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EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS, PART II

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS, PART II

Tuesday, July 15, 2014

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Duffy, Pearce, Westmoreland, Luetkemeyer, Stutzman, Pittenger, Barr, Cotton, Rothfus; Meeks, McCarthy of New York, Scott, Green, Perlmutter, Heck, and Sinema.

Also present: Representative Royce.

Chairwoman CAPITO. Good afternoon, everyone.

Due to several series of votes that we are going to have on the Floor, Mr. Meeks and I have agreed to submit Member opening statements for the record and we will move directly to the witness testimony. I am sure you are all crying about that, but anyway, I would like to start with our first witness and I want to welcome her, my fellow West Virginian, Sara M. Cline—I call her Sally—commissioner, West Virginia Division of Financial Institutions, on behalf of the Conference of State Bank Supervisors.

Welcome.

You all have 5 minutes for your opening statements and you can submit your more extended statements for the record, which I believe most of you have done, in any event.

So welcome, Commissioner Cline.

STATEMENT OF SARA M. CLINE, COMMISSIONER, WEST VIRGINIA DIVISION OF FINANCIAL INSTITUTIONS, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS (CSBS)

Ms. CLINE. Thank you very much. Good afternoon, Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee. My name is Sally Cline and I serve as the commissioner of the West Virginia Division of Financial Institutions. It is my pleasure to testify before you today on behalf of the Conference of State Bank Supervisors on H.R. 4626 and other bills before the committee.

H.R. 4626 is just one example of Congress and State regulators' shared interest in promoting smart and efficient financial regulation. This bill will help States efficiently regulate State-licensed non-bank financial services companies through expanded use of the Nationwide Mortgage Licensing System & Registry, or the NMLS.

NMLS was established by State regulators in January 2008. We launched the system to regulate the mortgage industry more comprehensively and more consistently. NMLS has been successful in giving regulators the ability to keep track of bad actors and provides responsible mortgage lenders with greater efficiency and consistency in the licensing process.

Congress recognized this and codified NMLS into Federal law through the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). NMLS proved to be such a successful and critical regulatory tool in the mortgage licensing arena that State regulators, including my agency in West Virginia, have expanded its use to serve as the licensing system for other State-licensed non-bank financial services providers.

Since April of 2012, State regulators have been using NMLS to include licensees such as check cashers, debt collectors, and money transmitters. This month, my department began using NMLS to license money service businesses. In total, 29 State agencies are using NMLS to license additional industries, with more coming on the system each quarter.

The expanded use of NMLS has brought greater uniformity and transparency to non-depository financial services industries, and it has streamlined the licensing process for both licensees and regulators. A gap in the law, however, limits our ability to use NMLS as a licensing system for certain non-mortgage financial services providers.

Under the SAFE Act, information contained in the NMLS retains whatever privileged and confidentiality protections that information enjoyed prior to being entered into the system as long as that information is shared among mortgage regulators. Because my department licenses and supervises mortgage lending, my agency is considered a mortgage industry regulator.

Any regulatory information my department shares with other mortgage industry regulators through NMLS keeps all legal protections related to confidentiality and privilege. But if I needed to share licensing and other regulatory information through NMLS with a State regulator that does not license or supervise mortgage lending, that regulator might not be able to comply with the privilege and confidentiality protections that I must follow.

The change proposed by H.R. 4626 addresses this uncertainty, and would provide me and my regulated entities with confidence that our information shared through the NMLS will continue to be protected under State and Federal law. State banking regulators continue to strive for better ways to supervise our diverse system of financial services businesses, and we support the committee's examination of bills designed to alleviate community bank regulatory burden.

Our focus is not necessarily on less regulation, but on right-sized regulations—regulations, for example, that take into consideration

the portfolio lending and relationship-based business model of community banks.

My colleagues and I appreciate the work that Chairwoman Capito has done in sponsoring H.R. 4626, and we thank the many members of this committee who support it. We urge swift passage of the bill in order to cut regulatory burden, streamline the licensing process, and promote regulatory coordination at the State and Federal level.

Thank you for the opportunity to testify today on this important topic. I look forward to answering any questions you may have.

[The prepared statement of Commissioner Cline can be found on page 117 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Daniel Blanton, chief executive officer, Georgia Bank & Trust, on behalf of the American Bankers Association.

Welcome.

STATEMENT OF R. DANIEL BLANTON, CHIEF EXECUTIVE OFFICER, GEORGIA BANK & TRUST; AND VICE CHAIRMAN, THE AMERICAN BANKERS ASSOCIATION (ABA), ON BEHALF OF ABA

Mr. BLANTON. Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, my name is Dan Blanton. I am the CEO of Georgia Bank & Trust in Augusta, Georgia, and vice chairman of the American Bankers Association. I appreciate the opportunity to present the views of the ABA regarding regulatory relief for community banks.

Today, our diverse banking industry is made up of banks of all sizes and types. This depth and breadth is required to meet the broad array of financial needs of our communities and customers. Our $16 trillion economy requires a diverse U.S. banking system.

Community banks are the backbone of Main Streets across America. Our presence in both small towns and large cities means we have a personal stake in the vitality of our communities. When a bank sets down roots, communities thrive.

There is a widespread appreciation for the benefits community banks provide to communities across the country. Yet many actions taken by the banking agencies have hurt, not helped, community banks.

During the last decade, the regulatory burden for community banks has multiplied tenfold. Managing this tsunami of regulations is a significant challenge for a bank of any size, but for the medium-sized bank with only 40 employees, it is overwhelming.

Today, it is not unusual to hear bankers from strong, healthy banks say that they are ready to sell to larger banks because the regulatory burden has become too much to manage. The sad fact is that over the course of the last decade, 1,500 community banks have disappeared. Each bank that disappears from the community makes that community poorer.

It is time to move from good intentions to changes that can make tangible results. We applaud the efforts of Congress to help community banks. Many of the bills being discussed today are a strong

step towards relieving the burden felt by community banks, ensuring that they can continue to drive the community's growth.

We urge Congress to work together, both House and Senate, to pass legislation that will help community banks better serve our customers. There are a number of measures being discussed today. We appreciate the work of this subcommittee to address these important issues. Let me briefly touch on some measures that the ABA supports.

One immediate issue that must be addressed is Operation Choke Point. This program requires banks to act as policeman and judge, holding them responsible for the actions of their customers. The Department of Justice pursues banks to shut down accounts of merchants targeted without formal enforcement action, and even charges having not been brought against these merchants.

Banks are committed to combating the financing of financial crimes. We already keep records and report suspicious activities to law enforcement.

The policy is for banks to serve, observe, and report, but not to police. Banks should not be judge and jury on whether their customers are operating illegally. Thus, ABA supports H.R. 4986, introduced by Representative Luetkemeyer, which directly solves the problem created by Operation Choke Point.

ABA also supports H.R. 4042, introduced by Representatives Luetkemeyer and Perlmutter, which would delay the implementation of Basel rules on mortgage servicing assets until the impact can be studied and better alternatives explored. Many community banks sell a portion of their mortgage loans but retain the servicing rights to these loans to maintain a relationship with their local customers.

Harsh treatment of MSRs under Basel III would force many community banks to sell these rights to non-banks. This is a loss for the bank and its customer, as it can break up a long-term relationship to serve loans and meet customers' financial needs.

ABA also supports H.R. 4626, introduced by Chairwoman Capito, to protect the confidentiality of information shared with State regulators; and also H.R. 3913, introduced by Representative Duffy, which requires a cost-benefits analysis of new regulations.

We stand ready to work with you to make changes that will secure the future of one of the Nation's most important assets: its community banks.

Thank you, and I am happy to answer any questions you may have.

[The prepared statement of Mr. Blanton can be found on page 41 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is—my plan here is to have one more testimony and then we are going to have to go into recess while we meet our obligations on the Floor. I apologize for that, but that is kind of life on Capitol Hill—Mr. Doug Fecher, who is the president and chief executive officer of Wright-Patt Credit Union, testifying on behalf of the Credit Union National Association.

Welcome.

STATEMENT OF DOUGLAS A. FECHER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, WRIGHT-PATT CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. FECHER. Thank you.

Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, thank you for the opportunity to testify at today's hearing. As you said, my name is Doug Fecher and I am president and CEO of Wright-Patt Credit Union in Beavercreek, Ohio. I am testifying today on behalf of the Credit Union National Association.

Nearly 2 years ago, I had the privilege of testifying before the Oversight & Government Reform Committee at a hearing exploring whether financial regulation was restricting access to credit. I say now as I said then: Credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not just one new law or revised regulation that challenges credit unions, but the cumulative effect of all regulatory changes. The frequency with which new and revised regulations have been promulgated in recent years and the complexity of these requirements is staggering.

Two years later, the situation has not improved; rather, it is worse. Since 2008, credit unions have had to deal with more than 180 regulatory changes from at least 15 different Federal agencies. These changes are putting credit unions and other small institutions out of business. Nearly 300 credit unions merge every year, and the primary driver of this consolidation is regulatory burden.

Because most compliance costs do not vary by size, regulatory burden is proportionately greater for smaller institutions than it is for larger institutions. If a credit union offers a service, it has to be concerned about complying with virtually all of the same rules as a larger institution, but they have no choice but to spread those costs over a much smaller volume of business and have fewer resources available to implement the changes.

This is one reason we continue to urge this subcommittee to encourage the Consumer Financial Protection Bureau (CFPB) to use their exemption authority with alacrity. If Congress wants credit unions and other small, community-based financial institutions to survive, the avalanche of regulatory change must end. When regulation makes it too expensive for credit unions to serve their members, consumers are not being protected; they are being harmed.

Today's hearing is important because there are several bills under consideration that would help reduce regulatory burden. But these bills are not a complete solution to the problem; they represent only a step in the right direction.

CUNA supports H.R. 3240, which directs the GAO to study how the Federal Reserve has used Regulation D to conduct monetary policy. This regulation adversely impacts credit union members when they trigger more than six automatic transfers from savings to checking accounts in a month.

Members are frustrated when their payments do not go through and they are hit with an unexpected NSF fee. We think the cap on automatic transfers ought to be increased, and this legislation is a first step in that regard.

We also support H.R. 3374, which would provide parity to banks and thrifts wishing to offer prize-linked savings accounts to their customers. Federal credit unions and State-chartered credit unions in States with enabling legislation already have this authority. This legislation would extend the authority to banks.

We think these are good programs for savers, and if a bank wants to offer them, they ought to be able to. We support the bill.

H.R. 4042 would direct the Federal banking agencies to conduct a study of appropriate capital requirements for mortgage servicing assets for small banking institutions. We certainly understand the concerns expressed by the banking trade associations with respect to capital requirements related to mortgage servicing rights because we have similar concerns regarding the much more stringent requirement that NCUA recently proposed for credit unions.

H.R. 4042 was introduced prior to the publication of NCUA's proposed risk-based capital rule, and the sponsors could not have contemplated the need to include credit unions as part of this legislation. We request that H.R. 4042 be amended to include NCUA among the agencies conducting the joint study and to delay implementation of NCUA's proposed rule until the study has been completed.

In addition to these bills, CUNA also supports: H.R. 4626, which is a technical correction to the SAFE Act; H.R. 4986, dealing with Operation Choke Point; and the discussion draft related to appraisal requirements. Our views on these and other bills under consideration are outlined in my written statement. CUNA commends the sponsors of each of these bills for their leadership.

Madam Chairwoman, as I mentioned, these bills are simply a step in the right direction towards reducing regulatory burden. There is much more work that needs to be done. That is why in my written statement I included a discussion of our concerns with NCUA's proposed rule on risk-based capital; our support of legislation related to credit union residential loan parity, introduced by Representative Royce; and our encouragement of legislation to increase the threshold for CFPB examinations.

We hope the subcommittee will consider these issues in the near future.

Thank you very much for the opportunity to testify at today's hearing. I look forward to answering any questions the subcommittee may have.

[The prepared statement of Mr. Fecher can be found on page 125 of the appendix.]

Chairwoman CAPITO. Thank you very much.

Now, the subcommittee will stand in recess subject to the call of the Chair. We will return following our vote series, which we approximate to be at about 2:45. Thank you.

[recess].

Mr. DUFFY [presiding]. The subcommittee will now come to order.

The Chair now recognizes Mr. Vallandingham for his statement.

STATEMENT OF SAMUEL A. VALLANDINGHAM, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FIRST STATE BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. VALLANDINGHAM. Thank you.

Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, I am Samuel Vallandingham, president and CEO of the First State Bank, a $270 million community bank in Barboursville, West Virginia. I am pleased to be here on behalf of the more than 6,500 community banks represented by the Independent Community Bankers of America.

I will focus my testimony on three bills before this committee that are of particular interest to community bankers: the Community Bank Mortgage Servicing Asset Capital Requirements Study Act; the End Operation Choke Point Act; and the discussion draft, the "Access to Affordable Mortgages Act." The common theme of these bills is government overreach, whether it is in the form of arbitrary capital requirements, law enforcement abuse and examination practices that harm legal and legitimate customers, or rigid and expensive appraisal requirements that escalate the cost of mortgage credit. ICBA is grateful to Representative Luetkemeyer for introducing these bills.

The first bill, H.R. 4042, would delay the effective date of the Basel III mortgage servicing asset, or MSA, provisions for non-systemic banking institutions and mandate a joint agency study of the appropriate capital treatment of MSAs. Community bank mortgage servicing is at risk due to the punitive new capital provisions of Basel III. Banks that have strong capital ratios today and that have serviced mortgages for decades without problems would have starkly lower capital ratios under the new rule.

My bank would lose over $1.6 million in common Tier I equity, reducing our Tier I ratio by 50 basis points. The capital reduction, combined with higher risk-weighting of MSAs, would reduce our risk-based capital ratio by 95 basis points. This impact would force me to fundamentally change my business model.

The Basel III rule is, in fact, increasing systemic risk—the opposite of its intended effect. A high volume of MSAs is shifting from regulated bank servicers to the shadow banking system.

Non-bank servicers are not subject to prudential standards such as capital, liquidity, or risk management oversight. FSOC and Comptroller Thomas Curry have expressed serious concerns about the impact of this trend on financial stability. Community banks are best qualified to service the loans they originate and have done so without problems for decades.

The study mandated by H.R. 4042 would provide information that is critical for the design of appropriate rule. We urge its expeditious consideration by this committee.

The second bill, H.R. 4986, would preserve the ability of banks to serve legal and legitimate business customers without undue pressure from law enforcement or examiners. H.R. 4986 is a response to the Justice Department's Operation Choke Point, which is pressuring community banks to sever relationships with long-term customers in legal and legitimate businesses. Choke Point has

quickly become a threat to the free exercise of commerce and the rule of law.

Community banks currently dedicate significant energy and resources to monitoring, detecting, and reporting fraud and other financial problems in compliance with the Bank Secrecy Act. Banks are eager to cooperate with law enforcement, but we cannot and should not act as police.

At the same time, bank regulators have been scrutinizing bank relationships with businesses deemed high-risk or that supposedly create reputational risk. We are grateful to Chairman Hensarling for addressing this issue in a recent letter to the banking agencies. It is beyond the scope of the supervisory process to assess a bank's reputational risk or to prohibit or discourage banks from serving legal customers.

Community banks are the best judge of their own reputational risk. At my bank, we safeguard our reputation by conducting due diligence of each customer relationship and monitoring these relationships on an ongoing basis.

H.R. 4986 would clarify responsibilities of cooperation between banks and law enforcement in cases of financial fraud; it would promote direct prosecution of fraudsters; and it would preserve access to banking services for legal businesses. In addition, the bill would rein in DOJ's abusive use of subpoena authority and create a safe harbor for banks serving businesses that meet specific criteria.

We urge the committee to take up this legislation without delay.

The third and last bill I will discuss, the Access to Affordable Mortgages Act, will provide an exemption from independent appraisal requirements for any mortgage with a value of $250,000 or less held in portfolio, regardless of its interest rate or its QM status. When a lender holds a loan in portfolio, it bears the full risk of default, and has every incentive to ensure that the loan is appropriately collateralized. In-house appraisals or property valuations performed by bank staff are more cost-effective for the borrower, especially for low-value loans.

This draft bill will increase the flow of mortgage credit for moderate-income borrowers and strengthen the housing recovery in rural and small-town markets.

Thank you, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Vallandingham can be found on page 184 of the appendix.]

Mr. DUFFY. Thank you, Mr. Vallandingham. I should have properly introduced you as the president and chief executive officer of First State Bank, testifying on behalf of the Independent Community Bankers of America. Thank you for your testimony.

Next, Mr. Clendaniel, the president and chief executive officer of Dover Federal Credit Union, testifying on behalf of the National Association of Federal Credit Unions, is recognized for 5 minutes

STATEMENT OF DAVID CLENDANIEL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DOVER FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. CLENDANIEL. Good afternoon, Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee. My name is David Clendaniel and I am the president and CEO of Dover Federal Credit Union, a position I have held since 1997.

I am testifying today on behalf of NAFCU. NAFCU and the entire credit union community appreciate the opportunity to participate in today's hearing regarding legislative proposals to help provide regulatory relief for community financial institutions.

Credit unions didn't cause the financial crisis and shouldn't be subject to regulations aimed at those that did. Unfortunately, that has not been the case thus far.

At Dover Federal our compliance costs have more than tripled since 2009, as we don't have the economies of scale that large institutions have. We hear from many credit unions that enough is enough when it comes to the tidal wave of new regulations.

Before commenting on the legislation before us today, I would like to update the committee on NCUA's risk-based capital proposal and what impact this rule could have if it becomes final without significant changes. As members of the subcommittee are aware, this ongoing issue is of the utmost importance to credit unions of all sizes.

My written testimony outlines in detail the concerns we have with this proposal. Without significant changes to the proposed rule many credit unions, including mine, would likely consider changing charters away from being a credit union due to the onerous nature of the proposal—a proposal that instead of emulating the Basel requirements for banks goes a lot further, particularly in its risk weights for credit unions.

We are pleased that the NCUA has indicated that they expect to make changes in the proposal before finalizing. Still, credit unions hope to have an opportunity to comment and provide feedback on these changes before they are final.

NAFCU believes that this rule is so impactful that it needs to be done right, with industry feedback throughout the process, so credit unions can be clear on how things work before they start making changes to comply. An important part of this is making sure there is a sufficient implementation period for any final rule. Congress must continue to provide oversight and make sure that the issue is studied and fully vetted for economic impact before the NCUA moves forward.

One way Congress could address this issue would be to add language to the Community Bank Mortgage Servicing Asset Capital Requirements Study Act, H.R. 4042, that is before the committee today. Since this bill already tackles an issue with Basel, it could be a suitable vehicle for Congress to weigh in on risk-based capital.

I would also like to highlight several other measures under consideration today that NAFCU supports. These include, first, the American Savings Promotion Act, H.R. 3374, that would amend Federal law to allow credit unions and other financial institutions to use savings promotion raffle products. As the country recovers

from the worst financial crisis of our time, creative programs with clear rules and guidelines that encourage household savings merit serious consideration.

Second, the End Operation Choke Point Act, H.R. 4986. Credit unions remain concerned with the aggressive nature of the Justice Department's Operation Choke Point Program. While preventing fraud is a laudable concern, this program is putting unnecessary onus on credit unions to police activities of legal third parties.

Third, the Regulation D Study Act, H.R. 3240. This bipartisan legislation would mandate the GAO to study the impact of the Federal Reserve Board's monetary reserve requirements on depository institutions, consumers, and monetary policy. Federal Reserve Regulation D is a prime example of an outdated regulation that is on NAFCU's "dirty dozen" list.

And finally, the SAVE Act Confidentiality and Privilege Enhancement Act, H.R. 4626. This common-sense technical fix is welcomed by credit unions.

My written statement highlights other measures we also support, including outlining several areas where relief and greater regulatory coordination is needed. I would encourage the subcommittee to consider those areas, as well.

In conclusion, the growing regulatory burden on credit unions from new laws and regulations is a top challenge facing the industry. NAFCU appreciates the subcommittee's work to review legislation to provide regulatory relief for credit unions. We would urge the committee to move forward on these ideas.

Congress should also continue vigorous oversight of the Federal financial agencies, including NCUA, and take action on these issues outlined in this statement where appropriate.

We thank you for the opportunity to share our thoughts with you today. I welcome any questions you may have. Thank you.

[The prepared statement of Mr. Clendaniel can be found on page 52 of the appendix.]

Mr. DUFFY. Thank you, Mr. Clendaniel.

The Chair now recognizes Mr. Isaac, senior managing director at FTI Consulting, for 5 minutes.

STATEMENT OF WILLIAM M. ISAAC, SENIOR MANAGING DIRECTOR, FTI CONSULTING, INC.; AND FORMER CHAIRMAN OF THE FDIC

Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, I am grateful that you are holding this hearing. The opinions I express today are my own; I do not purport to speak on behalf of my firm, FTI Consulting. And in the interest of full disclosure, some of FTI's clients have an interest in matters before the subcommittee today.

By way of background, I was appointed to the FDIC Board of Directors at age 34 by President Carter in 1978, and I was named Chairman by President Reagan in 1981. I returned to the private sector at the end of 1985 after serving nearly 2 years beyond my 6-year term at the FDIC.

I also served during my term at the FDIC as Chairman of the Financial Institutions Examination Council and as a member of the Basel Committee. In my view, Operation Choke Point is one of the

most dangerous programs I have experienced in my 45 years of service as a bank regulator, bank attorney and consultant, and bank board member.

Without legal authority, and based on a political agenda, unelected officials at the Department of Justice are coordinating with some bank regulators to deny essential banking services to companies engaged in lawful business activities that some government officials don't like. Bankers are being cowed into compliance by an oppressive regulatory regime.

Perfectly lawful businesses are being denied access to essential banking services because they offer products or services that unelected officials don't like. This ought to alarm and frighten each of us, irrespective of our ideology, party affiliation, or view of the particular products or services being cut off.

Regulators and the DOJ have highlighted some two dozen businesses they consider high-risk or undesirable. I have spent my entire professional career in banking and bank regulation and I don't discern any meaningful increase in risk in providing basic banking services such as deposit accounts, payroll processing, or check-clearing services to any of these businesses, compared to a host of other legitimate businesses.

