB is an arm of the White House,[65] Executive Order 12,866 effectively shields Federal bank regulators from White House review of their rules. The purpose of this carve-out is to ensure the expert neutrality of bank regulators and to insulate those rules from political manipulation by the White House and OMB. Instead, Congress, not the White House, retains ultimate control over Federal bank regulators' rules.

The OMB Memo seeks to intrude on Federal bank regulators' cost-benefit analyses by requiring them to submit a major rule analysis that is consistent with OIRA's cost-benefit analysis methodology. To begin with, it is not clear how Federal bank regulators can even do a meaningful cost-benefit analysis of nonbinding guidance. Beyond that, there are important reasons why Congress exempted cost-benefit analyses by Federal bank regulators from OIRA and OMB oversight in Executive Order 12,866. In financial regulation, it is generally harder to quantify benefits in the form of harms avoided than it is to quantify costs. Federal bank regulators must make numerous rulemaking decisions under conditions of incomplete data and uncertainty. Requiring Federal bank regulators to monetize all harms avoided—which might prove impossible—would dangerously tilt rulemaking analyses toward inaction and the status quo.

In short, Executive Order 12,866 means that OIRA's standards for cost-benefit analyses do not apply to Federal bank regulators' major rule analyses and may not be wielded as a threat to "delay OIRA's determination and an agency's ability to publish a rule and to make the rule effective." OMB's threat to hold up final rules by Federal bank regulators indefinitely for "insufficient or inadequate analysis" in OIRA's view[66] poses the added, serious concern that OMB or OIRA might call a regulator's bluff and press to renegotiate the provisions of a final rule pending publication of the rule's text, with no judicial review. Any attempt to do so would be a blatant affront to Federal bank regulator independence and a rank violation of Executive Order 12,866. Even more seriously, any such move by OIRA would represent an attempt under the unitary executive theory to bottle up rules, detaining them from Congressional review and wresting CRA oversight from Congress in the process. In that respect, it is well known that OIRA has mired final rules of executive agencies indefinitely while conducting its review.

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[59] See OMB Memo, supra n. 32, at 4.
[60] See id. at 5.
[61] See, e.g., Humphrey's Executor v. United States, 295 U.S. 602 (1935).
[62] Exec. Order No. 12,866, 58 FR 51,735, 51,753 (Oct. 4, 1993).
[63] Id.
[64] 44 U.S.C. §3502(5) (2012).
[65] 31 U.S.C. §501 (2012) (establishing OMB as "an office in the Executive Office of the President"). Because OMB resides within the White House, its website is nested within the White House website. See "Office Mgmt. and Budget, White House", *https://www.whitehouse.gov/omb.*
[66] OMB Memo, supra n. 32, at 5.

In the OMB Memo, OIRA implicitly commits itself to making a CRA determination on independent agency rules within 40 days.[67] Fortunately, if OIRA does not respect the 40-day timeframe, no statute or rule stops Federal bank regulators from publishing their rules at that point and transmitting their rules directly to Congress for CRA review. Any suggestion in the OMB Memo to the contrary has no legal effect.

To conclude, nonbinding agency guidances bring important transparency to Federal banking regulation and regulated firms depend heavily on them. In all likelihood, requiring those guidances to go through notice and comment and CRA review would backfire by causing agencies to scrap guidances altogether and increasing the likelihood of the "regulation by enforcement" that industry fears.

[67] Id. The memorandum states that OIRA may inform agencies that rules are not major within 10 days of notification. Other rules must undergo the major rule determination, for which OIRA advises independent agencies to allocate 30 days. Id.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM GREG BAER**

**Q.1.** The Financial Services Roundtable and The Clearing House Association, predecessors of the Bank Policy Institute, have previously requested written guidance from Federal agencies, including:

A. a 2013 request for written guidance from CFPB and HUD on Dodd–Frank mortgage standards;
B. a 2014 request for written guidance from CFPB on the TILA/RESPA integrated mortgage disclosures rule;
C. a 2015 request for guidance from the Federal banking agencies, through the FFIEC, on Call Reports; and
D. a 2016 comment letter suggesting guidance from the Federal Reserve and IRS on the tax consequences of total loss-absorbing capacity (TLAC) rules.

Please provide to the Committee all instances in which the Bank Policy Institute or its predecessors have requested or advocated guidance from the Federal financial institution regulatory agencies since July 21, 2010.

**A.1.** We are unable to provide a full accounting of "all instances" in which BPI or any of its predecessors have requested or advocated guidance. At least in our most recent iteration, we have consistently expressed concern about the agencies use of guidance because that guidance has often been treated as a binding rule through the examination process, even where no public notice was provided or comment sought. Such action is inconsistent with the Administrative Procedure Act and, unless the guidance is submitted to the Congress for review, with the Congressional Review Act. And it is poor Government, in the sense that public comment—not just from banks but other groups or individuals with interest and expertise in banking policy—tends to make for a better rule. Postcrisis, the combination of voluminous issuance of guidance along with agency treatment of that guidance as binding, effectively created a whole new regulatory regime about which the public had no input.

Therefore, we strongly support a 2018 interagency statement that reaffirmed that supervisory guidance "does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance." To the extent that in recent years the agencies have strayed from that practice, we are advocating a return to the appropriate role of guidance: to State the views of the agency, but not create binding obligations on regulated entities.

None of this is to deny that guidance can sometimes play a useful role, as it did until relatively recent times. If treated as nonbinding, guidance can inform regulated entities of agency priorities, and let them know of best (or worse) practices that the agency is observing. It is only when it is treated as binding in practice that we believe it needs to be issued as a rule under the law.

## RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM GREG BAER

**Q.1.** During this hearing, a number of my colleagues floated the idea of a neutral arbiter or an independent ombudsman to represent financial institutions who have concerns with Federal regulators' overreach. Would you support such a proposal? If so, what should this review process look like? What review powers do you believe the arbiter should have? If you do not support the proposal, please explain why.

**A.1.** We support the idea of a neutral arbiter for financial institutions concerned with regulatory overreach, but would caution that its utility can be quite limited. Each of the banking agencies currently has an intra-agency appeals process and an ombudsman, but a recent article that analyzed the process and outcomes of those regimes concluded that they were a failure. See Hill, Julie Anderson, "When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations", *Washington University Law Review* (2015). *https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/5/*

In sum, banks are loathe to appeal any adverse determination, for two reasons. First, and most significantly, they fear retaliation through the examination process. Moreover, this may seem like overreaction needing to be addressed by the institutions, but one must keep in mind that failing to address examiner concerns can result in a downgrade to the bank's Management rating. As noted in my testimony, such a downgrade—and until relatively recently—any unremediated examiner mandate—can act as a prohibition on expansion by the bank. And that prohibition is nonpublic and therefore effectively nonappealable. Second, appeals are made to the same agency that made the initial determination, and thus unlikely to succeed.

While the second concern could be resolved by allowing appeal to a third party, the first would remain. Therefore, we believe that reform in this area should focus more on requiring the agencies to adhere to statutory standards for deciding whether a firm can expand, rather than employing a "penalty box" approach, and revisiting the CAMELS rating regime to make it more objective, as the current approach is to make the most subjective of its component (Management) the most significant.

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## RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM MARGARET E. TAHYAR

**Q.1.** During this hearing, a number of my colleagues floated the idea of a neutral arbiter or an independent ombudsman to represent financial institutions who have concerns with Federal regulators' overreach. Would you support such a proposal? If so, what should this review process look like? What review powers do you believe the arbiter should have? If you do not support the proposal, please explain why.

**A.1.** Stronger ombudsmen and examination appeals processes are needed to start the cultural change. Recent efforts by the banking regulators to strengthen the authority of their internal ombudsmen and their examination review processes are welcome signs of

progress. I do not think that an external ombudsman outside of the banking agencies is the optimal structure; instead, more power and authority should be given to the current ombudsmen. Strong ombudsmen and robust appeals processes will not, however, be enough because of legitimate fears of retaliation despite attempts to provide protection against such retaliation. The root causes also need to be addressed. These are lack of transparency, limitations on the practical ability of the agency principals to oversee the supervisory staff's compliance with applicable legal restrictions on their discretion, the lack of any clear limits on the supervisory discretion to classify any shortcoming as a safety and soundness violation based on an individual supervisor's policy preferences, and the lack of legal training for bank supervisors. Congress should also focus on this more fundamental reform. Increased transparency of the supervisory process, including appropriate limits on the perimeter of what can be classified as confidential supervisory information or as safety and soundness violations, as well as better oversight of the supervisory staff's compliance with applicable legal restrictions on their discretion and better training about such legal restrictions, would increase the odds that supervisory staff would become more accountable to the public and agency leadership.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA FROM MARGARET E. TAHYAR**

**Q.1.** In your experience, what is the best approach to balance the competing demands of providing regulatory clarity while ensuring rigorous supervision that protects the safety and soundness of the U.S. financial system?

**A.1.** The best approach is to narrow the realm of confidential supervisory information to the core minimum necessary to protect financial stability or individual bank safety and soundness. As a bank regulatory lawyer, I fully recognize that some secrecy is needed to ensure candid conversations and protect the financial system. Yet we need to move away from the current situation, in which nearly anything a bank gives its regulator in the course of the supervisory process might be transformed into confidential supervisory information, with all the attendant consequences. Part of the solution is for bank examinations to return to a focus on the quantitative core and move away from qualitative judgments that reflect examiner policy preferences on how to run the business—the examiner as management consultant. Ultimately, however, confidential supervisory information is a creature of regulation, not etched in stone, and Congress can exert pressure on the banking agencies to reform their approach or even take legislative action to force change if needed.

Regulators should also take efforts to increase transparency, even within the current bounds of confidential supervisory information. In particular, the banking agencies should strive to release more granular data on the state of banking supervision, aggregated across the industry to anonymize the information. The Federal Reserve's November 2018 and May 2019 Supervision and Regulation Reports represent admirable efforts in the right direction. The banking sector is a critical part of our economy and the banking

agencies are a critical part of our Government, so it is imperative that bank supervisors are accountable to the public.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM PATRICIA A. MCCOY**

**Q.1.** Congress designed Federal regulatory agencies to be independent from the President's continuing influence so that they could make rules for our economy based on technocratic analysis and data, rather than political considerations. Can you describe why independence at regulatory agencies is critical?

**A.1.** Congress wisely conferred independence on Federal regulatory agencies for the long-term welfare of the American people. Independence promotes the general good in several important ways. First, it helps ensure that regulators will make informed decisions on the basis of data, scientific expertise, and facts. Second, it insulates regulators from pressure by the President and the Executive Branch to rig decisions in order to boost the reelection prospects of the President or the President's political party, to the detriment of the public generally. Such pressure could occur in at least two scenarios. Pressure might be exerted to curry favor with politically powerful industries or groups in tacit exchange for campaign contributions. Alternatively, the White House could lean on regulators to stimulate the economy in order to win election, indifferent to the long-term risks to the economy. Finally, independence helps shelter Federal regulators from lobbying by politically powerful and well-oiled industry interests seeking exceptions from regulatory actions that are designed to protect the American people. Independence, simply put, helps ensure that Federal regulators make decisions for the betterment of ordinary families and not as political favors.

**Q.2.** After abusive mortgages crashed the economy in 2008, you led the team at the Consumer Financial Protection Bureau (CFPB) that wrote the rules to fix the mortgage market and prevent another financial crisis. Can you describe, broadly, who wrote those rules and what evidence they used?