Operation Choke Point is fundamentally unfair to the banks and to the legal businesses that find their banking services cut off.

Once banking services are cut off to a legal business as a result of a subpoena or the threat of a subpoena, there is no chance for the business to appeal the decision. The company is simply in a business that, while legal, has been determined undesirable and therefore high-risk by the Federal bureaucracy. This Orwellian result ought to be frightening—it is frightening.

If government employees acting without statutory authority can coerce banks into denying services to firms engaged in lawful behavior that the government doesn't like, where does it stop? The point is simple and incredibly important: Under our constitutional republic, unelected government employees should not decide which lawful businesses may have access to banking services and which are to be denied. Those who have serious concerns about payday loans, check-cashing services, adult films, family planning clinics, or other products and services should take their concerns to State or Federal legislatures and attempt to enact reforms.

The DOJ should not be involved in bank regulation to any extent whatsoever. Its job is to prosecute crime, as defined by law. Bank regulators need to stay out of the political arena and focus all of their energy on ensuring that banks are operating in a safe and sound manner and are complying with all laws and regulations. Neither the DOJ nor the bank regulators should be allowed to dictate which lawful businesses will be granted or denied access to banking services.

Representative Luetkemeyer's bill provides a safe harbor to promote nondiscriminatory access to financial products and services by banks and credit unions to businesses that are licensed, registered as money services businesses, or have reasoned legal opinions demonstrating the legality of their business. The legislation also seeks to rein in DOJ's subpoena authority by requiring judicial oversight.

Importantly, banks and credit unions would retain their legal authority and discretion in establishing or maintaining relationships with existing and potential customers. The Constitution dictates that the place to debate whether payday lending or any other lawful business should be allowed to operate and have access to the banking system is in the halls of Congress and the State legislatures, not in the back rooms of government bureaucracies.

The Luetkemeyer bill is an extremely important step in reining in government agencies that are greatly overstepping their authority and breaching the constitutional separation of powers among the three branches of government and between the States and the Federal Government. While some of us may applaud the attack against payday lending, ammunition distributors, or home-based charities, we will likely take a very different position when a new Administration decides to attack activities more near and dear to our hearts.

I urge the Congress to enact immediately, without delay, the Luetkemeyer bill, as Operation Choke Point is doing severe and irreparable damage to firms engaged in lawful business activities.

Thank you.

[The prepared statement of Mr. Isaac can be found on page 149 of the appendix.]

Mr. DUFFY. Thank you, Mr. Isaac. Well said. Thank you for your testimony.

The Chair now recognizes Ms. Saunders, the associate director of the National Consumer Law Center, for 5 minutes.

STATEMENT OF LAUREN K. SAUNDERS, ASSOCIATE DIRECTOR, THE NATIONAL CONSUMER LAW CENTER, WASHINGTON, D.C., ON BEHALF OF AMERICANS FOR FINANCIAL REFORM, THE NATIONAL CONSUMER LAW CENTER (ON BEHALF OF ITS LOW INCOME CLIENTS), THE CENTER FOR RESPONSIBLE LENDING, THE CONSUMER FEDERATION OF AMERICA, AND U.S. PIRG

Ms. SAUNDERS. Thank you very much.

Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, thank you for inviting me to testify today. I am here to speak in opposition to H.R. 4986 and other actions that would weaken efforts to stop banks from facilitating illegal activity.

Banks play a critical role in enabling fraudsters to debit consumers' bank accounts. In 2008, the Office of the Comptroller of the Currency (OCC) ordered Wachovia Bank to pay $125 million to reimburse elderly consumers whose accounts were debited by scammers. Wachovia had plenty of warning signs of fraud but chose to continue processing payments for a lucrative client.

After Wachovia cut them off, some scammers moved to Zions Bank, where they continued scamming seniors. Three banks had previously turned down one scammer, but a bank broker that specialized in finding banks willing to take on high-risk clients took them to Zions in exchange for a share of the profits. Minimal vetting would have alerted Zions, which soon had direct evidence of its own, including warnings from regulators and the bank's chief risk officer, but Zions suppressed these concerns in light of the high profits.

Zions Bank is one of the banks that have received subpoenas from Operation Choke Point, which focuses on banks that know or willfully ignore evidence that they are facilitating fraud and illegal activity.

The first—and to date, only—Choke Point case was against Four Oaks Bank & Trust, which helped process payments for illegal and fraudulent payday loans, a Ponzi scheme, and an illegal gambling site. The bank overlooked hundreds of consumer complaints, warnings from State A.G.s, and extremely high rates of payments rejected as unauthorized.

The Four Oaks case is exactly the type of case that the Justice Department should be bringing. But instead of focusing on what DOJ is actually doing, some critics have drawn sweeping conclusions from anecdotes on individual bank account closures.

Since long before Operation Choke Point, payday lenders and check-cashers had been complaining about bank account closures. In 2006, the Financial Service Centers of America testified that, "For the past 6 years banks have been abandoning us—first in a trickle, then continuously accelerating, so that now few banks are willing to service us." That was in 2006.

Some of the recent bank account closures may have more to do with the money-transmitting side of a payday lender's business than the loan side. Entities with insufficient anti-money-laundering regimes may have trouble finding banks. And some banks may prefer not to do the due diligence at all and to leave that line of business to banks that will, as they should.

In addition, when banks choose to process payments in areas rife with fraud and illegal activity, regulators are right to insist that they be aware of the risks. Banks that can stop fraud should, and they are also on the hook if they originate a payment that is unauthorized or if the authorization is invalid due to fraud or illegality.

If some banks have misunderstood a bank's duties in high-risk areas, that can be clarified. But it would be a terrible mistake to weaken controls that can block illegal activity from the payment system.

H.R. 4986 would prohibit regulators from warning banks about the risks of illegal payments. It would create an inappropriate safe harbor for payments processed for an entity with a State license, a money transmitter registration, or even just a letter from its attorney.

A State license is no guarantee that a bank will not expose the bank to liability. CashCall is a licensed lender in many States, but it continued debiting consumer checking accounts for money they did not owe after the payday lender it was collecting for shut down its operations in response to enforcement actions and court orders.

Similarly, registration as a money transmitter does not ensure compliance with anti-money-laundering or know-your-customer rules. And virtually anyone can get a letter from an attorney vouching for the legality of their conduct.

Remember, fraud hurts more than the direct victims. Online businesses and stores like Target lose business when consumers are afraid to shop. When a scammer's bank debits a consumer account at a small bank, it costs the consumer's bank, on average, $100 to deal with the unauthorized charge, and as high as $500.

I urge you to oppose H.R. 4986 and other measures that would undermine efforts to prevent illegal activity that harms millions of Americans, businesses, and American security.

Thank you for inviting me to testify today. I am happy to answer any questions you may have.

[The prepared statement of Ms. Saunders can be found on page 161 of the appendix.]

Mr. DUFFY. Thank you, Ms. Saunders.

The Chair now recognizes Mr. Stanley, the policy director for Americans for Financial Reform, for 5 minutes.

STATEMENT OF MARCUS M. STANLEY, POLICY DIRECTOR, AMERICANS FOR FINANCIAL REFORM (AFR)

Mr. STANLEY. Thank you.

Chairwoman Capito and members of the subcommittee, thank you for the opportunity to testify before you today on behalf of Americans for Financial Reform. AFR opposes H.R. 3913, H.R. 5037, and the Access to Affordable Mortgages Act of 2014. I also note that Lauren Saunders has testified on behalf of AFR as well as the National Consumer Law Center in opposition to H.R. 4986.

AFR has no position at this time on the other bills being discussed today.

H.R. 3913 would amend the Volcker Rule to, among other things, ban any rulemaking under the section that would "impose a burden on competition that is not necessary or appropriate." AFR has consistently opposed this kind of broad, vague statutory mandates. Such mandates are an open invitation to endless lawsuits by well-funded Wall Street interests seeking to overturn rules that may reduce their profits, even if such rules serve the public interest.

This mandate also appears to prioritize competition over other public interest considerations, such as equity and financial stability. Existing law already provides ample opportunity for judicial review of agency decisions. Congress should not encourage further lawsuits by placing such vague directives in statute.

We also disagree with the premise that the Volcker Rule creates an excessive burden on competition. Bank trading activities are dominated by a small number of too-big-to-fail banks. Restricting proprietary trading at such banks should improve competitive balance, not harm it.

Nor should the Volcker Rule harm the international competitiveness of U.S. industry. This claim ignores the 60-year period during which U.S. banks operated under Glass-Steagall restrictions, which were much more far-reaching than the Volcker Rule. This historical experience does not provide evidence of harm to international competitiveness.

H.R. 5037 would impose new requirements and duties on the Office of Financial Research (OFR). We oppose this legislation as both redundant and harmful.

These requirements are redundant because the OFR already engages in extensive public reporting, consults frequently with member agencies, and is subject to the full range of cybersecurity requirements applicable to the U.S. Treasury. The requirements are harmful because the specific requirements in the bill would damage the OFR's ability to perform its mission.

H.R. 5037 requires the OFR to provide a public advance description of every report, guidance, working paper, or information request to be conducted during the coming year, as well as planned work dates associated with each such action. Besides being unrealistic, this requirement would provide a roadmap to Wall Street interests on how to lobby the OFR concerning each detail of its work in progress.

The bill further requires OFR to make public the exact time and nature of every consultation with any member agency staffer regarding any report as well as every recommendation made in such a consultation. Making these details public would exercise a significant chilling effect on the willingness of member agency personnel to share frank views with the OFR. Even transparency laws such as the Freedom of Information Act provide a deliberative process exemption to safeguard deliberations on work in progress, but this is absent from H.R. 5037.

We also disagree that OFR's current level of public transparency or consultation is inadequate. OFR's annual reports and working papers provide significant detail on current and upcoming projects as well as views on key financial risks.

More recently, the OFR has been required to provide detailed quarterly reports to Congress on all spending and actions in the past quarter. The Treasury's recent letter to the House on the OFR's asset management report also shows that the OFR engages in extensive consultation with member agencies.

Consultation with the SEC on the asset management report included the exchange of at least 15 draft versions of the report, at least 13 separate meetings, and additional informal consultation. SEC Chair Mary Jo White has stated that the SEC commented extensively on the report when it was in progress.

The OFR's mission of studying potential emerging threats to U.S. financial stability is a critical one. In order to perform its mission, the OFR must have independence from political pressures that may affect its member agencies.

The way to improve the OFR's work is to support its independence and its ability to act as a warning voice concerning threats others may choose to overlook. The changes in H.R. 5037 would have the opposite effect.

The Access to Affordable Mortgages Act of 2014 would exempt higher-risk mortgages of $250,000 or under from new appraisal requirements included in the Dodd-Frank Act. We oppose this exemption.

"Higher-risk mortgages" refers to what were once called "subprime mortgages." Fraud and predatory lending connected to subprime mortgage origination was a major cause of the 2008 financial crisis.

Exempting higher-risk mortgages of up to $250,000 from appraisal requirements would significantly undermine these new regulatory protections. The $250,000 exemption would include almost half of all new homes sold in the United States and likely well over half of higher-risk mortgage loans.

The requirement that a lender retain the loan on their balance sheet for at least 3 years does provide some protection. But data

on subprime loan defaults shows significant increases in default past the 36-month point.

H.R. 4042 would mandate further study and delay in the implementation of new capital rules on mortgage servicing assets. AFR does not currently have a position on H.R. 4042. However, we do have some concerns regarding this legislation. These concerns are detailed in my written testimony.

Thank you very much, and now I am happy to answer any questions you may have.

[The prepared statement of Mr. Stanley can be found on page 177 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Stanley.

With that, we will begin the question portion of our hearing, and I will yield myself 5 minutes for questioning.

Commissioner Cline, you noted in your written testimony and your oral testimony that the NMLS system has been successful in streamlining the licensing system for mortgage loan originators and improving information sharing from State to State. Could you share with the committee why you think H.R. 4626 would bolster these new licensing regimes? But better yet, could you kind of frame it in terms of how it might help protect consumers?

Ms. CLINE. Yes. Thank you, Chairwoman Capito. And thank you for your support of H.R. 4626.

Currently, under the SAFE Act, information is protected and shared between mortgage regulators. What H.R. 4626 will do is extend those protections of confidential and privileged information between all regulators who choose to use the NMLS to license other types of nonmortgage financial service providers.

This system has been proven to increase uniformity. It is reducing regulatory burden for the licensees. And it is enhancing better coordination between the agencies that license these entities.

As far as consumer protections, it does enhance consumer protection and it benefits not only consumers but the industry as well.

Chairwoman CAPITO. I would imagine, too, that it better protects probably personal and private information for each consumer as their information becomes a part of this system. That, to me, would be one of the major benefits of this. Is that correct?

Ms. CLINE. That is correct. The NMLS employs numerous controls to protect the privacy and the security of sensitive information. It is required to be compliant with the Federal Information Security Management Act, which it employs over 154 controls that are—they are reviewed, validated, and tested by an independent third party on an annual basis. The NMLS is also required to comply with all State and Federal laws.

But yes, in fact—

Chairwoman CAPITO. Thank you.

Ms. CLINE. —it is a secure system.

Chairwoman CAPITO. Thank you.

Mr. Vallandingham, one of the issues we are discussing today is the ability of financial institutions to maintain mortgage servicing rights for the mortgages they originate. As you noted in your testimony, recent regulatory actions are making it more difficult to do so. Can you share with the subcommittee how your institution views mortgage servicing rights, and what that means for you as

a community bank to still be engaged in this practice, and how that would influence consumers in your areas?

Mr. VALLANDINGHAM. Absolutely. As I stated in my testimony, we would lose $1.6 million in Tier I capital. I have spent half my life building our servicing portfolio, and it would take that business model away from us. Our primary business line is mortgage lending and the servicing that subsequently is created by that, and ultimately, we would have to dramatically change our business model because we could no longer grow and build that servicing.

It is in a time period when servicing has increased cost, and ultimately our economies of scale have been crushed. And at that point in time this would hinder us from continuing to grow and being able to build on a business model that has been extremely successful for our organization.

In terms of our consumers, I get daily requests from borrowers who want to buy a new home and come back to us because of the service that they get. Community banks are better positioned to provide the high-touch, high-quality service to mortgage borrowers than some of these non-bank shadow market servicers that have grown exponentially because of this.

So ultimately, I think community banks do a better job of it and we want to continue to build on that. This will absolutely cap that business and take small banks out of the servicing market.

Chairwoman CAPITO. And I would imagine, too, your customers would prefer to know exactly when and how and who is servicing their mortgage rather than have it be off in a different State or very remote from them. Sometimes people run into problems, and being able to go to the institution they know is carrying these servicing rights would be, I think, a bonus to a consumer, correct?

Mr. VALLANDINGHAM. My employees have such close relationships with their borrowers that they often get letters, they know about their family events, they even get presents at holidays. When you call our organization and you want to ask about your mortgage, you know that Debbie Kerns is going to answer the phone in escrow and she is going to explain your escrow analysis to you.

Chairwoman CAPITO. Right.

Mr. VALLANDINGHAM. If you were to call one of the larger national non-bank providers you don't know who you would get. You might even get a recording. And you don't know that you would get your question answered.

Chairwoman CAPITO. Thank you. I have run over my time. Thank you.

Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman.

And I thank the witnesses for appearing.

And I am also very grateful that I live in a country where no one is above the law. And I am especially grateful to God that I live in a country where no one is beneath the law.

If there is one among you who believes that banks do not break the law, would you kindly extend a hand into the air?

I take it from the absence of hands in the air that there are none among you and I ask that the record reflect that no one believes, on this panel, that banks do not break the law.

Mr. Blanton and Mr. Isaac, there was a case that has been mentioned out of North Carolina, a case that involved hundreds of consumer complaints, as was indicated by Ms. Saunders, a case that involved many, many complaints from banks, a case wherein a settlement was made for $1.2 million. This bank received $850,000 in fees. The Justice Department interceded and as a result, there was some redress.

I hope it won't surprise you to know that earlier today there was a witness present from the Justice Department who indicated that but for this Operation Choke Point, that settlement would not have taken place. So I ask you, my dear friends, Mr. Isaac, do you have any disagreement with the settlement against Four Oaks bank?

Mr. Isaac?

Mr. ISAAC. I am not intimately familiar with the case, but—

Mr. GREEN. All right.

Mr. ISAAC. —I understand that there was some fairly egregious behavior there, and I believe that there should have been action taken, and I don't believe—

Mr. GREEN. Thank you very much.

Mr. ISAAC. —and I don't believe that Operation—

Mr. GREEN. Let me, if I may, go to my next witness, and I will come back to you.

Mr. ISAAC. Could I just finish the answer?

Mr. GREEN. Not just yet, if I may, please.

Mr. ISAAC. Okay.

Mr. GREEN. I want to accord you every courtesy. I don't mean to be rude, crude, and unrefined, but I have a limited amount of time.

Let me now move to Mr. Blanton.

Do you find any reason to differ with the way that case was resolved? And do you find that it was appropriate to take action, given that banks were complaining against Four Oaks?

Mr. BLANTON. From what I understand, I believe that there were instances where that happened. I think there were plenty of signs there to indicate that, and I think action happened. Whether or not Choke Point was a trigger—

Mr. GREEN. If I may, let me intercede again because I have a minute and 40-plus seconds.

A witness from the Justice Department—I can accord you his name for edification purposes: Mr. Delery, Assistant Attorney General, Department of Justice—indicated that it was Operation Choke Point that gave them the opportunity to bring to justice in this circumstance.

I have read the bill that you both favor and I respect my colleagues, but are you desiring to put banks in a position such that they cannot answer for unlawful conduct, Mr. Isaac? Is that your desire?

Mr. ISAAC. Of course not. I prosecuted a lot—

Mr. GREEN. Is that your desire, Mr—

Mr. ISAAC. I have prosecuted a lot of—

Mr. GREEN. —Blanton? Is that your desire?

Mr. BLANTON. No, sir, it is not.

Mr. GREEN. This bill produces more than a safe harbor; it provides an escape from liability.

Mr. BLANTON. I would say, though, if the bank was doing its job properly—

Mr. GREEN. The bank wasn't doing its job properly and that is why you and I are having this discussion. It wasn't doing its job properly. Do you want banks to just have an absolute get-out-of-jail-free card so that they can take advantage of consumers? You heard Ms. Saunders talk about the hundreds of consumer complaints.

Ms. Saunders, is that correct? Were you correct when you said that?

Ms. SAUNDERS. I was quoting from the complaint in the Four Oaks case, yes.

Mr. GREEN. And do you concur that it was necessary for the Justice Department to intercede?

Ms. SAUNDERS. Absolutely. They stopped a lot of fraud and illegal activity by intervening.

Mr. GREEN. Thank you, Madam Chairwoman. I yield back.

Chairwoman CAPITO. Thank you.

Mr. Duffy, for 5 minutes.

Mr. DUFFY. I was going to ask a poll question about how many of you think that Federal bureaucrats and Obama Administration officials are breaking the law, but I am going to skip that right now.

Ms. Saunders, I want to talk to you about Operation Choke Point. You agree with this policy from DOJ, is that correct?

Ms. SAUNDERS. Yes. As I understand it, the operation focuses on fraud and illegal activity and banks that are in a position to stop it and I agree with that focus.

Mr. DUFFY. And you went to law school. You are an attorney, correct?

Ms. SAUNDERS. Yes.

Mr. DUFFY. Were you here for the testimony this morning?

Ms. SAUNDERS. I was not.

Mr. DUFFY. Okay. So we heard from Mr. Delery from DOJ, and during the course of his testimony he was constantly talking about fraudulent merchants that had to be addressed through Operation Choke Point.

The problem is that Operation Choke Point focuses on these merchants' ability to bank but doesn't look at any fraudulent behavior with the merchants themselves. And so if you don't bank a third party payer or a payday loan institution or a gun sales institution, they can't do business. You put them out of business.

But there is no due process. There is no ability to have a hearing. There is no ability to have a judge hear testimony and make a determination of, "Yes, these people have committed fraud," or, "No, they are innocent."

What you have is a bureaucrat in the DOJ saying, like you just said, "I have done an investigation. I have taken complaints, and this is fraud."

You believe in due process, don't you?

Ms. SAUNDERS. I do.

Mr. DUFFY. And if you are one of these subject merchants, don't you think that they should have due process? Shouldn't they have a hearing to determine whether they have committed fraud under

our laws or whether they are innocent? We shouldn't just have bureaucrats in the DOJ do this, should we?

Ms. SAUNDERS. I think if a bank has a merchant that has unauthorized returns that are through the roof, warnings from regulators of fraudulent illegal activity, I don't think we need to wait for a trial to track down the people around the globe who may be scamming people before the bank says, "You know what? I think there is fraud going on here and I am not going to be part of it."

Mr. DUFFY. I was a prosecutor, and we would collect a lot of evidence and a lot of firsthand statements and complaints, and if we just convicted people without a trial and said, "Well, look at all the information. I am not going to track down this defendant and give them due process. I am not going to give them a trial."

What kind of government do we become if we don't offer these protections to what we all believe is a legitimate business until proven otherwise? When you have this bureaucrat say, "I have done an investigation." It is not open. It can't be reviewed by the Congress; it can't be accessed by the merchant. And I have just found that you have committed fraud and we are going to cut off your ability to bank.

Is that the right way we should do business in the American Government? Because that is what they are doing.

Ms. SAUNDERS. I think it is a surprising statement to say that a bank should not stop processing payments when they have substantial, egregious evidence of fraud going on and that they need to keep processing payments and debiting consumer accounts before we can have—

Mr. DUFFY. I don't know what law school you went to, but we afford people due process. We just don't say, "There is evidence, and so I convict." I am astounded that you are giving this testimony today saying there is evidence, with no trial, just conviction with evidence.

Ms. SAUNDERS. I see no conviction here, but in the Wachovia case, for example, I don't think it would be right to continue debiting—letting scammers debit seniors' accounts just because we haven't yet had a trial of all those scammers. If Wachovia knows what is going on, they know they are—these are scammers using them to debit consumer accounts, they ought to stop it.