**A.2.** When Congress charged the CFPB with promulgating the mortgage rules in the Dodd–Frank Act, ensuring sustainable mortgages while advancing access to credit and minimizing industry burden were of uppermost importance to the Bureau. For this reason, the CFPB's mortgage rules were the product of extensive factual research, mortgage expertise, and public consultation. The economists, lawyers, and markets experts in the Bureau's Research, Markets, and Regulations Division took the lead in drafting the mortgage rules, following voluminous written public comment and outreach to all affected parties, including consumers, financial providers, independent researchers, community housing organizations, industry associations, consumer advocacy groups, and sister State and Federal regulators. In the rulemaking for the integrated mortgage disclosures, the Bureau even posted each new draft of the prototype disclosures online and asked the crowd to suggest needed improvements. Based on the public's suggestions, the Bureau then improved the draft and posted the next version online. This crowdsourcing was repeated every month and the public eventually

submitted over 30,000 comments on the prototype forms. I can say from personal experience that the final disclosure forms were markedly better due to this public input.

Meanwhile, the Bureau's economists and researchers drew heavily on a wide assortment of other empirical data in designing the mortgage rules. Much of that data came from large national data sets reporting every residential mortgage origination in specific channels over a substantial time period. These data sets contained tens of millions of observations and allowed the Bureau's researchers to conduct sophisticated analyses of the projected effect of different rules on expected default rates, the cost of credit, and access to credit. In other instances, the Bureau created data sets to analyze questions such as the size of potential legal liability to lenders from specific types of mortgage rules. Separately, the CFPB's markets analysts conducted ongoing, in-depth studies of the business models and earnings reports of mortgage lenders to ensure that mortgage lending remained profitable and sustainable following adoption of the rules. This was augmented by CFPB analysis of the vast economics literature on the effects of residential mortgages and specific types of regulatory intervention on key outcomes such as delinquencies and cost of credit. In one notable instance—the integrated mortgage disclosure rule—the CFPB used the most sophisticated field testing available to ensure that the disclosure rule was broadly understandable and useful to consumers and industry participants.

**Q.3.** When you were writing the rules at CFPB, President Obama was in the White House and his appointees were leading the agency. Did you ever submit CFPB rules to the White House for review? Why or why not?

**A.3.** Neither I nor the CFPB submitted CFPB rules to the White House or the Office of Management and Budget (OMB) for review. This practice conformed to the Dodd–Frank Act, which prohibits OMB from asserting "jurisdiction or oversight over the affairs or operations of the Bureau." 12 U.S.C. §5497(a)(4)(E). Furthermore, this practice comported with Executive Order No. 12,866, 58 FR 51,735, 51,753 (Oct. 4, 1993), which exempts all Federal bank regulators, including the CFPB, from the requirement that agencies submit their rules to OMB for review and cost-benefit analysis. This express exemption applies to agencies designated as "independent regulatory agencies" in the Paperwork Reduction Act. The Paperwork Reduction Act's list of independent regulatory agencies includes the CFPB and all other Federal bank regulators. 44 U.S.C. §3502(5) (2012).

This exemption from OMB review of rules is a crucial mainstay of Federal bank regulators' independence. Because OMB is located within the White House and is subject to White House control, any provision requiring the CFPB and/or other Federal bank regulators to submit their rules to OMB would open up their rulemaking processes to White House pressure for short-term political benefit. Effectively, Executive Order No. 12,866 shields the CFPB and other Federal bank regulators from White House review of their rules. The purpose of this carve-out is to ensure the expert neutrality of CFPB rules and to insulate those rules from political manipulation

by OMB and the White House. Instead, Congress, not the White House, retains ultimate control over CFPB rules.

**Q.4.** On April 11, 2019, Acting OMB Director Russel Vought sent a memo to all heads of executive departments and agencies, including independent agencies, creating a "systematic process to determine whether rules that would not be submitted to OIRA . . . are major,"[1] a determination that should be made by looking at whether a rule will cost $100 million or more annually, will cause a major increase in costs or prices, or will have a significant adverse effect on players in the market. Are you concerned that the review of the cost-benefit analysis by OIRA of rules promulgated by independent agencies could substantively affect the rules?

**A.4.** I am deeply concerned that the OMB's back-door attempt to subject rules promulgated by independent agencies to cost-benefit analysis by OIRA could distort the content of those rules, to the detriment of the American public.

The April 11, 2019, OMB Memo[2] seeks to intrude on independent agencies' rulemaking autonomy by requiring them to submit major rule analyses under the Congressional Review Act (CRA) that are consistent with OIRA's cost-benefit analysis methodology. However, there are important reasons why Congress exempted cost-benefit analyses by independent agencies from OIRA and OMB oversight in Executive Order No. 12,866. One reason, discussed above, is to protect independent agencies from White House pressure for purposes of political gain. Another reason, discussed in my response to Senator Cortez Masto's Question 1, involves the precautionary nature of many rules by independent agencies. Precautionary rules are ones that seek to avoid harm. These types of rules pose challenges in cost-benefit analyses, because quantifying harms avoided is generally more difficult than quantifying costs. Because OIRA's cost-benefit methodology gives no or little weight to benefits that cannot be quantified, OIRA's methodology overweights costs and thus biases rulemaking decisions in favor of agency inertia. As such, OIRA's approach is poorly suited to a precautionary approach to harm.