Mr. DUFFY. Sure. But then shouldn't we—this is not the only case, and there was only one example that was given of someone who was prosecuted on the merchant side and Wachovia was cited, but beyond that no one else has been prosecuted.

And I guess I would ask the panel, do you know of merchants that have been put out of business because you have been unable to bank them because of Operation Choke Point?

Mr. Vallandingham?

Mr. VALLANDINGHAM. Yes. There is a current news article that Chase had been closing accounts for pawn shops in the State of West Virginia. So they have been given 30 days to move their account, close the account. They have done nothing wrong; they have had no—they are not debiting anyone's account. Just as a business class in our State, they are eliminated from the banking system.

Mr. DUFFY. And do you have any knowledge that they had a trial and a determination that they were doing business fraudulently?

Mr. VALLANDINGHAM. Absolutely not.

Mr. DUFFY. Right. So they didn't have due process, correct?

Mr. VALLANDINGHAM. No, they did not.

Mr. DUFFY. Ms. Saunders, that is my concern. We need to have due process in this country and we don't want bureaucrats in Washington sitting in the DOJ convicting people without a hearing.

And I guess that is why, coming to Mr. Luetkemeyer's bill, do you—does the panel agree that Mr. Luetkemeyer's bill takes a step in the right direction to make sure we give some protections to merchants from bureaucrats in the DOJ scheming to go after businesses or merchants that they don't like?

Mr. BLANTON. Yes. We support the bill.

Mr. DUFFY. My time has expired. I yield back.

Chairwoman CAPITO. Thank you.

Mr. Perlmutter, for 5 minutes.

Mr. PERLMUTTER. Thank you, Madam Chairwoman. And I agreed to give Mr. Green an opportunity to respond to Mr. Duffy for just 15 seconds.

Mr. GREEN. Thank you very much. And I take all of these things—

Mr. PERLMUTTER. I yield to Mr. Green.

Mr. GREEN. I tend to take things seriously—and thank you very much. If others perform activities that are unacceptable, I don't believe it gives us a license to accord unacceptable activities to other entities.

And I just want to go on record as saying whatever happens anywhere else doesn't change our need to make sure that we help protect consumers. They should not be beneath the law, and no one else—and no other entity should be above the law.

Mr. PERLMUTTER. Okay. Reclaiming my time, thank you, Madam Chairwoman.

Mr. Isaac, it is good to see you.

Mr. ISAAC. It is good to see you.

Mr. PERLMUTTER. I will start with the Choke Point question that we have been dealing with, and I am somewhere between Mr. Green and Mr. Duffy on this, that clearly there were some bad actors. Those bad actors, through an investigation, have been ferreted out. But in my opinion, you don't create, then, a dragnet that then continues to sweep-up more and more people into it; on a case-by-case basis you look for the fraud and you punish the fraudulent.

So I agree with Mr. Green to a certain degree. Mr. Luetkemeyer's bill I think is generally on the right track but goes too far, especially on the liability component of it. But I do appreciate his safe harbor piece, especially as it applies to something going on in Colorado and 23 other States, and that is, in fact, that those States have provided a regulatory scheme for the use and business of marijuana, and part of what is going on is it is very difficult for those businesses to bank.

And I ask unanimous consent to place the USA Today article from yesterday concerning the security measures that so many have to go through in the record.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. PERLMUTTER. I would like to see that those particular businesses that are legal in their States can continue to do business in

a way that they aren't shut off from the banking system. And I do think that Mr. Luetkemeyer's bill does provide for that, so that is a saving grace of the bill for me.

My questions, though, I would like to—Mr. Stanley, you were talking a little bit about the mortgage servicing. You said you really didn't have any complaints about it, but you still had some questions. What are your questions about it? Because I am supportive of kind of delaying it, making sure that the mortgage servicing doesn't flow from community banks and insured institutions to non-banks.

There are plenty of non-banks. I am happy for them to have business. But I don't want the insured institutions losing that business either. What do you say about that?

Mr. STANLEY. I think I have two things. In terms of our questions, the prudential regulators did carefully consider thousands of comments on their proposed Basel rules and they chose the significantly eased capital requirements in many areas, including residential mortgages, but they did not modify the ceiling on these mortgage servicing assets, and I think what we would like to see is more of the information from the regulators on how and why they reached that decision that might have included a lot of the data that this study might produce.

And in terms of movement to non-bank servicers, we feel there are a lot of things driving that, that it isn't just these capital rules, it is reputational, some of the violations, frankly, that the big banks did on servicing, some of the settlement issues. So there are a lot of things driving that, we feel.

Mr. PERLMUTTER. Okay. Thank you.

I think that there are a lot of—the Basel components, though, in my opinion, play a big role in driving some of that mortgage servicing to the non-banks, and that is why we are asking for a little bit of a timeout to just make sure whether I am right or wrong. And so that is why we are doing it.

Madam Chairwoman, if I could, I would like to introduce into the record several letters: a September 13, 2013, letter from the Board of Governors of the Federal Reserve System to me concerning mortgage servicing assets; a January 27, 2014, letter from the Board of Governors of the Federal Reserve System concerning that; a May 20th letter from the Independent Community Bankers of America; and a May 12th letter from the American Bankers Association.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. PERLMUTTER. Thank you. I yield back.

Chairwoman CAPITO. Mr. Westmoreland?

Mr. WESTMORELAND. Thank you, Madam Chairwoman.

Mr. Stanley, when was Americans for Financial Reform—when did you come into existence?

Mr. STANLEY. Americans for Financial Reform was created, I believe—I wasn't there at the time—in 2008 as a response to the financial crisis and the feeling that people needed to—

Mr. WESTMORELAND. That's okay. That is all I wanted. Thank you.

Now, to the six witnesses who live in the real world and have real-life experiences of lending money and banking people and working in the business, with respect to the FDIC's complicity in

Operation Choke Point, are you familiar with the list of high-risk activities identified by the FDIC in the summer of 2011 supervisory insights entitled, "Managing Risk in Third Party Payment Processor Relationships?"

Are you aware of any other list of high-risk merchants or activities published by the DOJ, the FDIC, the FRB, or the OCC?

Just a quick head shake. Good.

Were any of your institutions offered the opportunity to comment on the list before it was compiled and published?

Nobody?

Have any of these agencies reached out to your institutions since the list was published to determine the impact on your industry?

That is a little weird, isn't it, since it involves your industries? You would think that the government would at least want to have some input as to this.

Mr. Isaac, I know that you were past Chairman of the FDIC. Did you ever see anything while you were there that the Administration would have wanted to coordinate with regulators to specifically cut off access to financial services?

Mr. ISAAC. No, other than as prescribed by the law—for example, money laundering and so forth. But apart from that, cutting off drug dealers, terrorists, and so forth, which was enacted by Congress, no.

Mr. WESTMORELAND. Mr. Isaac, I want to ask you one other question. You briefly mentioned the idea that examiners and bank regulators are more concerned with the bank's reputational risk, seemingly to the exclusion of all other concerns, save the capital ratio. Is it possible this emphasis on reputational risk is detracting examiners from seeing other problems that may be happening at a bank?

Mr. ISAAC. I do believe, as I said in my full testimony, that I am very concerned about the degree to which the examiners over the past couple of decades have started focusing on reputational risk. I don't know what it means; I don't know anybody who knows what it means except that the bank is doing something that the regulator doesn't like but the regulator can't seem to quantify the risk and put it into the CAMELS rating system, which is the objective standard we are supposed to be using.

So I am very concerned about where we have gone with reputational risk. I would get rid of it. I don't think it is a helpful concept at all.

Mr. WESTMORELAND. Thank you.

Mr. Blanton, while I support the bills that are being considered today, I don't think any of them come really close to being the substantive regulatory relief that I have hoped that this committee would one day take up. There are still some issues around accounting methods, regulatory capital, classification of distressed assets, examiner overreach, and overreaction that I still hear from bankers every day. Are these the things that—as vice president of the American Bankers Association, are these the things you are hearing every day, too?

Mr. BLANTON. Yes, they are. We have a tremendous burden on our banks that is especially disproportionate to the smaller banks, in that they just really don't have the resources available. And it

is in a one-size-fits-all mentality to where my bank at $1.8 billion and a $200 million bank have to comply at the same level. It is very difficult for them to do that.

Mr. WESTMORELAND. Thank you.

Madam Chairwoman, I yield back the remainder of my time.

Chairwoman CAPITO. The gentleman yields back.

Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Madam Chairwoman.

I would first like to associate myself with the remarks of the gentleman from Colorado, Mr. Perlmutter, with respect to Congressman Luetkemeyer's legislation, both with respect to the desire to seek a happy balance within it and its positive intent, and also with respect to his concerns regarding the impact on States which have legalized some form of marijuana consumption.

And I would also like to thank the Chair. There are a lot of bills on today's agenda that we can vote out of this committee in a bipartisan way, and if I might editorialize, we don't have enough days like that. And I thank you for it.

Let's see. Who am I going to pick—is it Mr. Fecher? I'm sorry. I don't know how to pronounce your name.

Mr. FECHER. Yes. "Fecher."

Mr. HECK. "Fecher," with a hard "K."

Mr. FECHER. I am from a good old German family.

Mr. HECK. I think I know that, as a "Heck."

I am enthusiastic about H.R. 3374, the American Savings Protection Act, and I note that there are Federal laws which have the effect of prohibiting banks and certain thrifts from offering certain kinds of these, if you will, safe, regulated, and innovative savings products. And I am just wondering, from your professional experience, sir, can you think of any compelling policy basis for enabling certain financial institutions to offer these but prohibiting others from doing so?

Mr. FECHER. No, I cannot.

Mr. HECK. As you read the legislation, Mr. Fecher, is there anything in it that would preempt existing State laws in any way? Does it change a State's ability to regulate these kinds of products whatsoever?

Mr. FECHER. Not to my knowledge, no.

Mr. HECK. Would these products be subject to the same kind of regulatory oversight as any other financial product offered by a bank or a credit union?

Mr. FECHER. I believe they would, yes.

Mr. HECK. If you were to offer this in your institution—I assume you do not at the present time—would you pay for the promotion out of your marketing account and use that as an attraction for a cash prize to incentivize increased savings?

Mr. FECHER. Yes, we would.

Mr. HECK. You are an awfully easy witness to work with, Mr. Fecher. I would like to—

Mr. FECHER. We have had a lot of experience with these prize-based accounts. They help average Americans decide to save money because the interest rates that we are able to pay on our deposit accounts are so small, if you are saving $500 or maybe $1,000 it

is not really much of an incentive to get a .25 percent interest rate on that.

And so the perceived value of the opportunity to win something more meaningful will cause many Americans to establish a savings program that they might not otherwise have done. And we have seen that in the institutions that have done this. So as a matter of public policy, that is why I support it. I think we want Americans to save more money, especially Americans of more modest means who don't have the significant sums of money where interest rates matter more than this perceived value of these prize-based accounts.

So I think properly done, it is a matter of good public policy.

Mr. HECK. It took me four questions to get you to give the speech I wanted you to give, but I am extremely grateful, sir.

Mr. FECHER. I caught on after a couple of seconds.

Mr. HECK. I think the point is made. We don't save enough, and anything that we can do that does not compromise the consumer but incentivizes the kind of behavior that every single person sitting in this room believes would benefit them not only as individuals but society as a whole ought to be an easy public policy to pursue. And I want to publicly acknowledge and thank both Mr. Kilmer and Mr. Cotton for offering this legislation in hopes that my colleagues will give it a "yes" vote as soon as they can.

I have a minute left, so I will get to the meatier stuff in some regards, I guess, or the more controversial stuff.

You have raised some questions about the NCUA's risk-based capital rule—its proposed rule. I have shared those concerns. I have expressed my concern to the NCUA. I am not sure about the whole shift of risk weightings after we saw what we did in the financial crisis.

But if we are to go ahead and do something in this regard, I would be curious and interested to know what your reaction would be to that which I would only think is fair, to combine it with giving credit unions tools to raise additional capital. And as you know, there is legislation before this committee to do that.

Mr. FECHER. Right. Thank you, Representative. That is an important question. The NCUA's rule, as well-intended as it may be, to ensure that credit unions are adequately capitalized for the risk on their balance sheet—the rule, as written as proposed, actually requires higher capital risk weightings in many categories than even the community banks, despite the performance of credit unions through the recent Great Recession. And so that is the start of our concern.

You add that to the fact that a credit union's only way of raising capital is through its earnings, what it ends up meaning is that credit unions will be able to deliver less value to their members on the street. And so what we ask is that the subcommittee exercise oversight over NCUA's rule.

Now we believe NCUA will change the rule based on the over 2,200 comments that they received, but we believe it needs to be changed substantially. Frankly, our hope is that it is withdrawn and they start over again. Short of that actually happening, we would hope that the committee would take a good look at, ask questions kind of to what Mr. Stanley said before: How do you jus-

tify these risk weightings? What is the empirical evidence behind them?

Because if we set risk weightings that are just simply too high it will cause credit unions to withhold value from their consumer members on the street, and I don't think anybody wants that to happen.

Chairwoman CAPITO. Thank you. The gentleman's time has expired.

Mr. HECK. With one additional second of indulgence? I just want to reiterate, we really are very grateful to have before us legislation that we can all support.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you. And I think we will give credit where it is due to the ranking member, as well. We have worked together on these.

I would also like to ask unanimous consent to insert the following Member's opening statements into the record: Ms. Capito; Mr. Duffy; Mr. Luetkemeyer; Mr. Westmoreland; Mr. Cotton; Mr. Pittenger; Mr. Stutzman; and Mr. Meeks.

And with that, I will yield 5 minutes to Mr. Luetkemeyer for questions.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

I would like to ask the first question with regards to the appraisal requirement bill that we have before us.

And, Mr. Blanton, I want to ask it of you. This section removes the appraisal requirement on primary residences for those loans under a quarter of a million dollars and held in portfolio by a creditor for less than 3 years. Can you tell me, if we do this, what kind of risk that the bank is exposed to by going along with something like this?

Mr. BLANTON. By and large, we are exposed to the risk of making the loan and having this asset. And we can do evaluations that are more cost-conscious ways of determining the value of our asset—

Mr. LUETKEMEYER. So in other words, there is not going to be a whole lot more risk, basically, number one, the amount of the loan is kind of minimal compared to the size of the portfolio, probably, I would imagine; and number two, the customers if something is held in your portfolio, therefore, you are not somebody who is going to be as concerned about this as if it is somebody who is a fly-by-night guy.

Mr. BLANTON. No. With this asset in our portfolio we understand the customer, we understand the risk we are taking, and we have had various tools that are price-competitive for this customer to be able to handle this loan for him at a more reasonable price.

Mr. LUETKEMEYER. Perfect. Thank you very much.

Mr. Isaac, I loved your testimony. Thank you very much for your comments on Choke Point. I love that, "the most dangerous program that you have ever seen." I am going to keep that quote.

But I appreciate your being here today, especially from the standpoint that you are somebody who has not just talked the talk; you have walked the walk. You have been there, you have done that.

I was an examiner a long time ago, whenever you were actually FDIC Chairman, so that is how long it has been, but I appreciate

your remarks today. And I am just kind of curious—I know you were supportive of the bill—can you tell me—I know there were a couple of remarks with regards to going too far.

Does the bill address, in your mind, the problem that we have in the correct way, with DOJ and the FDIC joining together to try and root out entire industries of businesses versus going after the bad actors? Do you think that this bill goes far enough, or too far, or just right? Can you give me an analysis, please?

Mr. ISAAC. I think it is just about right. And I am not saying that people couldn't find ways to improve it here or there. We can always try to do better on anything. But I think it is just about right.

I have heard Mr. Delery's name mentioned several times in this hearing, and I guess he testified this morning. He has a memo dated September 9, 2013, which I would hope that everybody would read, particularly pages 10, 11, and 14, in which he makes some outrageous and very scary statements.

For example, this is on page 14: "We are targeting banks more than payment processors, and payment processors more than merchants."

Mr. LUETKEMEYER. One of the things that—

Mr. ISAAC. The theory is that if you target the banks, the banks will run these people out of business, and you don't have to spend money and resources going after the merchants, and he actually says that—

Mr. LUETKEMEYER. One of the things that—let me interrupt just a second.

Mr. ISAAC. Sure.

Mr. LUETKEMEYER. One of the things that concerns me is the fact that they are doing this under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), and I am sure you have adjudicated this law many times—

Mr. ISAAC. Yes.

Mr. LUETKEMEYER. —and you know that this is supposed to be a bill that is used to provide a defense for the banks rather than for a bill that goes after the banks, which is what they are trying to do. Is that a correct characterization of the law—

Mr. ISAAC. The—

Mr. LUETKEMEYER. —and what is going on?

Mr. ISAAC. The provisions they are using were intended to protect the banks—

Mr. LUETKEMEYER. Right.

Mr. ISAAC. —against fraud from—

Mr. LUETKEMEYER. And they have flipped the model, haven't they?

Mr. ISAAC. —and they are being used to punish the banks.

Mr. LUETKEMEYER. Their own interior—own inside memos indicate that they are not sure they even have the legal authority to do what they are doing. The other Oversight and Reform Committee has that.

Mr. ISAAC. He says in his own memo that this is dubious. I think it is less than dubious; it is—

Mr. LUETKEMEYER. Can you give me a brief overview of what you think will happen? Let's say we pass this legislation, H.R. 4986.

What will happen? What will be the response from the banks to this legislation?

Mr. ISAAC. I'm sorry—

Mr. LUETKEMEYER. What will be the response by the banks to this legislation? Are they going to—how will they react to this?

Mr. ISAAC. Unfortunately, it is not going to be an overnight panacea. When the banks have already thrown people out that are legitimate businesses, it is going to take time to get them back into the banking system.

But once the safe harbor is there, the banks are going to be able to make business decisions again, but I think you are going to be very leery, having had the regulators say what they have said about undesirable businesses and risk businesses. I think they are going to be very slow to come back in, but hopefully we can turn this around over time and we can stop the exodus, we can stop legal businesses from being thrown out of the banking system.

Mr. LUETKEMEYER. And if they do that, they are not going to go back in with somebody who is a bad actor.

Mr. ISAAC. Pardon?

Mr. LUETKEMEYER. I say, they are not going to go back into business with somebody who is a bad actor. They are going to pick and choose from all these folks that they have let go; they will go back out and pick all the good ones, wouldn't they?

Chairwoman CAPITO. The gentleman's time—

Mr. ISAAC. One would think.

Chairwoman CAPITO. —has expired. We are going to move on because we are—

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Chairwoman CAPITO. —heading up to votes.

Mr. Meeks?

Mr. MEEKS. Thank you, Madam Chairwoman.

And I want to join with what Mr. Heck has said. Balance is, I think, the key to this—to everything, is having the proper balance. And there is no question, I think, that most Members, especially on this committee, recognize that the regulatory burden on smaller and community financial institutions is significant and we need to provide regulatory relief.

The key is the balance, and it has to be the right relief to the appropriate sector because entities—there are still risks. Risks still exist in the financial system. The larger banks are still getting bigger, and they are still too-big-to-fail, and the expectation of rising interest rates poses a significant risk to the community financial institutions.

So we do have to move quickly, but we also have to be careful, I think, to make sure that it is the relief that is the right relief, is the targeted relief. And that is what we are trying to do here.

That is why I agree with Mr. Heck that many of the bills that are up today for discussions are targeted proposals that have gathered support—Democrats and Republicans, bipartisan. And so I congratulate my colleagues on both sides of the aisle for—we are all in this together.

I want to particularly say, though, that I am supporting, and think that H.R. 3240, by Mr. Pittenger; H.R. 3374, by Mr. Kilmer; H.R. 4626, by the Chair; and H.R. 5062, by my friend, Mr. Perl-

mutter—all the bills, I think, bipartisan, we are working on together trying to get it right. Sometimes, it takes time to do that.

Now, I have had and do have reservations about my friend, Mr. Luetkemeyer's bill, H.R. 4986, although I do have great and strong concerns about the Choke Point and how legal businesses have been impacted by this initiative. But the question is, does it go a little too far? Because I oppose any attempts to weaken the appraisal standards, as, I think, is proposed.

I would like to talk to you about that at some point.

And let me just start there and maybe I will ask Mr. Stanley, and my question tells you why, has there been any evidence that the existing appraisal regulations have led to restrictions in access to credit for low- and moderate-income borrowers? Because that is where my concerns lie.

Mr. Stanley?

Mr. STANLEY. I am not familiar with any such evidence. And there is substantial evidence that I think appraisal fraud did harm low- and moderate-income buyers prior to the financial crisis.

Mr. MEEKS. Thank you.

And let me just say—let me jump. I just looked at the time. I want to ask Ms. Saunders a question also.

I have stated that I have concerns about the way Operation Choke Point has impacted some of the legal entities that have operated within the law. Tell me, do you think that the approach that H.R. 4986 takes is the right approach to deal with this particular problem?

Ms. SAUNDERS. No, I don't. I think it would weaken tools against fraud. I think it would give a blank check to entities who happen to have a license but may still be engaged in an illegal activity that banks can stop.

I think the reasons that banks choose to close particular accounts are complex and we can't just look at the headlines. There are 17 million Americans in this country who don't have bank accounts, many who have been blacklisted from banks. I am sure we could find some patterns of businesses they are involved in.

And banks make their own business decisions about what areas of business they want to be in, things like money transmitting. Unfortunately, all the fraudsters out there, it forces us to be vigilant if we want to stop money going to drug cartels and other illegal activity, we need to be vigilant.

Some banks don't want to be in those lines of business. There are areas like debt settlement, the debt relief firms. We have done a lot of work against foreclosure rescue fraud, student loan debt relief scams. Anybody who watches TV sees those, and there is a lot of illegal and fraudulent activity out there.

So banks need to be vigilant, but I don't see any widespread evidence of a problem. If there are any miscommunications, I think those can be rectified without legislation.

Mr. MEEKS. We do have to be vigilant, but unfortunately, what happens is we make laws and we make laws for the bad guys, not for the good. Most of the folks who are sitting at this table all have good business practices.

And that is why I say we have to have the balance, because we have to try to make sure that when we do this balance, we don't

make laws that then overly negatively impact the good guys. But at the same time, we can't hurt the consumer and the individuals, and that is why I would just like to talk to Mr. Luetkemeyer and some others because I think we have gone a little too far.

Thank you, Madam Chairwoman—we have votes.

Chairwoman CAPITO. Mr. Pittenger?

Mr. PITTENGER. Thank you, Madam Chairwoman. And thank you for calling this really important hearing, which has really clarified so much of how the regulatory environment has impeded the availability of credit and capital to consumers.

I served on a community bank board for 10 years and certainly appreciate the impact of what has happened to community banks and to credit unions. What has happened, of course, is we have diluted the availability of those institutions and reduced them another 1,500 banks that aren't there today, aren't there to serve the communities. So, it is a great concern to me.

I would like to express thanks to Congresswoman Maloney for cosponsoring with me H.R. 3240, the Regulation D Study Act.

Mr. Fecher, you spoke in some degree regarding that study bill. I would like you to elaborate on why you think this legislation is necessary.

Mr. FECHER. The legislation is necessary because Regulation D, which I would imagine a lot of folks in this room have never ever heard of, causes unnecessary NSF charges to consumers when they exceed the statutory maximum number of automatic transfers from a savings account to a checking account to cover drafts or debits that may come in.

And it is not an uncommon occurrence, especially with the way money moves through the financial system today, that a member of a credit union—which happened at Wright-Patt Credit Union just last week—calls up and says, "Why did you charge this NSF fee?" We attempt to explain to them that they exceeded their number of statutorily required automatic transactions of six in the month and they say, "What?"

And they first think it is the credit union's fault, and then we explain, no, this is a Federal regulation that we have to enforce. And frankly, that makes them madder.

So we advocate for the bill, and we think it should be studied. We hope that the outcome of the study is that this tool for monetary policy, that number of transactions could almost be tripled without impacting the use of that regulation in terms of monetary policy. So briefly, that is what that regulation is all about, and we support the study.

Mr. PITTENGER. Let's put it in context in terms of where we are today with technology, and when this bill went into effect—this regulation went into effect, the rule of six transfers, there has been quite a change. It is just logic to review this today, it seems to me, from where we were before.

Mr. Blanton, you are nodding your head. Would you like to make a comment?

Mr. BLANTON. I do also agree. You are, in fact, penalizing people for properly managing their money. And with this system that it is now, it is archaic from when it was originally put in place, and you make us—it is very difficult for us to compete with non-

financial institutions that also compete for deposit dollars that don't have these restrictions.

Mr. PITTENGER. Mr. Clendaniel?

Mr. CLENDANIEL. I definitely agree with those comments. This is a common-sense bill, and an outdated regulation.

Mr. PITTENGER. How can consumers who are affected by the limitations on withdrawals put on the savings accounts—how are they really affected by this?

Mr. CLENDANIEL. Again, to echo what Mr. Fecher said, it—there is a lot of confusion, first off, on the consumer's behalf. And they just don't understand the fact that, what does that mean? What does it mean I can only do six this month? I did six last month at the teller line, yet I can only do six online this month.

So there is a confusion between where and how they can do those different transactions. Because in their mind, a transfer is a transfer, no matter if they do it by check, by teller, or by online services.

Mr. PITTENGER. Mr. Isaac, you are nodding. Do you have a comment?

Mr. ISAAC. I agree.

Mr. PITTENGER. Oh good. All right.

Thank you very much. I yield back my time.

Chairwoman CAPITO. The gentleman yields back.

It is the desire of the Chair to finish the hearing before—we have been called for a vote. We have about 7 minutes, and we have 2 questioners left.

So, Mr. Barr?

Mr. BARR. Thank you, Madam Chairwoman.

Ms. Cline, as you know, the Dodd-Frank Act placed finance companies, non-depository institutions, under the jurisdiction of the CFPB, but because of an oversight, the Act did not extend traditional protections of privilege to a variety of information that would be ordinarily disclosed in the course of a supervisory exam, either to the CFPB or to State agencies.

Mr. Perlmutter and I have introduced a bipartisan bill called the Examination and Supervisory Privilege Parity Act of 2014 to remedy this situation and to provide regulators and regulated parties with greater certainty about the protections that apply when information is shared to and among regulators.

Why is this legislation needed and what kind of disclosures would this foster, in your mind, that do not exist currently?

Ms. CLINE. State bank regulators and the CSBS are in support of this legislation. We think it is important that privileged information be covered. But in addition to privileged, we would recommend that the language be expanded to include confidentiality.

In my home State of West Virginia, information shared with my banking agency is shared under confidentiality rules; it doesn't cover privilege. So that would be our only recommendation, that your legislation also include a protection for confidential information, as well.

Mr. BARR. Thank you, Ms. Cline.

And for Mr. Blanton, Mr. Vallandingham, and Mr. Isaac, earlier today at another hearing, I shared with the Department of Justice and financial regulators the following story from a Kentucky resident who had received communication from their bank, and the e-

mail to our office was as follows: "Our family—and this is in reference to Operation Choke Point—company has been in the business of leasing our land to coal producers for decades. Today I returned a call from client services at our bank in Lexington, Kentucky. They asked if we lease land to coal producers that operate surface mines. They said that we are receiving pressure from bank regulators and will no longer do business with us if we have surface mines on our property."

Now to a man, every one of the regulators and the Department of Justice denied that they are participating in the EPA's war on coal. They denied that, notwithstanding what we know about Operation Choke Point.

But my question to you all is, as bankers, does it surprise you that a family business that does business in a politically targeted business, namely, surface mining, would receive that kind of a communication from their bank in light of the regulatory pressures that we are seeing?

Mr. Blanton?

Mr. BLANTON. It doesn't surprise me at all, unfortunately. We are seeing this in a lot of cases, and that wasn't on the list—the FDIC list—that wasn't there. But we are seeing this in a lot of cases, where undue pressure and judgments and opinions of whether it is a good or bad business are now being pushed down to the bank and forcing us to try and take action against customers such as that.

Mr. VALLANDINGHAM. That is the slippery slope that scares us all. Today, it is these two dozen business; what will it be tomorrow?

And at the end of the day, we are going to have to make choices about legal businesses, whether we can bank them or not, and ultimately put ourselves at additional liability. I will take it another step further. It is a supersession of States' rights. In our State, payday lenders aren't legal, so we don't have that issue. But in the State next to us, they are legal.

So ultimately, we are going to have to make some real-world decisions that I don't think we should be forced to make. And if somebody is committing fraud, we support the prosecution, but the bank wasn't committing the fraud. The third party was.

Mr. BARR. Mr. Isaac?

Mr. ISAAC. It doesn't surprise me at all, and it scares me. I don't know where we are going.

Mr. BARR. I think to your point, Mr. Isaac, that a bank's board and the bank's management is in a much better position to ascertain the reputational risk of that bank than an unaccountable, unelected Federal regulator in Washington, D.C. And the irony of all of this is that under Operation Choke Point, the Department of Justice is disfavoring certain politically unpopular businesses by denying them banking services, but at the same time they issue guidance designed to help illegal business like marijuana dealers get access to banking services.

What this tells me is that—

Chairwoman CAPITO. The gentleman's time has expired.

Mr. BARR. —using prosecutorial discretion, the Department of Justice is picking winners and losers in the marketplace.

Chairwoman CAPITO. Thank you. We are running close on time here.

Mr. BARR. Thank you.

I appreciate the indulgence. I yield back.

Chairwoman CAPITO. Mr. Royce?

Mr. ROYCE. Thank you, Madam Chairwoman. I appreciate you holding this hearing.

I introduced one of the bills before us here today, alongside the gentleman from Florida, Mr. Murphy, to bring some common-sense reforms to the Office of Financial Research over at the Treasury Department. That bill is H.R. 5037, the OFR Accountability Act. It does ensure improved transparency and better interagency coordination and stronger cybersecurity protections at the OFR.

And I think Members of Congress on both sides of the aisle have heard constant criticism about the quality of research at the OFR, the lack of real coordination between the Office and Federal financial regulators. And much of the criticism, frankly, is focused on the asset management and financial stability study published in September 2013 that they did.

With respect to this report, the House Oversight & Government Reform Committee found that the OFR failed to meaningfully consider the expert analysis provided by the career professional staff at the SEC, resulting in what a group of former regulators has called a flawed analysis of asset managers and fundamental misconceptions about how security markets function. The Oversight & Government Reform Committee concluded that while OFR paid lip service to the SEC staff's suggestions, OFR failed to meaningfully address the important issues flagged in the SEC memorandum.

So I think this legislation does it in a thoughtful way. The bill Mr. Murphy and I have put forward is balanced. It is a bipartisan approach that includes reforms to the OFR that, frankly, its inaction absolutely necessitates.

So I look forward to moving that bill expeditiously.

I do have one question, quickly. Maybe Mr. Clendaniel could speak up on this, but it is on another subject.

Madam Chairwoman, if I could ask our credit union witnesses what specific next steps they would like to see this committee take as it relates to NCUA's risk-based capital proposal.

Mr. CLENDANIEL. I don't think I will have enough time to go through all the steps with the time allowed, but I think the one thing that could be done to help all credit unions and all one hundred million members in the country is to include the NCUA proposal into H.R. 4042 and do a stop and study to make sure we know the full impact of what the proposal is and what is also the right proposal for credit unions and for the members.

Mr. ROYCE. Madam Chairwoman, because we have a vote on, perhaps I could put my full opening statement in the record and Mr. Clendaniel could put a full proposal forward.

And with that, I yield back, Madam Chairwoman.

Chairwoman CAPITO. I thank the gentleman for understanding the time constraints here.

I would like to submit for the record statements from the following organizations: the Appraisal Institute; the Consumer Financial Services Association of America; the National Association of

State Credit Union Supervisors, the American Financial Services Association; Toyota; and the Financial Services Roundtable.

I would like to thank everybody for your patience.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, I will declare this hearing adjourned, and I am going to run to my vote. Thank you.

[Whereupon, at 4:44 p.m., the hearing was adjourned.]

A P P E N D I X

July 15, 2014

The Honorable Tom Cotton
Statement for the Record
Subcommittee on Financial Institutions and Consumer Credit
Hearing entitled "Examining Regulatory Relief Proposals for Community Financial Institutions Part II"
July 15, 2014

Thank you, Chairwoman Capito and Ranking Member Meeks, for holding today's hearing. On behalf of my colleague from Washington, Mr. Kilmer, who has championed the issue of prize-linked savings (PLS) accounts since his days as a state legislator, I'm pleased to have the opportunity to discuss our American Savings Promotion Act, which we introduced last year.

This bipartisan legislation will help reverse a troubling decline in the personal savings rate of Americans. Such an effort is critical because research shows that savings is essential for educational attainment, financial stability, and economic mobility.

In 2013, the personal savings rate was an alarming 3.8%, down from 10.5% in 1963. This of course has macroeconomic implications but, more importantly, are the personal implications—the family that is one broken down car away from despair, the single parent who has no cushion if this week's paycheck falls short, the contractor struggling to find jobs in a slow economy.

Currently, 44% of American households lack the savings to cover basic expenses for three months, while almost 80% of Americans play the lottery. Researchers have shown that a practical and effective way to incentivize savings is through prize-linked savings accounts, which combine the excitement of the lottery with the security of a savings account by offering prizes in exchange for meaningful deposits. For example, for every deposit over $25, a Michigan credit union enters a participant into a raffle to win a $3,750 monthly prize and a $10,000 annual prize.

Because low-income Americans are the least likely to save money and the most likely to play the lottery, these products have been the most effective for first-time savers and low-to-moderate savers. Today nine states allow PLS accounts through credit unions, creating over 50,000 accounts with over $94 million in savings. However, federal statutes preclude these products in banks and thrifts. This legislation would seek to create the space in federal law to allow states to authorize and expand PLS products to more financial institutions and stem our savings crisis.

Opening Statement
Rep. Blaine Luetkemeyer (MO-03)
"Examining Regulatory Relief Proposals for Community Financial Institutions, Part II"
Committee on Financial Services
July 15, 2014

Thank you, Madam Chairman.

I appreciate this opportunity to discuss three of my legislative proposals. Like many of the bills we will consider today, these efforts offer regulatory relief for institutions and will result in more affordable financial products for their customers.

H.R. 4240, my *Community Bank Mortgage Servicing Asset Capital Requirements Study Act,* will help to ensure that banks can continue to service mortgages without facing unnecessarily high capital requirements until a study has been completed by regulators. My *Access to Affordable Mortgages Act* will help to lower the cost of high-priced mortgage loans by repealing certain appraisal requirements that tend to drive up costs and slow down closings, particularly in rural areas.

I'm also pleased that the Subcommittee has included H.R. 4986, my *End Operation Choke Point Act.* This bipartisan legislation comes in response to Operation Choke Point, the DOJ initiative that aims to push legal industries out of business. My bill puts in place the safe harbor necessary for financial institutions to serve legally-operating customers. Equally important: the legislation will ensure that DOJ will not be able to act unilaterally in broadly attacking legal industries.

Madam Chairman, the initiatives we will discuss today are key to returning balance to our financial system. I thank you and yield back.

Rep. Pittenger
Opening Statement
July 15, 2014

-Thank you Chairwoman Capito for yielding me the time to discuss these important issues.

-Today before the Committee is a number of bills to help address the onslaught of regulations pouring out from Washington.

-One bill in particular—HR 3240, the Regulation-D Study Act, simply directs the Government Accountability Office (GAO) to study the impact of the Federal Reserve Board's monetary reserve requirements, implemented through Regulation D, on depository institutions, consumers and monetary policy. The bill also directs the GAO to consult with credit unions and community banks.

-This legislation has strong bipartisan support, with 30 members signing on to it. I want to thank my colleague Carolyn Maloney for joining with me in introducing HR 3240.

-This is a common sense piece of legislation that is not only good for financial institutions but for American families as well. The issue of having only six transfers per month for bank accounts hasn't been reviewed in several decades. With new technological advancements and online banking we owe it to the American public to revisit this regulation.

- A GAO study will allow an objective assessment of whether the rarely changed monetary reserves imposed on depository institutions and consumers are necessary in order for the Fed to implement monetary policy in the 21st century.

-Thank you and I yield back the balance of my time.

Rep. Ed Royce (CA-39)
Full Committee Hearing entitled: "Examining Regulatory Relief Proposals for Community Financial Institutions, Part II".
07.15.2014

Madame Chair:

I appreciate you holding this hearing.

You have been an outspoken defender of free and competitive markets. Thank you for again highlighting the need for regulatory relief for Main Street, and mom –and— pop investors.

The purpose of many of the legislative proposals before us today is to ensure that our government is not harming those it claims to protect.

I introduced one of these bills – alongside the Gentlemen from Florida, Mr. Murphy – to bring some common-sense reforms to the Office of Financial Research (OFR) at the Treasury Department.

H.R. 5037, the OFR Accountability Act, ensures improved transparency, better interagency coordination, and stronger cybersecurity protections at the OFR.

Members of this Committee, on both sides of the aisle, have heard constant criticism about the quality of research at the OFR and lack of real coordination between the Office and federal financial regulators.

Much of this criticism has been focused on the OFR's Asset Management and Financial Stability study published in September 2013. With respect to this report, the House Oversight Committee found that the "OFR failed to meaningfully consider the expert analysis provided by the career, professional staff at the SEC" resulting in what a group of former regulators has called "a flawed analysis of asset managers and fundamental misconceptions about how securities markets function." The Oversight Committee concluded that "while OFR paid lip service to the SEC staff's suggestions, OFR failed to meaningfully address the important issues flagged in the SEC memorandum."

H.R. 5037 seeks to address these issues in a thoughtful way.

The bill requires the OFR to submit for public notice and comment an annual report that details the Office's work for the upcoming year, including reports, studies, and grants, among other activities.

Additionally, the bill requires the OFR to coordinate with financial regulators when conducting future studies. The OFR is not mandated to make changes suggested by interagency experts, but the Office must explain why it has not incorporated any suggested changes.

Some have criticized these requirements as both *overreaching* and *redundant.*

I had to scratch my head – trying to figure how both are possible. How can these requirements simultaneously add new, burdensome duties to the OFR while duplicating existing duties?

I think the answer lies in the fact that these are responsibilities that a well functioning agency can and should do on its own.

It is good public policy to be both transparent about your activities and coordinate with experts in financial regulation when writing studies in their field.

If the OFR already accomplished this, through their own actions, then the bill very well may be redundant… sadly they have not.

The bill Mr. Murphy and I have put forward is a balanced, bipartisan approach that includes reforms to the OFR that its inaction necessitates.

Finally, the legislations includes a requirement that the OFR bolster its cybersecurity defenses.

Cybersecurity breaches are a major threat to our economy, and an Office that holds as much sensitive material as the OFR ought to have protective measures in place.

This year, the GAO found the number of data breaches at federal agencies involving personally identifiable information has more than doubled over the last several years from 10,000 in 2009 to over 25,000 in 2013. Similarly the Department of Homeland Security reported 48,000 cyber incidents involving government systems in 2012.

I look forward to moving this bill expeditiously.

I yield back.

July 15, 2014

Testimony of

R. Daniel Blanton

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions & Consumer Credit

of the

Committee on Financial Services

United States House of Representatives

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July 15, 2014

Chairman Capito, Ranking Member Meeks, my name is Daniel Blanton, Chief Executive Officer of Southeastern Bank Financial Corporation and Georgia Bank & Trust, in Augusta Georgia. I am also the Vice Chairman of the American Bankers Association (ABA). I appreciate the opportunity to be here to present the views of the ABA regarding regulatory relief for small financial institutions. The ABA is the voice of the nation's $14 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend nearly $8 trillion in loans.

Georgia Bank and Trust is a $1.775 billion community bank established in 1989. We have 12 branches serving the Augusta area and extend $975 million in loans to our local communities.

Today, our diverse banking industry is made up of banks of all sizes and types, from small community banks to community-based regional banks, to large money center and global banks. This depth and breadth is required to meet the broad array of financial needs of our communities and customers. Our $16 trillion economy requires a diverse U.S. banking system.

Community banks make up 95 percent of all U.S. banking organizations and have been the backbone of all the Main Streets across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive.

The sad fact is that over the course of the last decade, 1,500 community banks have disappeared. This is why hearings like today's are so important. It is an opportunity to change the dialogue from just talking about how important community banks are to what can be done to stop

the rapid decline in the number of community banks and start taking action to assure we have a healthy and vibrant community bank sector.

There is a widespread appreciation for the benefits community banks provide to their communities across the country. Yet, many actions taken by the banking agencies have hurt, not helped community banks. For example, at the same time policy makers were urging banks to make more loans to help boost the economy, regulators were clamping down in an effort to drive all risk from the system. At the same time that banks were trying to reach out to their local businesses, the growing list of new rules and regulations meant more compliance officers and fewer customer-facing employees. At the same time banks were trying to deploy the precious capital they had, regulators were telling them to boost capital-to-asset ratios which often led to less lending.

During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank. Dodd-Frank is already adding to that burden for all institutions with 5,933 pages of proposed regulations and 8,002 pages of final regulations (as of May 29, 2014) and we're only half way through the 398 rules that must be promulgated and is poised to add hundreds more affecting all banks. Managing this tsunami of regulation is a significant challenge for a bank of any size, but for the median-sized bank with only 40 employees, it is overwhelming.

Today, it is not unusual to hear bankers—from strong, healthy banks—say they are ready to sell to larger banks because the regulatory burden has become too much to manage. These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose ability to serve their communities is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer.

It is time to move from good intentions to changes that have tangible results. We applaud the efforts of Congress to help community banks. In particular, I would like to thank Chairman Capito, Representative Duffy, Representative Kilmer, Representative Luetkemeyer, Representative Perlmuter, Representative Pittenger, and Representative Royce for introducing H.R. 3240, H.R. 3374, H.R. 3913, H.R. 4042, H.R. 4626, H.R. 4986, H.R. 5062, the OFR Accountability Act, and the draft TILA reform bill. Many of the bills being discussed today are a strong first step toward relieving the burden felt by community banks and ensuring that the community banking model remains viable. While no single piece of legislation alone can relieve the burden that community

banks face, many of the bills under consideration today could begin to provide much needed relief. We urge Congress to work together—House and Senate—to get legislation passed and sent to the President that will help community bankers better serve our customers.

One issue that is of particular importance is the Department of Justice program ***Operation Choke Point.*** This program is requiring banks to act as policemen and judges, holding them responsible for the actions of their customers without due legal process. Banks must shut down the accounts of customers that Justice suspects to be illegal, often with no formal court order or legal proceeding. Bankers cannot be guarantors of the lawful nature of their customer's operations—they have neither the compliance capacity, the financial capacity, nor we believe the legal obligation to take on that assurance. However, the risk of regulatory or enforcement retribution is a potent deterrent against banking any customer that the government decides is unworthy of payment system access—even though the government itself does not take direct action in court to prove its case against the targeted customer.

Another important issue is *the* ***treatment of Mortgage Servicing Rights (MSRs) in Basel III.*** Many community banks sell a portion of their mortgage loans, but retain the servicing rights to these loans. Retaining the servicing rights allows a bank to maintain a relationship with their local customer by continuing to be the primary touch point in regard to their loan. The harsh treatment of MSRs under Basel III will force many community banks to sell these rights to non-banks. This is a loss for both the bank, which is no longer able to maintain a long-term relationship with their community, and for consumers who will see their loan serviced by a third party.

In the remainder of my testimony, I want to first briefly describe the reasons for the concern that I and my community bank colleagues have about our current regulatory environment. Following that, I will provide details about specific actions that can be taken, including comments on the legislation being considered by this subcommittee. The ABA stands ready to work with this subcommittee to make changes that will secure the future of one of this nation's most important assets: Community Banks.