Here, it bears emphasizing that the OMB Memo lacks legal validity as applied to independent agencies. Executive Order No. 12,866 means that OIRA's standards for cost-benefit analyses do not apply to independent agencies' major rule analyses and may not be wielded as a threat to "delay OIRA's determination and an agency's ability to publish a rule and to make the rule effective." OMB's threat to hold up final rules by independent agencies indefinitely for "insufficient or inadequate analysis" in OIRA's view (see OMB Memo at 5) poses the added, serious concern that OMB or OIRA might call a regulator's bluff and press it to renegotiate the provisions of a final rule pending publication of the rule's text, with no judicial review. Any attempt to do so would be a blatant affront to agency independence and a rank violation of Executive Order

[1] Office of Management and Budget, "Guidance on Compliance With the Congressional Review Act", Russell T. Vought, April 11, 2019, *https://www.whitehouse.gov/wp-content/uploads/2019/04/M-19-14.pdf.*

[2] Memorandum from Russell T. Vought titled "Guidance on Compliance With the Congressional Review Act", OMB Memorandum M-19-14 (Apr. 11, 2019), *https://www.whitehouse.gov/wp-content/uploads/2019/04/M-19-14.pdf* (OMB Memo).

No. 12,866. Even more seriously, any such move by OIRA would represent an attempt to bottle up rules, detain them from Congressional review, and wrest CRA oversight from Congress in the process. OIRA has mired final rules of executive agencies indefinitely while conducting its review in the past and there is reason to think the same would occur if independent agencies had to submit the cost-benefit analyses of their rules to OIRA.

**Q.5.** This review "applies to more than just notice-and-comment rules; it also encompasses a wide range of other regulatory actions, including, inter alia, guidance documents, general statements of policy, and interpretive rules."[3] How will the mandatory submission of guidance documents for review affect the ability of agencies to do their jobs?

**A.5.** Please see my response to Question 3 from Senator Cortez Masto.

**Q.6.** If Donald Trump was president when you were writing the mortgage rules in 2011 and his OMB demanded the opportunity to review cost benefit analysis as it just did, what do you believe could have happened to those rules?

**A.6.** Please see my response to Question 4 above. The CFPB used rigorous cost-benefit analyses in the mortgage rules. Despite the strong foundation supporting those rules, the OMB Memo, had it been in effect at the time, would have raised concerns that OMB might have withheld the major rule determination required by the Congressional Review Act on grounds that the CFPB's regulatory impact analyses did not adhere to OIRA's cost-benefit analysis methodology.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM PATRICIA A. MCCOY**

**Q.1.** In our discussion, you raised concerns with the OMB memo specifying the methodology for cost-benefit analysis. Do you believe there is a better process by which to determine cost-benefit or a rulemaking or guidance?

**A.1.** To answer this question, it is necessary to distinguish between regulations and guidances. In the case of regulations, the most important consideration is preserving the discretion of the independent Federal bank regulators to determine the appropriate methodology for their regulatory impact or cost-benefit analyses. Federal bank regulators take regulatory impact analyses extremely seriously. Since the enactment of the Dodd–Frank Act, they have strengthened and refined their regulatory impact and cost-benefit analyses, particularly given the heightened judicial scrutiny that those analyses now receive after the D.C. Circuit's decision in Business Roundtable v. Sec. and Exch. Comm'n, 647 F.3d 1144, 1148 (D.C. Cir. 2011).[1]

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[3] Id.

[1] See, e.g., Board of Governors of the Federal Reserve System, Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings 9, 20 (June 2011), *http://oig.federalreserve.gov/reports/Congressional-Response-economic-analysis-2011web.pdf* (stating that the Federal Reserve "conducts its rulemaking activities in a manner that is generally consistent with the philosophy and principles outlined in the Executive orders" and suggesting that the Federal Reserve acts consistently with at least some aspects of the guid-

An overly rigid cost-benefit methodology that required quantification of all costs and benefits could jeopardize financial institutions' solvency, consumer welfare, or financial stability. That is because in financial regulation, it is generally harder to quantify benefits in the form of harms avoided than to quantify costs. Federal bank regulators must make numerous rulemaking decisions under conditions of incomplete data and uncertainty. Requiring Federal bank regulators to monetize all harms avoided—which might prove impossible—would dangerously tilt rulemaking analyses toward inaction and the status quo.

In the case of guidances, it is difficult or impossible to conduct regulatory impact or cost-benefit analyses because guidances are not binding on private third parties and therefore do not impose defined costs.

**Q.2.** In your testimony, you raise concerns regarding political influence on our Nation's economy and financial system. Can you elaborate on the potential harms political influence on our financial system may have?

**A.2.** Insulating bank regulation from political influence is vital to the long-term economic welfare of our Nation and the American public. A couple of examples illustrate why this is the case. If Federal bank regulators lacked independence, a President could pressure those agencies to deregulate the banking industry to an excessive degree in order to increase bank lending, goose the economy, and boost the President's reelection prospects. If the ensuing deregulation resulted in unwise lending and an eventual spike in loan delinquencies, the economy might experience a short-term bump but long-term losses. In a similar way, White House pressure on the Federal Reserve Board to lower interest rates could stimulate the economy in the short term, to the President's political benefit, but inflict harm on the economy in the long term by stoking inflation and reducing the buying power of ordinary Americans.

**Q.3.** Could you discuss the potential impact that a drawn out OIRA review or Congressional Review Act process on guidance could have on the markets, or the economy as a whole?

**A.3.** As I noted in my written testimony (p. 9 [p. 54 herein]), notice-and-comment proceedings for major rules take at least 2 years and normally longer. Congressional Review Act transmission and review prolong this process even further.

Imposing those same procedures on guidance would have unintentional effects redounding to the detriment of markets or the economy as a whole. For instance, agencies might respond by issuing pronouncements that otherwise would be nonbinding guidances as binding legislative rules. This would put a drag on financial firms by unnecessarily increasing the number of binding rules they had to observe and raising their legal exposure for violation of those new rules. If the financial sector became less efficient and

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ance in OMB Circular A-4); GAO Report GAO-12-151, Dodd–Frank Act Regulations: Implementation Could Benefit From Additional Analyses and Coordination 12 (Nov. 2011), *http://www.gao.gov/new.items/d12151.pdf* (reporting statements by the Federal Reserve Board, FDIC, NCUA, and OCC that their agencies follow OMB's guidance in spirit or principle. CFPB officials also stated that the Bureau expects to follow the spirit of OMB's guidance, "in a manner consistent with the Dodd–Frank Act, which speaks directly to the consideration of benefits, costs, and impacts").

increasingly cautious in lending and investment as a result, the larger economy could suffer adverse knock-on effects in the form of reduced access to capital and credit.

Alternatively, agencies might respond to more onerous guidance procedures by issuing fewer compliance guidances or none at all. This would hurt honest companies' efforts to comply with regulations, because many guidances are designed to aid industry with compliance. As a result, firms would face increased legal exposure for violations of rules, with a potential negative impact on earnings and their willingness to take reasonable business risks. Any such excessive business caution could dampen the financial sector and reduce credit and investment to the economy as a whole.

**Q.4.** Some of your fellow witnesses raised concerns regarding the opacity of the Matters Requiring Attention (MRA) and the Matters Requiring Immediate Attention (MRIA) process, and have suggested giving financial institutions a process by which to arbitrate or contest these actions. Would you support such a process and if so, why? If not, please explain why.

**A.4.** Depository institutions and their holding companies already have several avenues of recourse to challenge MRAs and MRIAs with which they disagree (see pp. 4–5 [50–51 herein] of my written testimony). First, they can meet privately with examiners and their supervisors to propose changes to or contest those actions. Second, all Federal bank regulators maintain ombudsmen whom financial institutions can enlist to help resolve any problems from MRAs and MRIAs. Third, Federal bank regulators all have procedures for formal agency reviews of examination results, including MRAs and MRIAs. And fourth, the banking industry can informally petition Federal bank regulators to reduce the burden of MRAs and MRIAs through across-the-board reforms. Indeed, in response to banking industry calls, the Board of Governors of the Federal Reserve System proposed a guidance in 2017 that would reduce the burden on financial institutions' boards of directors to respond to MRAs and MRIAs. See Federal Reserve System, "Proposed guidance on Supervisory Expectation for Boards of Director", 82 FR 37219 (Aug. 9, 2017).

In view of these multiple avenues of relief from MRAs and MRIAs, there is no justification for tying Federal bank supervisors in knots by conferring depository institutions with a right to arbitrate MRAs and MRIAs. Such a cumbersome procedure would intensify the problem experienced during the lead-up to the 2008 financial crisis, when Federal bank examiners routinely failed to insist that institutions address and resolve outstanding MRAs and MRIAs from their prior examinations and regularly failed to take enforcement for persistent unsafe and unsound practices. IndyMac Bank, F.S.B., was an especially egregious example, but it was not alone. See Office of Inspector General, Department of the Treasury, *Safety and Soundness: Material Loss Review of IndyMac Bank*, FSB 17-19, 24-26, 33-34, 63-70 (OIG-09-032, Feb. 26, 2009). This widespread regulatory inaction contributed to the 2008 financial crisis and its fallout. If anything, the regulatory inaction that culminated in the crisis of 2008 underscores the importance of preserving today's stronger MRA and MRIA process, not weakening it

through rigid arbitration procedures. Adopting such arbitration procedures would embolden unsafe institutions to discourage Federal examiners from writing up needed MRAs and MRIAs, thereby endangering the Deposit Insurance Fund, uninsured depositors, and the banking system as a whole.

**Q.5.** During this hearing, a number of my colleagues floated the idea of a neutral arbiter or an independent ombudsman to represent financial institutions who have concerns with Federal regulators' overreach. Would you support such a proposal? If so, what review powers do you believe the arbiter should have? If you do not support the proposal, please explain why.

**A.5.** Federal statutes already provide financial institutions that are aggrieved by Federal regulators' actions with a neutral, independent arbiter in the form of Article III courts. Under the Administrative Procedure Act (APA), aggrieved institutions can seek federal judicial review of a broad array of final agency actions, including rules and agency enforcement. 5 U.S.C. §§701–706. This right to Article III judicial review is on top of the multiple avenues of internal agency relief to which financial institutions are entitled (see pp. 4–5 [50–51 herein] of my written testimony).

Superimposing the right to another neutral arbiter or independent arbiter would be unwise and potentially disastrous. First, it would undermine the carefully drafted procedures in the APA for independent, neutral judicial review and the judiciary's constitutional responsibility for conducting that review. Second, it would supplant the judgment of Federal bank regulators with decisions by outside arbiters who lack responsibility for the safety of the larger financial system. Especially in this era of heightened systemic risk, that would be a dangerous path to tread. Finally, it would hamper the nimbleness of Federal bank regulators to respond to emerging threats by bogging them down in unnecessary and time-consuming procedures.

**Q.6.** In your conversation, you discussed improvements to the MRA and the MRIA process. What are the problems with the current process? What reforms do you believe need to be made to the process? Do you believe there should be a threshold of some sort for what MRAs and MRIAs go through the process?

**A.6.** It would be a mistake to hamstring Federal bank regulators' ability to cite depository institutions for unsafe and unsound practices and seek remediation of those practices by legislating artificial limits on the MRA and MRIA process. Regulators need full latitude to address practices that threaten the safety and soundness of depository institutions and MRAs and MRIAs are important to that flexibility and discretion. To the extent that the MRA and MRIA process could benefit from streamlining, that should be resolved through transparent engagement with the public by Federal bank regulators. The banking industry is fully capable of exploring any needed reforms with regulators and, indeed, those discussions have already set in motion a pending guidance by the Federal Reserve Board to reduce the demands imposed by MRAs and MRIAs. See Federal Reserve System, "Proposed Guidance on Supervisory Expectation for Boards of Director", 82 FR 37219 (Aug. 9, 2017).