I. The Costs To Implement New Regulations Are Substantial, Weighing Most Heavily On Community Banks

Community banks, as do all banks, work hard every day to meet the credit and financial needs of their customers and communities. Community banks have a presence much greater than their total assets suggests. According to FDIC's Community Banking Study released in December 2012, community banks accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. In 629 U.S. counties—or almost one-fifth of all U.S. counties—the only banking offices are operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services

The ability to meet local needs has not been easy with the increased regulatory costs and second-guessing by bank examiners. During the last decade, the regulatory burden for community banks has multiplied tenfold and it is no surprise that nearly 18 percent of community banks disappeared in that period.

Unfortunately, the cumulative impact of years of new regulations and the proliferation of non-bank and non-taxed and subsidized competitors (such as credit unions and the Farm Credit System) are combining into a potent mixture that will surely, if left unchecked, lead to more and more consolidations of small banks.

Make no mistake about it, this burden is keenly felt by all banks, but particularly small banks that do not have as many resources to manage all the new regulations and the changes in existing ones. Besides the real hard dollar costs, there are important opportunity costs related to the products and services that cannot be offered or offered only at higher costs to our customers. In dramatic illustration of this point, a 2011 ABA survey of bank compliance officers found that compliance burdens have caused almost 45 percent of the banks to stop offering loan or deposit accounts. In addition, almost 43 percent of the banks decided to not launch a new product, delivery channel or enter a geographic market because of the expected compliance cost or risk.

Furthermore, research by the Federal Reserve over the years has confirmed that the burden of regulations falls disproportionately on smaller banks. The Federal Reserve Bank of Minneapolis has estimated that hiring one additional employee to respond to the increased regulatory requirements would reduce the return on assets by 23 basis points for the median bank with total assets of $50

million or less. To put this estimate in perspective, ***such a decline could cause about 13 percent of the banks of that size to go from being profitable to unprofitable.***

As a $1.7 billion bank, we are better able to spread out some of the compliance costs than our smaller brethren. For the median-sized bank in this country with $173 million in assets and 40 employees, the burden is magnified tremendously. I was shocked to learn recently about a $70 million bank in Kansas that has three and a half FTE compliance employees out of a total of 23 employees. He was particularly frustrated to have 15 percent of his staff dealing with government regulations that do nothing for lending in his small community. Besides internal audits, banks now have to have outside audits for compliance which is a significant expense for smaller banks. Then, the regulators spend time auditing the audits. Checkers checking checkers is a costly and wasteful exercise that provides no value-added for the safety and soundness of the bank and does nothing to protect the bank's customers

II. Many of the Bills Considered Today are an Important First Step to Providing Relief For Community Banks

ABA applauds this subcommittee for holding hearings like today's and seriously addressing the challenges faced by community banks. I will touch on how the bills being discussed today can help provide much needed relief for community banks.

Mortgage Servicing Asset Treatment Under Basel III Should Be Corrected

ABA supports H.R. 4042 introduced by Rep. Blaine Luetkemeyer and Rep. Ed Perlmutter. This legislation would delay the implementation of the Basel rules on MSAs until the impact of the new rules can be studied and better alternatives explored.

Many banks that make mortgage loans also engage in servicing, which primarily consists of collecting mortgage payments and forwarding them to the "owner" of the loan; collecting insurance and tax payments; and addressing problems such as late payments, delinquencies, and defaults. Banks commonly sell mortgage loans into the secondary market but retain the right to service the loan (called "servicing retained"). This strategy is an important way for banks to maintain valuable connections with their customers, while managing interest rate risk by selling long-term credit

assets. Servicing mortgage loans for investors is a specialty of many U.S. banks and has provided a strong source of fee income for decades.

Banks are retaining less mortgage servicing due to Basel III's unfavorable capital treatment of mortgage servicing assets ("MSAs"). As a result, Basel III is unintentionally increasing the concentration of servicing held by less regulated, non-bank firms such as mortgage companies, REITs, hedge funds, and private equity firms that are not subject to the new capital restrictions. The long-term relationships that banks and their customers have established should not be penalized by Basel III's punitive capital treatment of MSAs.

Banks should be encouraged to service the loans that they make to their customers. The Basel III rules should not create an environment that drives servicing out of banks by making it more difficult for banks to hold servicing assets.

H.R. 4042 stops the negative effects until the impact can be fully examined. The bill requires the regulators to study the risk of holding MSAs; the recent history of MSAs during the financial crisis; the impact of the new rules both on the ability of community and mid-size banks to compete and on the structure of the mortgage servicing business; and alternative regulatory approaches that could be implemented. The bill requires this analysis to be done within one year of the date of enactment and suspends the current MSA capital rule during that period. The bill does not apply to the large international banks that Basel III was meant to address.

Costs and Benefits Should be Weighed for Any New Regulation

ABA supports H.R. 3913 introduced by Rep. Sean Duffy. This bill would ensure that regulatory agencies consider promotion of efficiency, competition, and capital formation before issuing or modifying certain regulations. Too often regulations are piled on, without regard to whether the cost of the regulation is justified by the goal it seeks to achieve. This bill would compel regulators to weigh the costs and benefits of new regulations, as well as provide a statement with their considerations.

Confidentiality of Information Should Be Protected

ABA supports H.R. 4626 introduced by Chairman Capito. This bill would apply the same confidentiality standards to information shared with state regulators as is currently applied to information shared with the Federal Reserve.

Operation Choke Point Should Be Ended

ABA supports H.R. 4986, introduced by Rep. Blaine Luetkemeyer which directly addresses and solves the problem created under "Operation Choke Point." Banks are in the business of providing financial services for law-abiding customers, and they share a common goal with law enforcement of maintaining the integrity of the payments system. Our members are committed to combatting the financing of terrorism, money-laundering and other serious financial crimes. Banks already keep records and report suspicious activities to law enforcement; however Operation Choke Point makes banks responsible for policing their customers, ensuring that all of them are operating legally. Banks should not be judge and jury on whether their customers are operating legally.

Through the Bank Secrecy Act (BSA) and its subsequent legislative extensions, Congress established the role that banks play to accomplish this mission. It assigns banks the obligation to ***keep records of transactions*** and ***report suspicious activities*** (and certain types of cash transactions) to enable law enforcement to do their jobs of investigating and prosecuting financial crimes against those that initiate them. This statutory division of responsibility creates a cooperative partnership between the financial services industry and the government that respects those separate roles and preserves judicial due process for those suspected of financial crime. The policy is for banks to serve, observe and report; not to police, expel or drive underground.

Banks devote enormous personnel and technological resources every year to fight financial crime to meet the unfunded Congressional mandates of the Bank Secrecy Act and its related laws. All depository institutions combined filed close to ***one million suspicious activity reports*** (SARs) in the past year alone, covering such subjects as mortgage fraud, identity theft, counterfeit debit and credit cards, and wire transfer fraud. These SARs are intended to help federal and local law enforcement identify and develop cases in the fight against financial crime. However, as we have noted in past testimony, there is a fundamental lack of accountability for law enforcement's use of this and other BSA data.

Unfortunately, regulatory pile-on has converted the straightforward BSA/AML mandate to identify customers, keep transaction records and report suspicious activities into the government directed bank surveillance Act with over 350 pages of examination procedures, plus regulatory guidance. This regulatory drift has been further leveraged by the banking agencies to impose additional layers of regulatory and reputation risk on banks performing normal banking services on businesses for all types engaged in interstate commerce.

For one, the FDIC expects our members to differentiate across the patchwork of legal requirements applied to the businesses they bank and will criticize banks whose controls do not ensure that their customers—and even their customers' customers—are operating in compliance with applicable state and federal laws. Without notice and comment, the FDIC has imposed its guidance ***with the force of law*** by making it the basis for BSA enforcement orders that mandate adherence to its terms. This results in an impossible and statutorily unfounded standard, extending far beyond the division of responsibility between banks and law enforcement to protect the legitimacy of the payment system.

On top of this regulatory groundwork, the Department of Justice has initiated Operation Choke Point that starts with the premise that businesses of any type cannot effectively operate without access to banking services. DOJ pursues banks to shut down accounts of merchants targeted by the DOJ without formal enforcement action or even charges having been brought against these merchants. Thus, in the absence of any court order or other legal enforcement proceeding against the actual fraudsters, the program targets the bank for facilitating transactions of a customer.

DOJ identifies the banks to investigate using the very SARs the banking industry has filed in fulfillment of its role to report suspicious activity. Rather than use such leads to investigate, determine culpability and directly prosecute the perpetrators, the DOJ has instead turned the industry's reporting efforts onto the reporters themselves.

Taken together the banking agencies and the Department of Justice are placing on banks the burden to differentiate between proper or improper conduct of their customers, and to close "high-risk" accounts or face unacceptable levels of regulatory criticism or retribution. This ratcheting up regulatory and reputation risk forces banks to de-risk their business lines by terminating customers whose operations may be entirely legal but who have risky profiles. This regulatory environment undermines our industry's efforts to support local businesses and grow our national economy. It also undermines customers whose economic viability is severed by government blacklisting without recourse to judicial due process.

Our concern with Operation Choke Point is not its goal of fighting financial fraud, but rather the policy premise upon which the initiative is based, the faulty legal foundation it asserts, and the manner in which it is applied. We believe that it is time to renounce Operation Choke Point and recalibrate the BSA/AML regime to restore the intended division of responsibility between the

financial industry's reporting role and law enforcement's role of prosecuting the perpetrators of fraud and financial crime directly.

Accordingly ABA supports H.R. 4986 which embodies the following principles:

- Stops the improper application of FIRREA Section 951 by limiting it to the original purposes of protecting banks from frauds committed against them.
- Reinforces the safe harbor for banks engaged in suspicious activity reporting by protecting them against assertions of liability for the knowledge they obtain about customers who are accessing normal banking and payment services.
- Recognizes the partnership role of the financial industry while respecting the rights of its customers by properly applying the law enforcement information sharing process established under the USA PATRIOT Act's section 314(a).
- Holds law enforcement agencies accountable for demonstrating the utility of SAR and other BSA data reporting that vindicates the unfunded costs imposed on the financial system providers to meet their reporting obligations.
- Prevents law enforcement or regulatory agencies from enforcing, or imposing through supervisory process, any financial institution operating requirements for conducting normal payment services for customers in the absence of rule-making establishing such standards.

We believe that we can combat financial fraud more effectively working together with our regulatory agencies and law enforcement than we can by making our industry surrogate targets for the real wrongdoers.

Conclusion

An individual regulation may not seem oppressive, but the cumulative impact of all the new rules plus the revisions of existing regulations is oppressive. The regulatory burden from Dodd-Frank must be addressed in order to give all banks, and especially community banks, a fighting chance to maintain long-term viability and meet the needs of local communities everywhere. The consequences of excessive regulation are real. Costs are rising, access to capital is limited for community banks, and revenue sources have been severely cut. It means a weaker economy. It means slower job growth. With the regulatory overreaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is difficult at best.

Community banks are resilient. Banks like mine will find a way to succeed. But the headwinds we face daily with excessive red tape makes our job much harder and hurts the communities we are

dedicated to serve. With Congress's help in lifting some of the burden, community banks are set to thrive and turn the economic tide in favor of our communities. We need to move from simple, good intentions to action that creates tangible results.

Testimony of

Mr. David Clendaniel

President and CEO of Dover Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"Examining Regulatory Relief Proposals for Community Financial Institutions Part II"

Before the

United States House Financial Services Financial Institutions and Consumer Credit Subcommittee

United States House of Representatives

July 15, 2014

Introduction

Good afternoon Chairman Capito, Ranking Member Meeks and Members of the Subcommittee. My name is David Clendaniel and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I am happy to be appearing before the subcommittee today to talk about regulatory relief. I look forward to providing feedback on the specific legislation you are considering, in addition to giving a general overview of the current regulatory environment and the most timely issues credit unions like mine face.

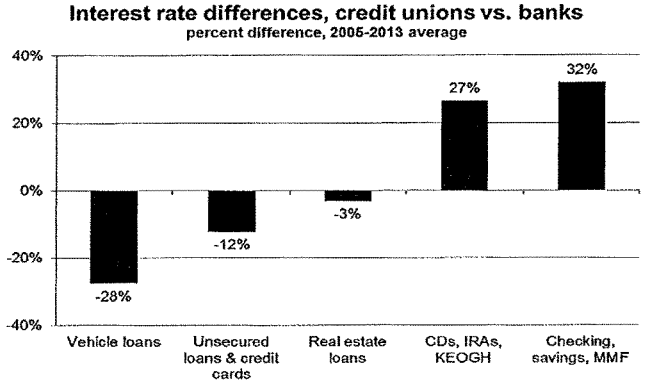
I have served as the President and CEO of Dover Federal Credit Union in Dover, Delaware since 1997. Holding degrees from both the University of Delaware and Delaware State University, I have spent over thirty years in the financial services industry. I have been with Dover FCU in a number of executive positions for over twenty years. Dover Federal Credit Union was first chartered in 1958 by a handful of Air Force and civilian workers at Dover Air Force Base. Today we serve over 39,000 members with assets exceeding $400 million.

As you know, NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU-member credit unions collectively account for approximately 69 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in today's hearing regarding legislative proposals designed to help our nation's financial institutions better serve the American public.

I. Increased Regulatory Burden has Impacted Credit Unions

Credit unions have a long track record of helping the economy and making loans when other lenders often have left various markets. This was evidenced during the recent financial crisis when credit unions kept making auto loans, home loans, and small business loans when other lenders cut back. Still, credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital.

Credit unions continue to play a crucial role in the recovery of our nation's economy. Credit unions remain a relatively small part of the marketplace when compared to the banking industry. They are oftentimes a lender of last resort for consumers that have been denied credit via other financial institutions. As detailed in the chart below, on average from 2005-2013, credit unions consistently outperformed banks with lower interest rates on loans and higher returns on savings and deposits.



Today, credit union lending continues to grow at a solid pace, up about 14% in March compared to 2009. In short, credit unions didn't cause the financial crisis, helped blunt the crisis by continuing to lend during difficult times, and perhaps most importantly, continue to play a key role in the still fragile economic recovery. Although credit unions continue to focus on their members, the increasing complexity of the regulatory environment is taking a toll on the credit union industry. While NAFCU and its member credit unions take safety and soundness extremely seriously, the regulatory pendulum post-crisis has swung too far towards an environment of overregulation that threatens to stifle economic growth. As the National Credit Union Administration (NCUA) and the Consumer Financial Protection Bureau (CFPB) work to prevent the next financial crisis, even the most well intended regulations have the potential to regulate our industry out of business.

During the consideration of financial reform, NAFCU was concerned about the possibility of overregulation of good actors such as credit unions, and this was why NAFCU was the only credit union trade association to oppose the CFPB having rulemaking authority over credit unions. Unfortunately, many of our concerns, about the increased regulatory burdens that credit unions would face under the CFPB, have proven true. While there are credible arguments to be made for the existence of a CFPB, its primary focus should be on regulating the unregulated bad actors, not adding new regulatory burdens to good actors like credit unions that already fall under a functional regulator. As expected, the breadth and pace of CFPB rulemaking is troublesome, and the unprecedented new compliance burden placed on credit unions has been immense.

The impact of this growing compliance burden is evident as the number of financial institutions continues to decline, dropping by 19.9% (more than 1,600) institutions since 2007. This trend rings true for credit unions as well, and a main reason for the decline is the increasing cost and complexity of complying with the ever-increasing onslaught of regulations. Many smaller institutions simply cannot keep up with the new regulatory tide and have to merge out of business or be taken over.

This growing demand on credit unions is demonstrated by a 2011 NAFCU survey of our membership that found that nearly 97% of respondents were spending more time on regulatory compliance issues than they did in 2009. A 2012 NAFCU survey of our membership found that 94% of respondents had seen their compliance burdens increase since the passage of the *Dodd-Frank Act* in 2010. Furthermore, a March of 2013 survey of NAFCU members found that nearly 27% had increased their full-time equivalents (FTEs) for compliance personnel in 2013, as compared to 2012. That same survey found that over 70% of respondents have had non-compliance staff members take on compliance-related duties due to the increasing regulatory burden. This highlights the fact that many non-compliance staff are being forced to take time away from serving members to spend time on compliance issues. Furthermore, a number of credit unions have also turned to outside vendors to help them with compliance issues – a survey of NAFCU members, conducted in June of 2014, found that nearly 80% of respondents are using third-party vendors to help comply with the new TILA-RESPA requirements from the CFPB.

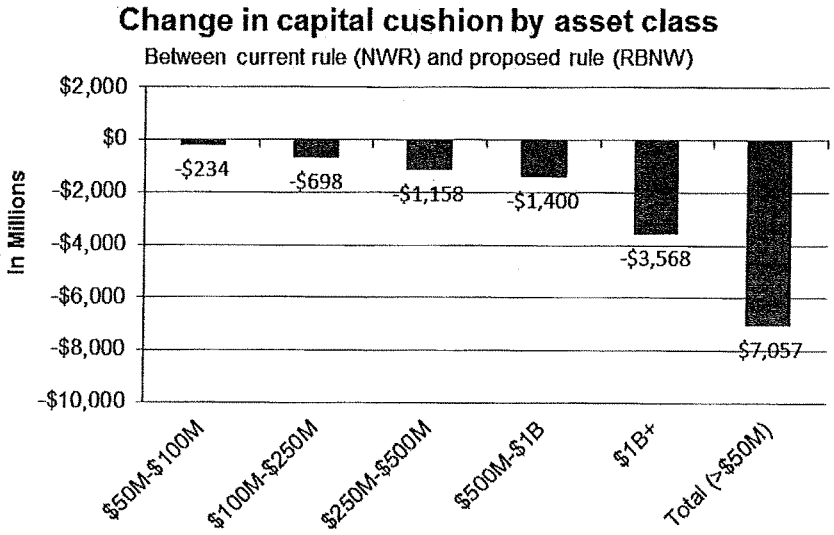
At Dover FCU our current annual expenditure on compliance is over $250,000, compared with about $80,000 that we spent in 2009 before the *Dodd-Frank Act*. While increased costs for compliance related expenses over time are normal, this spike is directly correlated to the regulations being promulgated by the CFPB as mandated in *Dodd-Frank*. As described above, Dover is also in the unfortunate circumstance of non-compliance staff being pulled off their normal duties out of necessity to work on compliance related issues. As a result of this stress on our key staff, we are in the process of hiring another compliance officer bringing our total compliance expenditure well above $300,000 annually. It should be noted that this figure does not include staff training to comply with various regulations which totals nearly 3,000 personnel hours or another $57,000 annually.

II. NCUA's Risk-Based Capital Proposal: Regulating Credit Unions Out of Existence

Before commenting on the legislation before us today, I would like to update the committee on NCUA's risk-based capital proposal for credit unions and what impact this rule will have on the credit union industry it if becomes final without significant changes. As members of the subcommittee are aware, this ongoing issue is of the utmost importance to credit unions of all sizes and the one-size-fits-all approach currently being taken by NCUA will stifle growth, innovation and diversification at credit unions.

NAFCU's Economics and Research department prepared the impact analysis graph found below that outline the impact the proposal would have on credit unions based on their asset size. Our analysis of the proposed rule determined that credit unions with more than $50 million in assets will have to hold $7.1 billion more in additional reserves to achieve the same capital cushion levels that they currently maintain. While NCUA contends that a lower amount of capital is actually needed for impacted credit unions to remain at a well-capitalized level, the agency is ignoring the fact that most credit unions seek to maintain a capital cushion above the minimum needed for that level – often because NCUA's own examiners have encouraged them to do so. Because credit unions cannot raise capital from the open market like other financial institutions, this cost of maintaining a cushion will undoubtedly be passed on to the 97 million credit union

members across the country. A survey of NAFCU's membership taken found that nearly 60% of respondents believe the proposed rule would force their credit union to hold more capital, while nearly 65% believe this proposal would force them to realign their balance sheet. Simply put, if the NCUA implements this rule as proposed, credit unions will have less capital to loan to credit worthy borrowers, whether for a mortgage, auto, or business loan.



Additionally, it is also worth drawing the subcommittee's attention to the chart below breaking-down risk-weighting at the FDIC (under Basel III) compared to the proposed risk-weighting by NCUA highlighting the areas that will be especially problematic for our nation's credit unions.

	Category	Sub-Category	NCUA proposal	FDIC weights
Numerator	Liabilities		1	1
	Equity		1	1
	Contra Assets		1	1
	Other Assets	Goodwill	-1	-1
		Identifiable intangible assets	-1	-1
		NCUSIF	-1	**
	Cash		0	0
	Investments*	0-1 Year	0.2	0.2
		1-3 Years	0.5	0.2
		3-5 Years	0.75	0.2
		5-10 Years	1.5	0.2
		>10 Years	2	0.2
		Corporate CU Member Capital	1	**
		Corporate Paid-in Capital	2	**
Denominator	Real Estate Loans	Nondelinquent 1st mort R/E loans (excl. MBLs)		
		<25% of assets	0.5	0.5
		25-35% of Assets	0.75	0.5
		>35% of Assets	1	0.5
		Other R/E and delinquent R/E		
		<10% of Assets	1	1
		10-20% of Assets	1.25	1
		>20% of Assets	1.5	1
	Other Loans	Nondelinquent student loans	1	1
		Nondelinquent other loans	0.75	1
		Delinquent other loans	1.5	1.5
		SBA	-0.8	-0.8
		Member business loans		
		<15% of Assets	1	1
		15-25% of Assets	1.5	1
		>25% of Assets	2	1
	Other Assets	Goodwill	-1	-1
		Identifiable intangible assets	-1	-1
		NCUSIF	-1	**
		Invt in CUSO	2.5	**
		Mort servicing rights	2.5	2.5
		All other assets	1	1
	Off Bal Sheet	Loans with recourse	0.75	**
		Unfunded commitments bus loans (75% conversion)	1	**
		Unfunded commitments non-bus loans (10% conversion)	0.75	**
	Capitalization thresholds			
		Well Capitalized	10.5%	10.0%
		Adequately Capitalized	8.0%	8.0%

* U.S. Treasuries and other direct and unconditional claims on the U.S. government are weighted at zero by both NCUA and FDIC. Most other credit union investments are weighted from 0.2 to 2 according to their maturity. They would generally be rated at a constant 0.2 under the FDIC rule.