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

**LETTER SUBMITTED BY CBA**

HELPING FINANCE THE AMERICAN DREAM SINCE 1919.

April 30, 2019

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
U.S. Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
U.S. Senate
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the Consumer Bankers Association (CBA), I write to share our comments on the Senate Banking Committee's hearing entitled "Guidance, Supervisory Expectations, and the Rule of Law: How do the Banking Agencies Regulate and Supervise Institutions?". CBA is the voice of the retail banking industry whose products and services provide access to credit for consumers and small businesses. Our members operate in all 50 states, serve more than 150 million Americans, and collectively hold two-thirds of the country's total depository assets.

**The Role of Guidance**

CBA supports a regulatory framework that provides clear rules of the road which have been vetted through formal notice and comment periods. The rulemaking process, as mandated by the Administrative Procedure Act and the Dodd-Frank Act, is time consuming for a reason: it demands agencies adhere to a strict process that invites those who are affected by a proposal to have a say in the creation of the rule. While we are strong proponents of formal rulemaking, we also recognize there is an appropriate role for regulatory guidance to provide financial institutions with needed clarity.

Unfortunately, the Consumer Financial Protection Bureau (CFPB) under the leadership of former Director Cordray tested the boundaries of the use of guidance when it issued its 2013 bulletin on indirect auto lending. This was a clear example of the Bureau overstepping its authority and Congress agreed by revoking this form of guidance in 2018.

To ensure proper rulemaking and instructive guidance is issued for future CFPB actions, CBA supports previously introduced bi-partisan legislation known as the GUIDE Act, which would provide greater clarity to what constitutes guidance, improve compliance with consumer financial protection laws, and bring predictability to the Bureau's rulemaking. The bill would require the Bureau to issue guidance necessary or appropriate to comply with consumer protection laws. It would provide for public notice and a comment period for the issuance, amendment, or revocation of guidance, with clear timelines for industry. It would provide liability protection for acting in good faith in accordance with guidance. The bill would also create a penalty matrix that would require the Bureau to publish penalty guidelines that determine the size of any civil monetary penalties issued by the Bureau based on the severity of the violation of Federal consumer law. By requiring the Bureau to issue clear guidance and rules, the financial services industry can build and offer products and services with greater clarity.

1225 EYE STREET, NW, SUITE 550, WASHINGTON, D.C. 20005
consumerbankers.com

**Supervision**

Bank examinations are an essential function of the regulatory process that oversees financial institutions and ensures compliance with regulations and adherence to safety and soundness standards. It is critical prudential bank examiners and CFPB examiners be experienced, competent and conduct their jobs without pre-judgement. Unfortunately, it has been the experience of some CBA members that CFPB examiners have had little to no experience making examinations disjointed, overly burdensome, and time consuming. CBA also strongly encourages the CFPB to promote a level regulatory playing field through the robust supervision of nonbanks, who are playing an increasingly large role in mortgage originations and consumer deposit taking, among other areas.

In addition, CBA supports a supervisory structure that allows financial institutions to have an independent third party review disputes on supervisory actions and provide impartial rulings. In the 115th Congress, CBA supported H.R. 4545, the Financial Institution's Examination Fairness and Reform Act. This bill would provide additional clarity to the examination process and allow banks and credit unions the right to have supervisory determinations reviewed by the newly created Independent Examination Review Director that would be housed under the Federal Financial Examinations Institution Council (FFIEC). The bill would also require reasonable time limits for examiners to provide their findings to the institutions they oversee. CBA encourages Congress to support this legislation to increase impartiality and help streamline the examination process for banks and credit unions.

**Regulatory Coordination**

CBA member banks are often supervised by multiple federal regulators (not to mention the state regulatory bodies that supervise state chartered banks). A single financial services company can be examined by the Federal Reserve, the OCC, the FDIC, and the CFPB. In some cases, more than one agency is examining a bank for similar or related issues, each with a slightly different set of lenses. The same documents can be requested, or variations can be sought, and similar inquiries can be made to the same people. Better coordination is needed to minimize the cost and burden to the financial institutions, permitting them to better serve their customers.

In a similar vein, enforcement can be a multiple agency process, with each agency taking on the same issue and imposing its own penalties for related violations. At times this appears to be driven by a desire to demonstrate its regulatory authority and not defer to any other regulatory body, but this duplication is an unnecessary cost that ultimately reduces the effectiveness of the entire enforcement process. The Treasury Department, in its 2017 report on financial services, recommended a single entity act as a coordinator of these regulatory actions. CBA encourages Congress to take a closer look at the benefits this approach to increased regulatory coordination would have on efficiency.

Thank you for the opportunity to share our thoughts on the financial regulatory framework, and particularly the role of guidance and supervision. CBA looks forward to working with you to ensure the U.S. financial regulation is structured in a way that promotes a safe and competitive marketplace which can meet consumers financial needs.

Sincerely,

Richard Hunt
President and CEO
Consumer Bankers Association

## LETTER SUBMITTED BY CUNA

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, DC 20003-3799

April 30, 2019

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of America's credit unions, I am writing regarding the Committee's upcoming hearing: "Guidance, Supervisory Expectations, and the Rule of Law: How do the Banking Agencies Regulate and Supervise Institutions?" The Credit Union National Association (CUNA) represents America's Credit Unions and their 115 million members.

In response to this important topic, we would like to highlight for the Committee our recent letter to the Consumer Financial Protection Bureau (CFPB or Bureau) regarding the Bureau's supervision of the nation's not-for-profit credit unions. Please find the attached April 22, 2019, letter to CFPB Director Kathy Kraninger.

In summary, Section 1025 of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (the Dodd-Frank Act) conveys supervision and enforcement authority with respect to consumer financial protection laws for credit unions with assets greater $10 billion to the Bureau.[1] At the end of 2018, only nine of the nearly 5,500 credit unions had assets greater than the $10 billion threshold and were therefore subject to Bureau's examination and enforcement authority.