** No direct comparison with FDIC

Widespread concern about this proposal is also highlighted by the over 2,000 comment letters NCUA has received to date about the content of the proposal and the process used to fast track the rule despite credit unions not contributing to the financial crisis. In NAFCU's own comment letter submitted on May 27, 2014, (attachment A) signed by the entire NAFCU Board of Directors and most Regulatory Committee members, significant concerns about the proposal included:

- Several issues related to NCUA's legal authority to issue the rule as proposed, such as:
  - Comparability with banking regulatory requirements;
  - Substitution of statutorily defined legal terms;
  - Individual minimum capital requirements;
  - Definition of a "complex" credit union;
- The need for a legislative solution in order to achieve a fair and balanced risk-based capital system;
- NCUA's treatment of the regulatory process including the refusal to extend the comment period and form an industry working group prior to releasing a proposed rule, and the need for an additional notice of proposed rulemaking with public comment period;
- NCUA's drastic understatement of credit unions that will be affected by this rule and whose balance sheets and business plans will need adjustment;
- NCUA's proposed risk-based capital ratio for well capitalized credit unions set at 10.5 percent;
- NCUA's treatment of risk-weighted assets and the lack of explanation for deviation from similar banking risk-weights;
- NCUA's incorporation of interest rate and concentration risk into risk-weighting for real estate, investments, and member business loans (MBL's);
- Individual minimum capital requirements for credit unions including issues with the subjectivity of their imposition;
- Components not included in the numerator portion of the risk-based capital ratio, such as goodwill;

- The 1.25 percent cap on Allowance for Loan and Lease Losses (ALLL) especially considering the Financial Accounting Standards Board's (FASB) most recent proposal on ALLL;
- Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule; and
- The proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule.

Many of these concerns were also expressed by Dover FCU in our own comment letter (attachment B) and by Representatives Pete King (R-NY) and ranking member Gregory Meeks (D-NY) in a bipartisan joint letter sent to NCUA that garnered the support of 324 of their House colleagues. Chairman Hensarling, Chairman Capito, Chairman McHenry and numerous other Members of the Financial Services Committee also weighed in with NCUA. On behalf of NAFCU member credit unions and the entire credit union community, we want to thank all of you for your steadfast support. The outpouring of concern from Congress has been significant and NAFCU remains hopeful that a final rule will reflect many of the issues raised.

Despite NCUA's refusal to extend the official comment period, the recent listening sessions on the proposal in Los Angeles, California, and Chicago, Illinois, reinforce the need for significant changes to the proposal and additional time for credit unions to digest the proposal and come into compliance. During these listening sessions, credit unions have repeatedly stated that they believe that, given the magnitude of this rule and its potentially devastating effects on our member credit unions, it is imperative that NCUA re-propose the rule.

As many of you are aware, the *Administrative Procedure Act* (APA) not only mandates consideration of all submitted comments, but it also requires an agency to engage in a subsequent comment period when the agency makes such substantive changes to a rule that it is no longer a logical outgrowth of the proposal. If NCUA implements changes to the proposed rule in accordance with even some of the 2,000 comments received, the changes will be substantive and more than mere adjustments or clarifications to the initial proposal. In fact, both NCUA Chairman Debbie Matz and Board Member Rick Metsger have publically supported changing

the treatment of risk-weighted assets. NAFCU believes that this change alone would qualify as "substantive" under the APA and warrant reissuing the proposal for public comment.

Furthermore, NAFCU encourages NCUA to allow credit unions the opportunity to voice their thoughts and concerns. The 2,000 comments submitted for the proposal clearly exemplify that credit unions around the country have a vested interested in this issue and they deserve the opportunity to comment given the magnitude of the potential negative impact of this proposal. Credit unions believe it is critical that NCUA effectively consider and incorporate industry input to ensure that an appropriate risk-based capital regime is adopted for the credit union industry. In the best interests of all stakeholders, therefore, credit unions urge the NCUA Board to operate in a collaborative manner with the credit union industry and reissue the risk-based capital proposal for comment so that we may have the necessary opportunity to raise their concerns and suggestions.

Should NCUA's proposal go forward with little or no changes, the new rule would precipitate the need for Congressional action on proposals to bring about capital changes for credit unions such as H.R. 719, the *Capital Access for Small Businesses and Jobs Act*, which would allow credit unions to have access to supplemental capital sources. In addition this would prompt the need for statutory changes necessary to design a true risk-based capital system for credit unions. Lastly, a final rule mirroring the proposal in terms of an individual credit union's risk-based capital requirements being changed through the exam process only reinforces the need for action on H.R. 1553, the *Financial Institutions Examination Fairness and Reform Act*. NAFCU looks forward to continuing to work with Congress on this timely issue.

III. NAFCU on Regulatory Burden: Legislative and Regulatory Action Needed

Finding ways to cut-down on burdensome and unnecessary regulatory compliance costs is the only way for credit unions to thrive and continue to provide their member-owners with basic

financial services and the exemplary service they need and deserve. It is also a top goal of NAFCU.

Ongoing discussions with NAFCU member credit unions led to the unveiling of NAFCU's "Five Point Plan for Regulatory Relief" (attachment C) in February of 2013, and a call for Congress to enact meaningful legislative reforms that would provide much needed assistance to our nation's credit unions. The "Five Point Plan" covers key areas for credit unions including: Administrative Improvements for the Powers of NCUA; Capital Reforms for Credit Unions; Structural Improvements for Credit Unions; Operational Improvements for Credit Unions; and, 21st Century Standards for Data Security.

Recognizing that there are a number of outdated regulations and requirements that no longer make sense and need to be modernized or eliminated, NAFCU also compiled and released a document entitled "NAFCU'S Dirty Dozen" (attachment D) in December of 2013, that outlines twelve key regulatory issues credit unions face that should be eliminated or amended. The "Dirty Dozen" includes expanding credit union investment authority; updating NCUA's fixed assets rules; improving the process for credit unions seeking changes to their field of membership; increasing the number of transactions allowed to be made per month from savings accounts per the Federal Reserve Regulation D; providing flexibility for credit unions that offer member business loans; updating requirements to disclose account numbers to protect privacy of credit union members; updating advertisement requirements for loans products and share accounts; modernizing NCUA advertising requirements; making improvements to the Central Liquidity Fund; providing flexibility for federal credit unions to operate under state law in certain circumstances; simplifying regulations governing check processing and funds availability; and, eliminating redundant NCUA requirements to provide copies of appraisals upon request.

Our "Five Point Plan" and "Dirty Dozen" outline a number of areas where credit unions need action and we urge the Committee to review these documents. In our statement today, we highlight a number of key issues where regulatory burdens and proposals are posing immediate threats to the ability of credit unions to serve their members and give them the financial products that they want.

IV. Legislative Measures before the Subcommittee Today

NAFCU is pleased to participate in today's subcommittee hearing and comment on several of the proposals being reviewed as they relate to and impact our nation's credit unions. We appreciate the leadership of the Committee in bringing these measures forward and would urge action on these efforts at relief.

Community Bank Mortgage Servicing Asset Capital Requirements Study Act (H.R. 4042)
First and foremost, NAFCU has reviewed the bipartisan *Community Bank Mortgage Servicing Asset Capital Requirements Study Act* (H.R.4042) introduced by Reps. Luetkemeyer and Perlmutter that would delay the implementation of Basel III regulations on mortgage servicing assets until an impact study is conducted and alternatives are explored. Given the circumstances credit unions find themselves in with the risk-based capital proposal described in the first half of my testimony, NAFCU believes this is an appropriate vehicle to include a similar analysis be done by NCUA pertaining to their proposal.

In fact, members of Congress have asked NCUA for additional information about how the risk-weights for various asset classes were derived and there has been no explanation to date. It is also worth noting that the *Federal Credit Union Act* requires that the system of prompt corrective action NCUA prescribes by regulation be comparable to those that the banking regulators institute. In the many iterations of Basel and most recent rules that the FDIC has finalized, banking regulators have chosen not to incorporate interest rate and concentration risk into their risk-weights. However, NCUA's proposal incorporates both. While interest rate risk and concentration risk need to be managed and planned for at every credit union, the draconian proposal in question is not the way to avoid future losses.

Again, a thorough study of NCUA's proposal is appropriate and, quite frankly, should have been done from the outset. NAFCU would support suspending NCUA action on the risk-based capital proposal until such a study is done, delivered to Congress, and reviewed by lawmakers and the public.

SAFE Act Confidentiality and Privilege Enhancement Act (H.R. 4626)

NAFCU supports legislation introduced by Chairman Capito that would clarify the confidentiality of information shared between state and federal financial service regulators under the *S.A.F.E. Mortgage Licensing Act*. This commonsense technical fix is welcomed by credit unions as it applies to the Nationwide Mortgage Licensing System & Registry established as an oversight mechanism to collect information from Mortgage Loan Originators.

American Savings Promotion Act (H.R. 3374)

NAFCU supports this bipartisan legislation introduced by Representatives Cotton and Kilmer that would amend federal law to allow credit unions and other financial institutions to use savings promotion raffle products. As members of the committee may be aware, several states have passed laws to allow credit unions to offer these prize-linked savings accounts where members are incentivized to save through being entered into a lottery or raffle. Those credit unions that have instituted such programs have found them to be successful tools. As the country recovers from the worst financial crisis of our time, creative programs with clear rules and guidelines that encourage household savings merit serious consideration.

End Operation Choke Point Act (H.R. 4986)

While NAFCU understands the importance of the government's role in fighting fraud and taking enforcement action where appropriate, our member credit unions remain concerned about the aggressive nature of the Justice Department's "Operation Choke Point" program. As members of the subcommittee are aware, this initiative investigates financial institutions, including credit unions, that provide banking services to certain types of businesses that are subject to greater instances of fraud. While preventing fraud is a laudable concern, this approach is putting unnecessary onus on credit unions to police activities of legal third parties. The mere prospect of an enforcement action is sufficient cause for some financial institutions to restrict access to their payments systems to only well established companies. Not only does this cause an unnecessary level of angst for the financial institutions, if left unchecked it could seriously deter future growth and innovation.

For these reasons NAFCU supports Representative Leutkemeyer's legislation, the *End Operation Choke Point Act* (H.R. 4986), that would create a legal safe harbor for financial institutions, including credit unions, that meet qualifying criteria. For a financial institution to meet such criteria the merchant would have to be licensed to offer the product or service it's selling; be registered as a money transmitting business; or provide a legal opinion that demonstrates the legality of its business operations.

The Regulation D Study Act (H.R. 3240)

NAFCU supports this bipartisan legislation introduced by Representatives Pittenger and Maloney that would mandate the Government Accountability Office to study the impact of the Federal Reserve Board's monetary reserve requirements on depository institutions, consumers and monetary policy.

As you are aware, Regulation D limits a credit union member's ability to transfer their money between savings and checking accounts to six transactions per month. Once a transaction is made beyond that limit, a member is either charged a fee or has their savings account is re-classified as a "transaction account". Under current Regulation D rules, savings accounts are not subject to reserve requirements, while transaction accounts are. This discrepancy tends to be confusing for credit union members and often forces credit union employees to focus their attention on the compliance issue rather than customer service.

Federal Reserve Regulation D is a prime example of a regulation that hasn't been reconsidered by Congress or the agencies in far too long and that is why it was included on the aforementioned NAFCU's "Dirty Dozen" list. NAFCU believes a study of whether this outdated monetary reserve requirements imposed on depository institutions and consumers are necessary would result in strong evidence for the regulation's full repeal.

Rep. Leutkemeyer's Discussion Draft related to Appraiser Requirements under TILA

NAFCU supports the intent in Rep. Leutkemeyer's discussion draft that would exempt higher-risk mortgages of $250,000 or less from appraisal requirement provisions under the *Truth in Lending Act* if the lender holds the loan in portfolio for at least 3 years. As the committee

reviews this bill for potential changes, NAFCU would also support the $250k threshold being raised to a higher level. This bill would also provide important legal safeguards for lenders acting in good faith throughout the appraisal process.

H.R. 3913, Rep. Duffy's bill to require certain considerations before issuing regulations

We support the concept of this legislation by Representative Duffy to amend the Bank Holding Company Act of 1956 to require agencies to make certain considerations relating to the promotion of efficiency, competition, and capital formation before issuing or modifying certain regulations. We would urge that parallel language to apply such a standard to the NCUA and the CFPB as appropriate be included should the legislation move forward.

V. Additional Areas Where Credit Unions Need Relief

In addition to the proposals to provide relief before the Subcommittee today and the areas outlined in NAFCU's "Five-Point Plan for Regulatory Relief" and our "Dirty Dozen" regulations, I would like to bring to the Subcommittee's attention a few additional measures that can help provide relief.

CFPB Reforms

We are pleased that the Financial Services Committee has already acted on a series of measures to improve the governance and transparency of the CFPB. One additional area that could use action are the arbitrary thresholds established under the *Dodd-Frank Act*. NAFCU believes that, at the very least, all credit unions, not just those under $10 billion, should be exempt from examination by the CFPB. Furthermore, the additional thresholds established in the Dodd-Frank Act should be raised and indexed. For example, the Act established $10 billion as an arbitrary threshold for financial institutions being subject to the Durbin interchange price cap. We believe that raising such a threshold would still accomplish the same objectives, while not penalizing the number of "good actors" that have found themselves above the arbitrary $10 billion line but below mega-bank status. At the very least, the $10 billion line should be indexed for inflation on an annual basis – going back retroactively to its establishment.

Other Approaches to Relief from the Credit Union MBL Cap

While NAFCU supports and urges action on H.R. 688, the *Credit Union Small Business Jobs Creation Act*, we would also urge Congressional action on the *Credit Union Residential Loan Parity Act*, H.R. 4226, which would exclude loans made non-owner occupied 1- to 4-family dwelling from the definition of a member business loan. Furthermore, we would urge support for H.R. 5061, legislation recently introduced by House Veterans Affairs Committee Chairman Jeff Miller (R-FL), to exempt loans made to our nation's veterans from the definition of a member business loan. This measure can not only help our nation's returning heroes, but also the American economy.

Examination Fairness

New examination fairness provisions should be enacted to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation. As outlined earlier, NAFCU supports the bipartisan "*Financial Institutions Examination Fairness and Reform Act*" (H.R. 1553) introduced on April 15, 2013, by Chairman Capito and Representative Maloney and is hopeful that the issues this bill seeks to address are given consideration moving forward. Credit unions must have adequate notice of and proper guidance for exams, the right to appeal to an independent administrative law judge during the appeal process, and be assured that they are protected from examiner retaliation.

VI. Regulatory Coordination is More Important Than Ever

With numerous new rulemakings coming from regulators, coordination between the agencies is more important than ever. Congress should use its oversight authority to make sure that regulators are coordinating their efforts and not duplicating burdens on credit unions by working independently on changes to regulations that impact the same areas of service. There are a number of areas where opportunities for coordination exist and can be beneficial.

Financial Stability Oversight Council (FSOC)

NAFCU has been on the forefront encouraging the FSOC regulators to fulfill their Dodd-Frank mandated duty to facilitate rule coordination. This duty includes facilitating information sharing

and coordination among the member agencies of domestic financial services policy development, rulemaking, examinations, reporting requirements and enforcement actions. Through this role, the FSOC is effectively charged with ameliorating weaknesses within the regulatory structure and promoting a safer and more stable system. It is extremely important to credit unions for our industry's copious regulators to coordinate with each other to help mitigate regulatory burden. We urge Congress to exercise oversight in this regard and consider putting into statute parameters that would encourage the FSOC to fulfill this duty in a thorough and timely manner.

Data Security

Outside of advocating for federal legislation with regard to the safekeeping of information and breach notification requirements for our nation's retailers, NAFCU has also urged regulatory coordination for credit unions already in compliance with the stringent standards in the *Gramm-Leach-Bliley Act*. In the wake of the massive Target data breach in December of 2013, the Federal Trade Commission began exploring a range of regulatory options to assist consumers, businesses, and financial institutions. Moving forward, it is imperative that NCUA ensure that credit unions are protected from any unnecessary regulatory burden and continue to allow them to provide quality services to their members.

VII. Conclusion: The Need for Regulatory Relief and Congressional Oversight

The growing regulatory burden on credit unions is the top challenge facing the industry today. The number of credit unions continues to decline, as the compliance requirements in a post Dodd-Frank environment have grown to a tipping point where it is hard for many smaller institutions to survive. Credit unions want to continue to aid in the economic recovery, but are being stymied by overregulation. NAFCU appreciates the subcommittee's work to review legislation that would provide relief for credit unions through commonsense and coordinated regulation and eliminating or amending outdated requirements.

Congress should also continue vigorous oversight of the federal financial agencies, including NCUA, and take action on this issues outline in this statement where they fail to take appropriate steps.

We thank you for the opportunity to share our thoughts with you today. I welcome any questions you might have.

Attachment A: NAFCU's May 27, 2014, comment letter on the NCUA's Prompt Corrective Action/ Risk-Based Capital proposal

Attachment B: Dover Federal Credit Union's May 14, 2014, comment letter on the NCUA's Prompt Corrective Action/ Risk-Based Capital proposal

Attachment C: NAFCU's "Five Point Plan for Regulatory Relief" released in February 2013

Attachment D: NAFCU's "Dirty Dozen" – Twelve Regulations to Eliminate or Amend

Attachment A: NAFCU's May 27, 2014, comment letter on the NCUA's Prompt Corrective Action/ Risk-Based Capital proposal

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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

May 27, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: Comments on NCUA Prompt Corrective Action – Risk-Based Capital Proposed Rule

Dear Mr. Poliquin:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding the proposed rule on prompt corrective action and risk-based capital. As the credit union community comments on this rule, NAFCU is hopeful that the National Credit Union Administration (NCUA or Agency) Board will realize the devastating effect that this proposal will have on the credit union industry, the American consumer, and our nation's small businesses. While we are supportive of the idea of a risk-based capital regime for credit unions, the current NCUA proposal is not appropriate for credit unions or the credit union industry. If it were to be implemented as proposed, credit unions would find themselves at a significant competitive disadvantage to banks. As proposed, the rule is one-size-fits-all and would serve to stifle growth, innovation, and diversification within credit unions. We ask that the NCUA Board withdraw the rule or alternatively make major modifications to the proposal before any rule is finalized.

NAFCU has many concerns with the proposed rule which we explain in detail below; however, our major concerns include:

- Several issues related to NCUA's legal authority to issue the rule as proposed, such as:
  - Comparability with banking regulatory requirements;
  - Substitution of statutorily defined legal terms;
  - Individual minimum capital requirements;
  - Definition of a "complex" credit union;
- The need for a legislative solution in order to achieve a fair and balanced risk-based capital system;
- NCUA's treatment of the regulatory process including the refusal to extend the comment period and form an industry working group prior to releasing a

proposed rule, and the need for an additional notice of proposed rulemaking with public comment period;

- NCUA's drastic understatement of credit unions that will be affected by this rule and whose balance sheets and business plans will need adjustment;
- NCUA's proposed risk-based capital ratio for well capitalized credit unions set at 10.5 percent;
- NCUA's treatment of risk-weighted assets and the lack of explanation for deviation from similar banking risk-weights;
- NCUA's incorporation of interest rate and concentration risk into risk-weighting for real estate, investments, and member business loans (MBL's);
- Individual minimum capital requirements for credit unions including issues with the subjectivity of their imposition;
- Components not included in the numerator portion of the risk-based capital ratio, such as goodwill;
- The 1.25 percent cap on Allowance for Loan and Lease Losses (ALLL) especially considering the Financial Accounting Standards Board's (FASB) most recent proposal on ALLL;
- Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule; and
- The proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule.

Legal Authority

NAFCU does not believe that NCUA has the legal authority to issue the rule as proposed. There are several areas of the proposed rule where NAFCU questions whether the rule is consistent with the requirements of the Federal Credit Union Act (FCU Act.)

The FCU Act Requirements

The FCU Act 12 U.S.C. §1790d contains the requirements for Prompt Corrective Action (PCA), including the required regulations and the risk-based net worth requirement. These provisions were added to the FCU Act by the Credit Union Membership Access Act of 1998 (CUMAA).

NCUA acknowledges in the proposed rule that it derives its legal authority for promulgating the proposed risk-based capital rule from sections 1766[1] and 1790d of the FCU Act, and maintains that the proposed rule achieves the purposes that the FCU Act requires.

NCUA states in the proposed rule that "Congress set forth a basic structure for PCA in section 216 that consists of three principal components: (1) A framework combining mandatory actions prescribed by statute with discretionary actions developed by NCUA; (2) an alternative system of PCA to be developed by NCUA for credit unions defined as

[1] This section refers to powers of the NCUA Board.

'new'; and (3) a risk-based net worth requirement to apply to credit unions that NCUA defines as 'complex.'"[2]

Comparability

The FCU Act requires that the NCUA Board "shall, by regulation, prescribe a system of prompt corrective action for insured credit unions that is—(i) consistent with this section; and (ii) **comparable** to section 1831o of this title."[3] (Emphasis added.) This reference to 12 U.S.C. §1831o is to the PCA requirements of the Federal Deposit Insurance Act, as implemented through the Federal Deposit Insurance Corporation (FDIC) regulations.

During the deliberations on CUMAA, Congress also stated on the record that "'Comparable' here means parallel in substance (though not necessarily identical in detail) and equivalent in rigor."[4] This proposed rule goes far beyond this interpretation of comparable in a number of instances that are highlighted throughout this letter.