For the reasons specified in our letter, we argue that not only does the Bureau have the authority to delegate the supervisory responsibilities for credit unions with more than $10 billion in assets to the National Credit Union Administration, but it should do so based on credit unions' deep history of consumer protection, the support this action has received from NCUA, the protections in the Dodd-Frank Act that preserve the Bureau's authority, and the opportunity this action presents to reallocate supervisory resources to other critical Bureau priorities.

On behalf of America's credit unions and their 115 million members, thank you for the opportunity to share our thoughts on the supervision of financial institutions and the appropriateness of the CFPB delegating authority to NCUA.

Sincerely,

Jim Nussle
President & CEO

**Attached:** Letter to CFPB Director Kraninger re: the Bureau's authority to delegate supervision of credit unions over $10 billion in assets to the National Credit Union Administration

[1] 12 U.S.C. § 1551

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, DC 20003-3799

April 22, 2019

The Honorable Kathy Kraninger
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Dear Director Kraninger:

On behalf of the Credit Union National Association (CUNA), I am writing to urge you to exercise the Consumer Financial Protection Bureau's (Bureau) authority to delegate supervision of credit unions over $10 billion in assets to the National Credit Union Administration (NCUA). CUNA represents America's credit unions and their 115 million members.

**General Comments**

Section 1025 of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (the Dodd-Frank Act) conveys supervision and enforcement authority with respect to consumer financial protection laws for credit unions with assets greater $10 billion to the Bureau.[1] At the end of 2018, only nine of the nearly 5,500 credit unions had assets greater than the $10 billion threshold and were therefore subject to Bureau's examination and enforcement authority. For the reasons stated herein, we argue that not only does the Bureau have the authority to delegate the supervisory responsibilities for credit unions with more than $10 billion in assets to the NCUA, but it should do so based on credit unions' deep history of consumer protection, the support this action has received from NCUA, the protections in the Dodd-Frank Act that preserve the Bureau's authority, and the opportunity this action presents to apply these supervisory resources to other critical Bureau priorities.

**The Bureau Has the Authority to Delegate Supervision of Credit Unions with More than $10 billion in assets to the NCUA**

The Bureau can delegate its examination and enforcement over the nine largest credit unions to the NCUA by exempting these credit unions from section 1025 of the Dodd-Frank Act using authority Congress granted the Bureau under section 1022(b)(3)(A). This provision states that the Bureau:

> *[M]ay conditionally or unconditionally exempt any class of covered persons . . . from any provision of this title, or from any rule issued under this title, as the Bureau determines necessary or appropriate to carry out the purposes and objectives of this title, taking into consideration the [following] factors [as appropriate]: (i) the total assets of the class of covered persons; (ii) the volume*

[1] 12 U.S.C. § 1551

> *of transactions involving consumer financial products or services in which the class of covered persons engages; and (iii) existing provisions of law which are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections.*[2]

The statutory language is unambiguous: The Bureau has the authority to *conditionally or unconditionally* exempt *any class of covered person*—including credit unions—from *any provision* of Title X of the Dodd-Frank Act—including the provisions related to Bureau-conducted examinations. The exemption of credit unions with over $10 billion in assets from Bureau-conducted consumer financial protection examinations could be conditioned upon the NCUA conducting those examinations, in practical effect this would be a delegation of authority.

In addition, the section goes on to state this authority may be executed after—as appropriate—the Bureau considers the three enumerated statutory factors. Taking these factors into consideration reinforces the Bureau's ability to use this authority to delegate supervision of credit unions with more than $10 billion in assets to the NCUA. With respect to the first factor, credit unions' total combined assets are far fewer than the total combined assets of banks—and even some individual banks—as well as other financial institutions subject to the Bureau's authority. While the credit unions with more than $10 billion in total assets are large credit unions, they all are small financial institutions. Similarly, with respect to the second factor, while the transaction volumes of the largest credit unions may be greater relative to other credit unions, the transaction volumes are far fewer than comparable banks. And, with respect to the third, the Bureau would not completely cede control over credit unions with this delegation, as the Bureau would still retain rulemaking authority over consumer protection regulations that impact all credit unions, and the Bureau also could participate in examination and enforcement decisions should it determine such involvement necessary.

**The Bureau Should Transfer Examination and Enforcement Authority of the Largest Credit Unions to the NCUA**

Without question, the Bureau could use its authority under section 1022 to delegate supervisory authority of the credit unions with more than $10 billion in assets to NCUA. Here is why the Bureau should do this:

*Credit Unions' Structure and Mission Are Unique in the Financial Services Sector and Provide Credit Union Members with Extraordinary Protections and Benefits Not Enjoyed by Users of Other Providers*

As not-for-profit financial cooperatives dedicated to promoting thrift and providing access to credit for provident purposes to their members, credit unions have a structure and statutory mission that make them unique in the financial services sector and afford consumers with substantial protections they do not enjoy when using other providers. Credit unions' structure and mission provides them fundamentally different operating motives compared to for-profit banks and nonbank providers which result in credit unions putting their member-owners first. Predicated on a one-member, one-vote franchise, the member-owner relationship that credit

[2] 12 U.S.C. § 5512(b)(3).

union members have with their credit union ensures that the credit union is operated by its members, for its members; in contrast, users of for-profit institutions have no control over the decisions the institution makes. There is no question that an institution operates in the best interest of those who control it; for credit unions, the control rests in the hands of the member-owners. We encourage the Bureau to recognize that the credit union structure and mission affords consumers extraordinary consumer protections that no other provider offers.

Credit unions' "people helping people" approach has resulted in credit unions' long and deep history of providing their members with safe and affordable financial services. A substantial body of evidence exists to suggest that credit unions are not engaged in the abusive activity that the Bureau was designed to mitigate.