Risk-Based Net Worth vs. Risk-Based Capital Terminology

NCUA's proposed amendments to 12 C.F.R. §702.102 would replace statutorily defined terms with what it considers to be "functionally equivalent" terms.[5] NAFCU questions whether NCUA has the legal authority to deviate from these statutory terms. The FCU Act also requires a "risk based net worth requirement for complex credit unions;" the statutory requirement reads:

> ***"Risk-based net worth requirement for complex credit unions.—***
>
> *(1) In general.—The regulations required under subsection (b)(1) of this section shall include a risk-based net worth requirement for insured credit unions that are complex, as defined by the Board based on the portfolios of assets and liabilities of credit unions.*
>
> *(2) Standard.—The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection."*[6] *(Emphasis added.)*

The FCU Act also provides specific definitions for "net worth"[7] and "net worth ratio."[8] These terms are specifically defined in the FCU Act as follows:

> "(2) ***Net worth.—The term "net worth"***
> *(A) with respect to any insured credit union, means the retained earnings balance of the credit union, as determined under generally accepted accounting principles, together with any amounts that were previously retained earnings of any other credit union with which the credit union has combined;*

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[2] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11185.
[3] 12 U.S.C. § 1790d(b)(1)(A).
[4] S. Rep. No. 193, 105th Cong., 2d Sess. 13 (1998) (S. Rep.).
[5] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11191.
[6] 12 U.S.C. § 1790d(d).
[7] 12 U.S.C. § 1790d(o)(2).
[8] 12 U.S.C. § 1790d(o)(3).

(B) with respect to any insured credit union, includes, at the Board's discretion and subject to rules and regulations established by the Board, assistance provided under section 208 to facilitate a least-cost resolution consistent with the best interests of the credit union system; and
(C) with respect to a low-income credit union, includes secondary capital accounts that are—
(i) uninsured; and
(ii) subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the Fund.[9]

(3) Net worth ratio.
The term "net worth ratio" means, with respect to a credit union, the ratio of the net worth of the credit union to the total assets of the credit union."[10] *(Emphasis added.)*

The preamble to the proposed rule discusses NCUA's proposed amendments to § 702.102, including changes to the terminology used. NCUA acknowledges that the FCU Act specifically uses the term "risk-based net worth requirement" but proposes to replace that terminology with "risk-based capital," which it contends is "functionally equivalent."[11]

The proposed rule also replaces the term "net worth" with the term "capital categories" to describe the combined "net worth ratio" and "risk-based net worth" measurements, as well as several other modifications to the terminology currently used.

NCUA contends that "no substantive changes to the requirements of section 216(c) are intended by these changes in terminology."[12] These changes are not only substantive, but redefine statutorily defined terms including "net worth" and "net worth ratio" with terms that do not encompass the same things.

These statutorily defined terms may not be redefined by NCUA through regulation in order to place an ill-fitting risk-based capital system on top of the current PCA system. NAFCU believes that if NCUA really wants to institute a working risk-based capital system that would be comparable to what banks have, then NCUA would need Congress to change the FCU Act to give it the authority to do so.

Individual Minimum Capital Requirements

NAFCU questions whether NCUA has the statutory authority to institute individual minimum capital requirements. Under the proposed rule, NCUA introduces a new power to raise individual minimum capital requirements for credit unions "that varies from any of the risk-based capital requirement (s) that would otherwise apply to the credit union..."[13] The proposed rule contains a list of circumstances where NCUA could raise a credit union's individual minimum capital requirements that includes, among others, a credit union receiving special supervisory attention or a portfolio that reflects weak credit quality or significant likelihood of financial loss. The FCU Act 12 U.S.C. § 1790d(h) states:

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[9] 12 U.S.C. § 1790d(o)(2).
[10] 12 U.S.C. § 1790d(o)(3).
[11] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11191.
[12] *Id.*
[13] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11216 (to be codified at 12 C.F.R. § 702.105(a)).

"(h) More stringent treatment based on other supervisory criteria

With respect to the exercise of authority by the Board under regulations comparable to section 1831o(g) of this title—

(1) the Board may not reclassify an insured credit union into a lower net worth category, or treat an insured credit union as if it were in a lower net worth category, for reasons not pertaining to the safety and soundness of that credit union; and

(2) the Board may not delegate its authority to reclassify an insured credit union into a lower net worth category or to treat an insured credit union as if it were in a lower net worth category." (Emphasis added.)

A broad interpretation of the statute[14] would allow for NCUA to use issues of safety and soundness to reclassify an insured credit union or treat it as though it were in a lower net-worth category. By doing so, the NCUA Board could subject those individual credit unions that did not meet the individual minimum capital requirements to the same restrictions as those credit unions that are less than well capitalized. The statute, if read broadly, could allow for the NCUA Board to downgrade a credit union in cases pertaining to safety and soundness.

Taking a more narrow interpretation of the statute, one could argue that having the authority to treat an insured credit union as if it were in a lower net worth category is not the same as having the authority to arbitrarily subject individual credit unions to different individual minimum capital requirements. While the effects of lowering a credit union's net worth category could be similar for a credit union under the proposed individual minimum capital requirement, it is not the same as being authorized to be able to pick the point at which a credit union would not be safe and sound.

Finally, a strict reading of the statute would not provide the authority necessary for the NCUA Board to promulgate a rule that includes proposed § 702.105. Nowhere in the statute does Congress specifically authorize the NCUA Board to provide different minimum capital requirements for individual credit unions.

There is a second major issue regarding individual minimum capital requirements. Assuming the NCUA Board is deemed to have the authority to institute a system that would allow for individual minimum capital requirements because of its interpretation of 12 U.S.C. § 1790d(h)(1), at issue is whether the NCUA Board can delegate that authority to anyone other than itself, such as an examiner or regional director. Congress was clear in its intent that this authority is not to be delegated to anyone other than the NCUA Board.[15]

The proposed rule uses phrases such as "The decision is necessarily based, in part, on subjective judgment grounded in agency expertise..."[16] and "NCUA may establish

[14] 12 U.S.C. § 1790d(h).
[15] 12 U.S.C. § 1790d(h)(2).
[16] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11217 (to be codified at 12 C.F.R. § 702.105(c)).

increased individual minimum capital requirements..."[17] The proposed § 702.105 uses the term NCUA, not NCUA Board, as is used in other parts of the proposed rule.[18] The proposed rule also specifically sets out in the summary that the initials "NCUA" are meant to mean the National Credit Union Administration as a whole agency and "Board" to mean the NCUA Board.[19] NAFCU believes this proposed rule intends to delegate the power to raise individual minimum capital requirements from the NCUA Board to other individuals or departments within the NCUA. This would fall directly outside the power authorized by Congress in 12 U.S.C. § 1790d. These discrepancies must be addressed in any final rule that is issued.

Definition of Complex

The proposed rule seeks to establish new more stringent risk-based capital standards for all credit unions with more than $50 million in assets, which NCUA has defined as "complex." NCUA's re-definition of a "complex" credit union is outside of the scope of the authority designated to it by Congress. The proposed rule arbitrarily sets the threshold at $50 million in assets with no additional tests to actually determine if the credit union itself is "complex."

The FCU Act[20] directs NCUA to develop a risk-based net worth system for complex credit unions that is based on the "portfolios of assets and liabilities of credit unions."[21] Congress could have directed NCUA to focus only on asset size in defining "complex." Instead, the FCU Act[22] requires NCUA to consider the complexity of a credit union's book of assets such as types of investments and loans, as well as liabilities. The definition of "complex" must be based on whether the credit union's financial activities and operations are sufficiently elaborate to warrant that credit union be designated as "complex" rather than just on its asset size.

As NAFCU has previously stated, the size of an institution does not determine the complexity of the assets and liabilities of a given credit union. There are many credit unions with well over $50 million in assets that are run out of one branch with only a handful of employees that often engage in only the most basic of transactions for members. Furthermore, there are many large credit unions that have very simple portfolios and are not involved in "risky" activities. There are also some smaller credit unions that engage in more risky activities that would require them to hold more capital. Limiting the definition of "complex" for credit unions to only those credit unions over $50 million is completely arbitrary and contrary to Congressional mandate.

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[17] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11216 (to be codified at 12 C.F.R. § 702.105(b)).
[18] See Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184 (to be codified at 12 C.F.R. §§ 702.110, 702.111, 702.112).
[19] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184.
[20] 12 U.S.C. 1790d(d).
[21] *Id.*
[22] As modified by The Credit Union Membership Access Act of 1998 (CUMAA).

Legislative Solution

NAFCU supports a risk-based capital system for credit unions. We support less capital for lower-risk credit unions and more capital for higher-risk credit unions. However, we continue to believe that we need Congress to make statutory changes to the FCU Act to achieve a fair system.

Ongoing discussions with NAFCU member credit unions led to the unveiling of NAFCU's "Five Point Plan for Regulatory Relief" in February 2013, and a call for Congress to enact meaningful legislative reforms that would provide much needed assistance to our nation's credit unions. In NAFCU's "Five Point Plan for Regulatory Relief," NAFCU calls on Congress to direct NCUA and industry representatives to conduct a study on PCA and recommend changes. It also calls on Congress to modernize capital standards by directing the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks and allows the NCUA Board to authorize supplemental capital. Finally, it asks Congress to establish special capital requirements for newly chartered federal credit unions that recognizes the unique nature and challenges of starting a new credit union.

NCUA's proposed rule on risk-based capital does not achieve a truly risk-based capital system for credit unions. NAFCU believes that the proposal is conceptually flawed, deviates from statutory requirements for PCA, and tries to establish an ill-fitting risk-based capital system without the necessary legislative solution. This results in a one-size-fits-all rule that will ultimately hurt credit unions while disregarding Congressional intent, and will require credit unions to hold additional unnecessary capital.

The FCU Act also prescribes that credit unions have net worth ratios of six percent to be considered adequately capitalized and seven percent for well capitalized,[23] while banks have leverage ratios of four percent to be adequately capitalized and five percent for well capitalized.[24] Credit unions are already at a competitive disadvantage to banks in this regard, and this proposed rule only serves to multiply that competitive disadvantage by requiring credit unions to hold even more capital as compared to banks.

These additional requirements are increasing the capital that credit unions cannot use to help members by providing loans. Furthermore, credit unions also have to account for a one percent contribution to the NCUSIF which constructively limits the amount of funds available for credit unions to extend credit, placing additional capital burdens on credit unions. NAFCU believes that NCUA should work with Congress to change PCA requirements such that credit unions are put on equal footing with and better able to compete with banks.

Should NCUA's current proposed rule go forward with little or no changes, the new rule would precipitate the need for other Congressional action to bring about capital changes for credit unions such as H.R. 719, the Capital Access for Small Businesses and Jobs Act,

[23] 12 U.S.C. § 1790d(c).
[24] 12 U.S.C. § 1831o.

which would allow credit unions to have access to supplemental capital sources. Additionally, the inclusion of an individual minimum capital requirement that starts with the examiner in any final rule only reinforces the need for action on H.R. 1553, the Financial Institutions Examination Fairness and Reform Act.

The Regulatory Process

Capital touches every part of a credit union's operations and decision-making. NAFCU believes that this proposed rule is one of the most important rulemakings to come out of the Agency in recent history. It is troubling that NCUA has refused to work with credit unions throughout the rulemaking process.

On May 8, 2013, NAFCU sent a letter to the NCUA Board requesting it to consider creating a working group on reforming current regulatory capital requirements for credit unions. That request specifically sought a working group made up of industry stakeholders to be formed and convened prior to any rulemaking by NCUA. NAFCU continued to stress to NCUA the need for a capital working group to perform an analysis prior to the issuance of a proposed rule on risk-based capital. Unfortunately, a working group was not convened prior to the release of this proposed rule.

Furthermore, NAFCU believes that for complex and important rules it is appropriate to issue an Advanced Notice of Proposed Rulemaking (ANPR) to collect public input on key issues. NCUA did not issue an ANPR prior to the release of the risk-based capital proposed rule. A risk-based capital rule is one such issue that is complex and important enough that an ANPR made sense for both the Agency and the credit union industry. It would also have given NCUA an opportunity to gather data from credit unions about the true effects of any changes in the capital regime. NAFCU believes that NCUA should have issued an ANPR to solicit comments from the public instead of releasing a proposed rule without credit union input either by formal comment period or working group.

Additionally, NCUA released a "Risk-Based Capital Calculator" when the NCUA Board approved the proposed rule in January 2014, and made this calculator available to the public. The calculator uses the most recent 5300 Call Report data and generates a credit union's current net worth ratio, net worth classification, and most importantly what the credit union's risk-based capital ratio would be pursuant to the proposed rule.

NAFCU believes that this calculator should not have been made available to the public. While this may be a useful tool for a credit union to understand what its capital position would be under the proposed rule, its public disclosure could have unintended consequences such as damage to a credit union's reputation. The proposed rule is complex and an uninformed viewer of this information could draw the wrong conclusions about the strength of the credit union, particularly as the rule is still in the proposal stage and subject to change. A better alternative would have been to provide credit unions with access to the calculator through a secure portal on NCUA's website.

On February 28, 2014, NAFCU sent a joint letter along with the Credit Union National Association (CUNA) to Chairman Matz to request an extension of the comment period by

90 days to give credit unions more time to understand this complex rule and to provide valuable feedback to NCUA about the possible effects of the rule on their credit union. Chairman Matz denied this request and in doing so, stated that the comment period provided enough time for credit unions to understand the rule and provide constructive comments to the Agency.

After Chairman Matz denied the request, credit unions continued to ask for more time and NAFCU, along with CUNA, wrote another letter to all members of the NCUA Board to again request that the comment period for the rule be extended for 90 days. That request was also denied. This rule is too important to rush the rulemaking process. Giving credit unions extra time to realize the full effects of the rule on present and future portfolios and business decisions easily outweighs any possible negatives in delaying its implementation.

Given the recent comments from NCUA Board members regarding the significant changes that will be made to the rule before it is finalized, NAFCU believes that NCUA should re-issue the proposed rule with any changes made using the input received from this comment period and the scheduled listening sessions through a notice of proposed rulemaking. This would give credit unions an opportunity to see those significant changes and contribute comments. If NCUA intends the final rule to include as many changes as the NCUA Board members have indicated, then NCUA will need to re-issue a proposed rule with another public comment period as required by the Administrative Procedure Act.

Affected Credit Unions

NCUA has stated publicly that this proposed rule would only affect around 200 credit unions.[25] That number simply includes those credit unions whose net worth classification will be downgraded. While there may only be around 200 credit unions whose net worth categories will be downgraded, there are many more credit unions that will be affected by this proposed rule. There are 1,404 federally-insured credit unions (FICUs)[26] that currently have more than $50 million in assets but are not currently defined as complex pursuant to PCA requirements. These credit unions would be defined as complex by the proposed rule. This means that 1,404 additional FICUs would be subject to a risk-based capital standard that would otherwise not be affected, based solely on the change in definition of "complex." All credit unions subject to the requirements of this proposed rule will need to carefully examine their balance sheets and potentially make substantial portfolio changes.

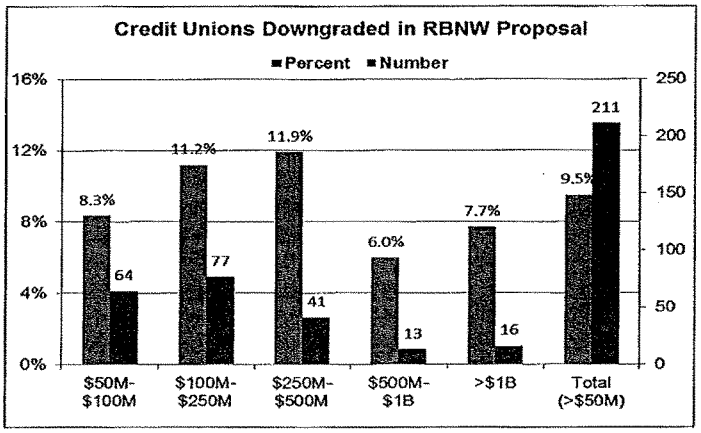
A survey of NAFCU's membership taken in April 2014 found that nearly 60 percent of respondents believe the proposed rule would force their credit union to hold more capital, while nearly 65 percent believe this proposal would force them to realign their balance sheet. If the NCUA implements this rule as proposed, most credit unions will have to hold more capital. This additional capital requirement is not commensurate with the actual risks

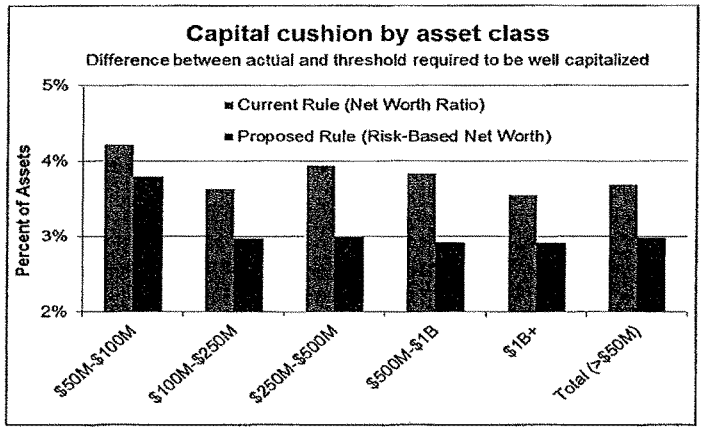
[25] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11188.

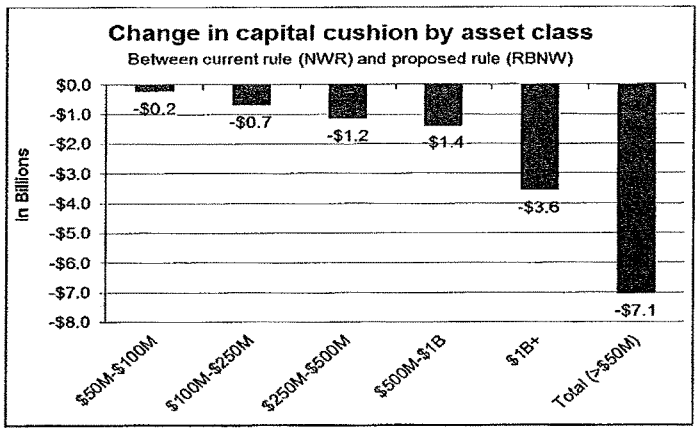
[26] As of December 31, 2013, there are 2,222 FICUs with assets over $50 million. 818 FICU's have a risk-based net worth over 6% and are currently rated as complex.1,404 FICU's have a risk-based net worth less than or equal to 6% and are therefore not considered complex by the current definition, but would be under the proposed rule.

of a credit union's portfolio, nor will it serve the intended purpose of protecting the National Credit Union Share Insurance Fund (NCUSIF).

NAFCU's Economics and Research department prepared the impact analysis graphs found below that outline the impact the proposal would have on credit unions based on asset size. Our analysis of the proposed rule determined that credit unions with more than $50 million in assets will have to hold $7.1 billion more in additional reserves to achieve the same currently maintained capital cushion. Because credit unions cannot raise capital from the open market like other financial institutions, this cost will undoubtedly be passed on to the 97 million credit union members across the country in the form of higher loan rates and lower rates on share accounts.







NAFCU questions whether it is appropriate to finalize a rule that would require credit unions to hold so much more capital as compared with the actual costs to the NCUSIF. Below is a chart that details the number of, and cost to, the NCUSIF of liquidated or assisted merger credit unions by asset class and year for credit unions under $250 million in assets. The total cost to the share insurance fund for all credit unions between $50 million and $250 million in assets from 2003 through 2012 was less than $285 million. This stands out as disproportionate when compared to the $898 million more in additional capital that would be required under the proposed rule for credit unions between $50 million and $250 million in assets to maintain the same capital cushion as in the current rule. Essentially, credit unions would be required to hold $898 million more in capital to maintain the same capital cushion as currently held in order to prevent what was less than $285 million in losses over the past 10 years.

The Number of and Cost to Insurance Fund of Liquidated or Assisted Merger Credit Unions by Asset Class and Year						
	Assets < $250M		Assets < $100M		Assets < $50M	
Year	Number	Cost to Ins Fund	Number	Cost to Ins Fund	Number	Cost to Ins Fund
2003	13	$ 10,158,257	13	$ 10,158,257	13	$ 10,158,257
2004	21	$ 11,892,786	21	$ 11,892,786	21	$ 11,892,786
2005	15	$ 15,088,257	15	$ 15,088,257	15	$ 15,088,257
2006	16	$ 6,717,182	16	$ 6,717,182	16	$ 6,717,182
2007	11	$ 9,470,960	10	$ 7,539,629	10	$ 7,539,629
2008	17	$ 32,989,171	16	$ 32,989,171	14	$ 31,334,427
2009	26	$ 156,497,713	24	$ 137,520,215	18	$ 36,954,777
2010	27	$ 60,346,866	23	$ 26,803,469	23	$ 26,803,469
2011	16	$ 52,876,674	14	$ 31,100,299	13	$ 18,259,280
2012	21	$ 138,544,436	19	$ 58,687,421	17	$ 48,865,808
Total	183	$ 494,582,303	171	$ 338,496,687	160	$ 213,613,873
Source: NCUA FOIA response 13-FOI-00097						

Between the years 2003-2012 there were 190 total credit union failures, but only 7 of these failures were credit unions above $250 million in assets. During this time period, the total number of credit unions under $250 million in assets that failed was 183. However, 160 of those failed credit unions were under $50 million in assets. There were only 23 failed credit unions between $50 million and $250 million in assets during that time period.

Additionally, almost half of the losses to the NCUSIF from 2003-2012 for those credit unions under $250 million in assets were incurred because of failures of credit unions with under $50 million in assets.

This rule will not cover those credit unions with under $50 million in assets. Meaning, if this proposed rule had been implemented prior to those failures, it would not have helped to prevent the losses to the NCUSIF. While holding additional capital for assets that do carry higher risk makes sense in a true risk-based system, holding more capital for the sake of holding more capital is not the solution, and will not prevent failures.

10.5% Risk-Based Capital Ratio

The proposed rule introduces a 10.5 percent risk-based capital ratio requirement in order for a credit union to be categorized as well capitalized. This ratio will make credit unions less competitive than their banking counterparts. NCUA reasons that the proposed "10.5 percent risk-based capital ratio target is comparable to the [o]ther [f]ederal [b]anking [r]egulatory [a]gencies' 8 percent plus the 2.5 percent capital conservation buffer..."[27] The Agency states this was done in order to "avoid the complexity of implementing a capital

[27] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11192.

conservation buffer."[28] In its efforts to avoid complexity, NCUA is proposing an ill-fitting risk-based capital ratio for credit unions.