Data from the Bureau's Consumer Complaint Database clearly shows how differently credit unions treat their members compared to other providers. At the highest level, each of the five largest banks has been the subject of more consumer complaints individually than the entire credit union industry. Overall, credit unions have been subject to 8,336 complaints since the Bureau began accepting consumers complaints. This represents 0.66% of all complaints submitted to the Bureau.

Analysis of data published by NCUA and banking regulators suggests that credit unions provide significant economic benefit to the consumers they serve.[3] In recent years, credit union members have benefited by as much as $12 billion because credit unions offer lending products at lower interest rates, saving products with higher rates of return, and other services with lower fees. In addition, the presence of credit unions in the marketplace has benefited consumers of other providers' services an additional $4 billion.

If the data from the Bureau and other regulators is insufficient to demonstrate just how well credit unions treat their members, consider what consumers say. In 2018, *Consumer Reports* reported that credit unions are among the highest rated services that they had ever rated, with 96% of members highly satisfied.[4]

Despite this record, credit unions have been subjected to one-size-fits-all regulatory requirements that have driven the cost of compliance to more than $6 billion annually. To make matters worse, compliance costs for credit unions are growing more than three times the rate on inflation. Much of these costs are to comply with regulations designed to mitigate abuses and activity that credit unions have not perpetrated.

Given the dearth of consumer complaints regarding credit unions, the substantial economic benefit they provide consumers, the extraordinarily high level of satisfaction consumers have toward credit unions and the substantial and rapidly growing cost of compliance with one-size-fits-all regulation for credit unions, the Bureau should delegate its supervisory authority over credit unions to the NCUA to allow this function to be conducted in conjunction with credit unions' safety and soundness examinations, thereby reducing regulatory burden for these credit unions without sacrificing important consumer protection.

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[3] Credit Union National Association. Membership Benefit Report. Year End 2018. *Available at:* https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/National-MemberBenefitsD18.pdf
[4] Consumer Report. "Best and Worst Banks According to Consumer Reports Members." Mar. 24, 2018. *Available at:* https://www.consumerreports.org/banks/best-and-worst-banks-and-credit-unions/

*NCUA Has Encouraged the Bureau to Take This Action*

In July 2017, then-NCUA Chairman McWatters wrote to then-Bureau Director Cordray requesting that Federally-insured credit unions (FICUs) be exempt from the examination and enforcement provisions of section 1025 of the Dodd-Frank Act.

In his letter, McWatters stated[5]:

> *As not-for-profit, consumer-owned and -controlled financial institutions, FICUs serve a unique, positive role for consumers in today's financial services marketplace. . .. That role can and should be distinguished from the role played by for-profit, investor-owned and -controlled financial institutions. Subjecting FICUs and their consumer/member owners to the duel examination—and, in the case of federal insured, state-chartered credit unions, triple examination—regime mandated under section 1025 of the CFPA imposes unnecessarily burdensome costs on FICUs, particularly given their positive, consumer-focused role.*

CUNA strongly supported the NCUA's position and urged the Bureau to accept and implement the request. Although the Bureau chose to decline the NCUA's request at the time, stating a lack of authority to execute the requested action, CUNA urges the Bureau to reevaluate its position on this question as part of any continuous review of the Bureau's statutory authority. CUNA believes the delegation of the Bureau's examination authority to NCUA using the Bureau's exemption authority is the best option for both credit unions and the members they serve.

*Delegation of Authority Is Not Abdication of Authority*

If the Bureau delegates examination and enforcement authority over credit unions with over $10 billion in assets to the NCUA, the NCUA would still consult with the Bureau to ensure its mission is being effectively pursued. As highlighted in the then-Chairman's letter, the NCUA has its own Office of Consumer Financial Protection that regularly coordinates and works with the Bureau as well as the Office of National Examination and Supervision which specializes in examining credit unions with over $10 billion in assets. In addition, both agencies are members of the Federal Financial Institutions Examination Council (FFIEC), which is tasked with promoting consistency in the supervision of financial institutions and encouraging uniform examination standards among its member agencies. This interagency coordination provides the mechanism for communication about financial institution practices and would allow the Bureau to provide consistent feedback on the examination and enforcement of consumer protection regulations for the largest credit unions.

Further, if the Bureau determined there were practices in the financial services marketplace that warranted further regulation and government oversight, it could always address these practices through regulations for financial institutions. Since its creation, the Bureau has

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[5] Letter from NCUA Chairman McWatters to then-Bureau Director Cordray, July 6, 2017 *Available at:* https://www.ncua.gov/files/press-releases-news/mcwatters-letter-to-CFPB-credit-union-examination-enforcement.pdf

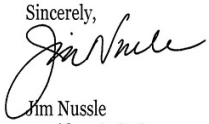
imposed many new regulatory requirements through the rulemaking process. It would be expected that the Bureau would continue to monitor practices in the industry and impose reasonable regulatory requirements as needed. The protection of consumers from bad actors in the market would not change if NCUA—not the Bureau—conducted routine exemptions for compliance with consumer protection regulations for credit unions with over $10 billion in assets.

**Conclusion**

We believe credit unions are best positioned to succeed when supervised and examined by a regulator particularly familiar with their unique characteristics, and there is no regulator more familiar with credit unions than NCUA. If NCUA was delegated the authority to conduct consumer protection examinations for credit unions with over $10 billion in assets, then not only would the affected credit unions benefit from reduced duplication and burden in examinations, but the Bureau could reduce its costs or apply the resources it would have used for credit union supervision to other priorities.

On behalf of America's credit unions and their 115 million members, we urge you to delegate supervision of credit unions over $10 billion in assets to the National Credit Union Administration, and we look forward to continuing to work with you to ensure consumers are protected from bad actors in the consumer financial services market.

Sincerely,



Jim Nussle
President & CEO