The impact of the 2.5 percent capital conservation buffer was designed specifically for banks and does not work for credit unions, and will result in an unnecessary additional increase to credit union capital requirements. The banking regulators developed the capital conservation buffer in order to ensure that banks retained capital in times when it was needed most. During the crisis, distressed banks were distributing capital to shareholders and employees even though it was negatively affecting their capital ratios. This led the banking regulators to include a capital conservation buffer of 2.5 percent on top of the Tier 1 risk-based capital ratio minimum level of 8 percent as part of the FDIC rules that become effective over the next five years.

The specific purpose of the capital conservation buffer is to ensure that banks are only able to pay stock dividends and share buybacks if they meet their 2.5 percent capital conservation buffer and not just the 8 percent Tier 1 risk-based capital minimum. This approach to capital distribution does fit the credit union business model.

NCUA failed to include any rationale or data for why it chose to have a 10.5 percent minimum capital requirement to be well capitalized other than to "avoid the complexity of implementing a capital conservation buffer."[29] NAFCU believes that the FDIC Tier 1 ratios are more consistent to the types of capital that credit unions are allowed to hold, as opposed to the FDIC's other risk-based capital ratios, as indicated in the chart below.

Net Worth Classification	Proposed Risk-Based Capital Ratio	FDIC Tier 1 Capital Requirements	NAFCU's Alternative
Well Capitalized	10.5% or above	8% or above	8% or above
Adequately Capitalized	8% to 10.49%	6% to 7.99%	6% to 7.99%
Undercapitalized	Less than 8%	Under 6%	Under 6%

NAFCU believes that unless NCUA provide compelling rationale and/or data to differ from the FDIC rule, NCUA should remove the 2.5 percent capital buffer component of the minimum risk-based capital ratios and make capital categories mirror the FDIC Tier 1 capital requirements.

Risk Weights

The proposed rule revises the risk-weights for many of NCUA's current asset classifications and requires higher minimum levels of capital for credit unions that are perceived as having riskier portfolios. NAFCU and its member credit unions have identified several key areas where risk-weighting in the proposal does not accurately capture the risks associated with the asset in question. In particular, a number of the NCUA proposed risk-weights require credit unions to hold much more capital as compared with the FDIC and Basel III requirements for community banks — often without solid justification for the deviations.

[28] *Id.*

[29] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11192.

Concentration Risk and Interest Rate Risk

As discussed above, the FCU Act requires that the system of prompt corrective action that the NCUA prescribes by regulation be comparable to those that the banking regulators institute.[30] In the many iterations of Basel and most recent rules that the FDIC has finalized, banking regulators have chosen not to incorporate interest rate risk and concentration risk into their risk-weights. However, NCUA's proposed rule incorporates concentration risk and interest rate risk into many of its proposed risk-weights. NAFCU acknowledges that interest rate and concentration risk are risks that every credit union needs to manage and plan for, but this rule is not the way to avoid losses due to those risks in the future.

NAFCU urges NCUA to eliminate the interest rate and concentration risk components of the risk-weighting for non-delinquent first mortgage real estate loans, other real estate secured loans, member business loans (MBLs), and investments. Rather, NCUA should change those risk-weights to be consistent with the risk-weighting given to those assets by the FDIC.

A risk-based capital rule is a poor tool for managing these additional risks, and simply requiring credit unions to hold more capital does not address or solve any issues that individual credit unions have when trying to manage those risks. Both Basel III and the FDIC interim final rule are constructed in such a way that authorities would employ other mechanisms to measure and control for risk other than credit risk. In order to comply with the comparability mandate of The FCU Act,[31] NCUA should follow the other federal banking regulatory agencies in this regard.

To better control for interest rate risk, NAFCU believes that a more sensible alternative to the proposed rule would be to continue to apply industry-accepted methods as part of a competent supervision and examination process.[32] Banking regulators have prescribed this as well and by holding credit unions to significantly different standards, NAFCU is concerned that NCUA may be running afoul of the will of Congress regarding the requirement that the rule be comparable to what banks have to follow.

This rule will also constrict capital availability that would otherwise be used for loans to members because credit unions will be required to hold more capital for interest rate and concentration risk. This is harmful to credit unions and to their members. During the financial crisis credit unions continued to lend when banks and other financial institutions pulled back. This rule would constrict the ability of credit unions to lend to members because so much more of their capital would have to be held for interest rate and

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[30] 12 U.S.C. §1790d(b)(1)(A)(ii).

[31] *Id.*

[32] NCUA already has a number of requirements and guidance regarding interest rate risk that credit unions must comply with, such as the interest-rate risk final rule, a letter to credit unions on the subject (12-CU-05), and it is the top subject in the most recent NCUA supervisory focus (13-CU-01). Instead of making credit unions hold more capital, NCUA should first look to its existing requirements and regulations.

concentration risk. This is another reason this rule puts credit unions at a disadvantage to banks.

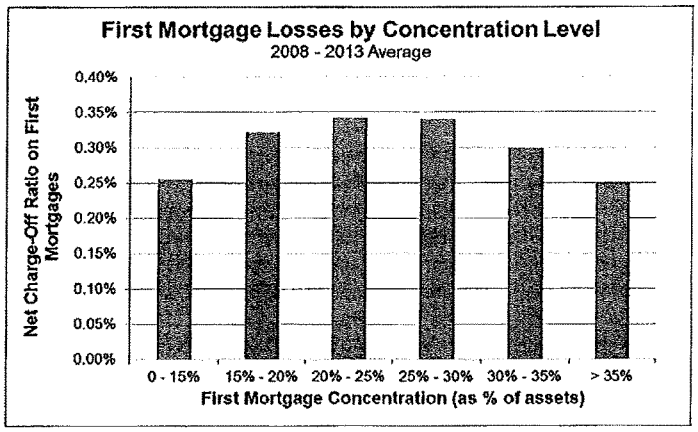
Non-Delinquent First Mortgage Real Estate Loans

NCUA's proposed rule uses the non-delinquent first mortgage real estate loans risk-weights to compensate for concentration risk by increasing the risk-weights to correspond with the percentage of those assets held by the credit union in its portfolio. The FDIC on the other hand, does not take into consideration concentration risk through its capital standards and assigns risk-weights for non-delinquent first mortgage real estate loans at 50 percent regardless of the concentration in the portfolio.

NAFCU believes that in any final rule, NCUA should set all non-delinquent first mortgage real estate loan risk-weights at 50 percent so as to align with FDIC weights as seen in the chart below.

Non-delinquent 1st Lien Real Estate Loans	**NCUA Proposed Risk-Weights**	**FDIC Risk-Weights**
<25% percent of assets	50 percent	50 percent
25 to 35% of assets	75 percent	50 percent
>35% of assets	100 percent	50 percent

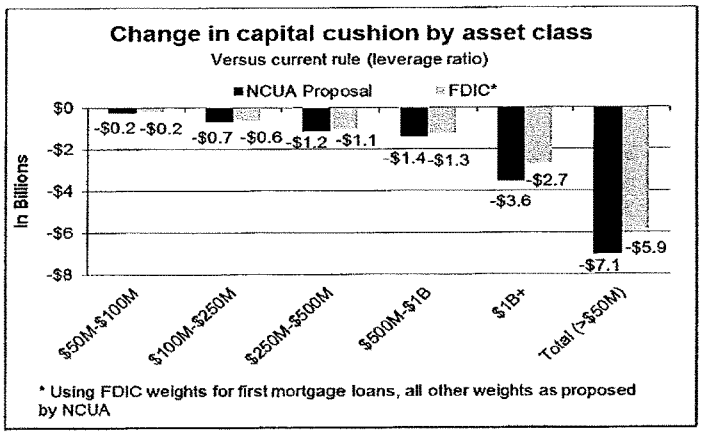
The risk-weights for each asset should also be rooted in the loss histories associated with that asset. When considering whether variable weights to account for concentration risk are warranted, it makes sense to look at the loss history for different levels of concentration for a given asset. Only in the case where higher asset concentrations are shown to result in higher loss histories would there be justification for increased risk-weights. In the case of non-delinquent first lien mortgage loans, the data shows that for different concentration levels, there has been no significant difference in average charge-offs since the onset of the financial crisis. Therefore, NCUA should do away with the risk-weights associated with higher concentrations of non-delinquent first mortgage loans and simply use a single risk-weight – 50 percent – for all outstanding loans.



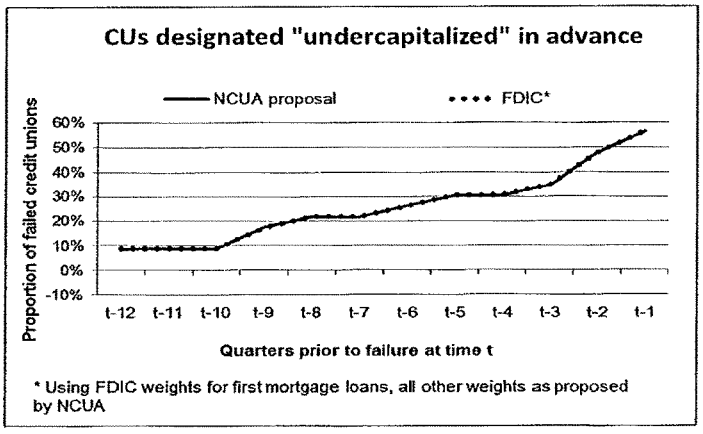
The graph above shows that aggregate losses for the highest concentrated credit unions (the "> 35%" group on the right) are equal to or lower than the losses for any other concentration group. NCUA argues that high concentrations of real estate and MBL loans led to numerous failures during recent years. This one-size fits all approach is not appropriate. Credit unions with high concentrations of mortgage loans on their books do not experience a higher loss rate on those loans than other credit unions, on average.

NAFCU also believes that concentration risk should be controlled through the supervision and examination process and not a one-size fits all capital regime that requires credit unions to hold more capital without allowing those credit unions with less risk to hold less capital.

The next chart shows that the capital cushion for credit unions would still shrink from current levels using FDIC risk-weights for non-delinquent first mortgage real estate loans, but the impact would not be as severe as under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset group above $100 million in assets as compared to the NCUA proposal.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights for non-delinquent first mortgage real estate loans. This proportion is tracked over the twelve quarters prior to a credit union's failure. The chart indicates that there is no difference between when the NCUA or FDIC weights would have designated a credit union as "undercapitalized" prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for other real estate loans will not detract at all from NCUA's intention that the proposed rule would act as an early warning system for troubled credit unions.



There are a number of other concerns regarding the logical inconsistencies with this one-size-fits-all capital rule. For example, the proposed rule's treatment of real estate presents issues where a credit union may take steps to remove credit and liquidity risk from its portfolio by selling a 30-year mortgage that is currently risk-weighted at 50 percent. If that same credit union were to sell these mortgages to Fannie Mae and take back a Fannie Mae security with an average life of seven years, that mortgage-backed security would be risk-weighted at 150 percent. By doing so, the credit union has minimized its liquidity and credit risk while not providing any more interest rate risk. The result is that the credit union will be required to hold three times as much capital while having a less risky asset. This represents just one of many examples of the proposed risk-weights in this rule that do not match the actual risks posed to the credit union.

Other Real Estate Loans

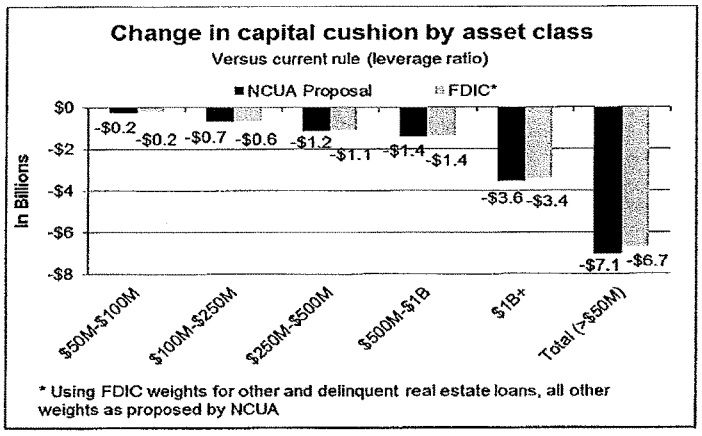
According to the proposed rule, "real estate-secured loans not meeting the definition of first mortgage real estate loans would be referred to as 'other real estate loans.'"[33] In the proposed rule, the risk-weights for these other real estate loans would incorporate concentration risk and increase as the percentage of these assets held by the credit union in its portfolio increases. The FDIC weights for these types of loans are 100 percent regardless of concentration.

NAFCU believes that in any final rule, NCUA should align other real estate loans risk-weights with FDIC weights as seen in the next table.

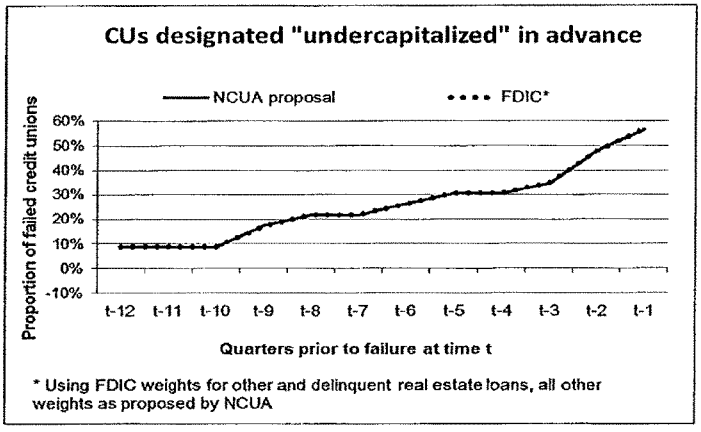
Other Real Estate Loans	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-10% percent of assets	100 percent	100 percent
>10 to 20% of assets	125 percent	100 percent
>20% of assets	150 percent	100 percent

The next chart shows that the capital cushion for credit unions would still shrink from current levels using the FDIC weights for other real estate loans, but the impact would not be as severe as under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset level size except $500 million — $1 billion (no change) as compared to the proposed rule as seen in the next graph.

[33] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11197.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights for other real estate loans. This proportion is tracked over the twelve quarters prior to a credit union's failure. The chart indicates that there is no difference between when the NCUA or NAFCU weights would have designated a credit union as "undercapitalized" prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for other real estate loans will not detract at all from NCUA's intention that the proposed rule would act as an early warning system for troubled credit unions.



Investments

The proposed rule uses the investment risk-weights to compensate for interest rate risk. This is apparent in the differences in proposed risk-weights for investments based on the Weighted-Average Life of Investments (WAL).

NAFCU has a number of issues with the proposed rule's risk-weights for investments. First, any final rule should eliminate the interest risk component from the capital requirements to align itself with FDIC risk-weights for investments. As noted above, credit unions already monitor and control for interest rate risk through internal policies and in accordance with NCUA examination and supervision policies. It is unnecessary and redundant for a risk-based capital regime to perform this function. This proposed rule is a one-size-fits-all requirement to hold more capital for almost all types of investments as a means to control for interest rate risk. Requiring more capital only serves as a disincentive to invest in longer-term investments, it does not provide the in-depth analysis to evaluate investments that is needed and brought about through the current supervision and examination process. [34]

As NAFCU compares the NCUA proposal to the FDIC requirements for risk-based capital, we note that for those investments that credit unions are permitted to make, the FDIC does not incorporate interest rate risk into the investment risk-weights for community banks. Instead, it generally weights the investments that credit unions can make with a single risk-weight regardless of maturity. FDIC weights most types of investments that credit unions are able to make at a 20 percent risk-weight regardless of the WAL. This is another example of how this rule would put credit unions at a competitive disadvantage to banks. NCUA's proposal also does not account for any mitigation efforts, such as variable-rate assets or derivatives, which would offset some exposure for credit unions to interest rate risk.

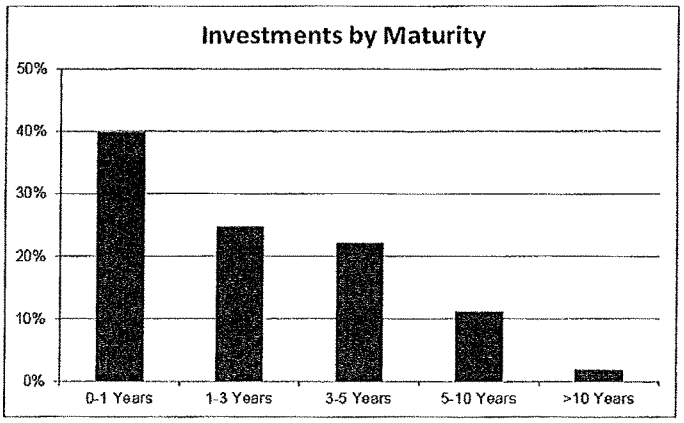
According to the proposed rule, the specific risk-weights are based primarily upon the 300 basis point interest rate shock used to prepare for a worst-case scenario of interest rate fluctuation. This means the NCUA has selected the increments for the investment weight scale to match the loss that would take place due to a 300 basis point interest rate shock. NAFCU believes that this methodology is flawed and does not result in the appropriate risk-weights for investments.

NAFCU strongly believes that NCUA should stay within their statutorily mandate and use the 20 percent FDIC risk-weights for investments regardless of WAL, as illustrated in the next chart.

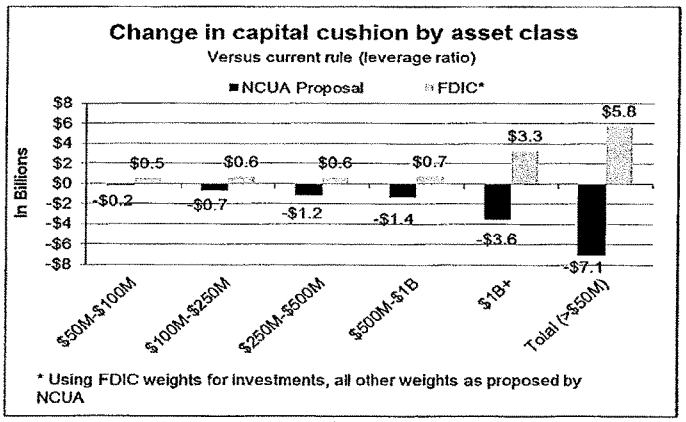
[34] NCUA already has a number of requirements and guidance that credit unions must comply with such as the interest-rate risk final rule, a letter to credit unions on the subject (12-CU-05), and it is the top subject in the most recent NCUA supervisory focus (13-CU-01). Instead of making credit unions hold more capital, NCUA should first look to its existing requirements and regulations.

Investments By WAL	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-1 year	20 percent	20 percent
1-3 years	50 percent	20 percent
3-5 years	75 percent	20 percent
5-10 years	150 percent	20 percent
>10 years	200 percent	20 percent

NCUA should also be mindful of the cooling effects of the final rule on short- and medium-term investments. The chart below shows the distribution of total credit union investments by maturity bucket. Note that only about 13 percent of credit union investments have an average life of over five years.

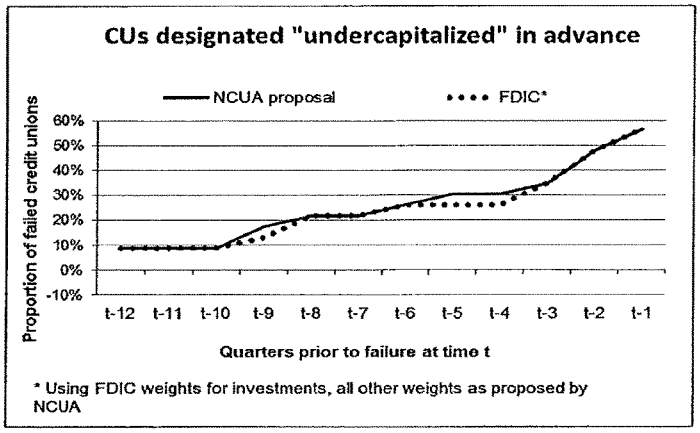


The FDIC risk-weights would benefit the capital cushion for credit unions at every asset level size as compared to the proposed rule. This is illustrated in the next graph.



Changing the risk-weighting to the FDIC risk-weights does not significantly affect the warning available prior to a failure of a troubled credit union. The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights. This proportion is tracked over the twelve quarters prior to a credit union's failure, serving as an early warning sign to NCUA that capital issues were on the horizon.

As the graph on the next page shows, using the FDIC risk-weights for investments would result in negligible changes in the early warning signs for troubled credit unions as compared to the proposed rule. As illustrated, the alternative investment risk-weights deviate only slightly in the t-6 through t-3 and t-10 through t-8 timeframes prior to failure.



To summarize, NAFCU strongly urges NCUA to remove the interest rate risk component from any final rule. Interest rate risk should continue to be controlled for and monitored through the supervision and examination process, continuing to incorporate industry standard methods. Finally, NCUA should use the FDIC risk-weights of 20 percent for investments regardless of the WAL of the investment.

Federal Reserve Deposits

The proposed rule does not specifically identify how cash held at the Federal Reserve is to be treated. The rule does address how cash on deposit (which is normally interpreted as cash on deposit at other insured financial institutions), cash equivalents, and cash on hand are to be treated, but does not propose a specific risk-weight for cash held at the Federal Reserve. Credit unions often have balances at the Federal Reserve as a repository for excess cash or to satisfy their minimum reserve requirement.

NAFCU believes that cash held at the Federal Reserve should have a risk-weight of zero percent. A zero percent risk-weight would take into account the Federal Reserve's unique relationship with the U.S. Government. NCUA should risk-weight all balances held at the Federal Reserve at zero percent.

Federal Home Loan Banks

The proposed rule also does not specifically address Federal Home Loan Banks (FHLB). NAFCU believes that the proposed rule could risk-rate FHLB consolidated obligations and stock from 20 percent to 200 percent creating a distinct disadvantage when compared to other insured depository institutions and potentially restricting credit extensions to the communities served by credit unions.

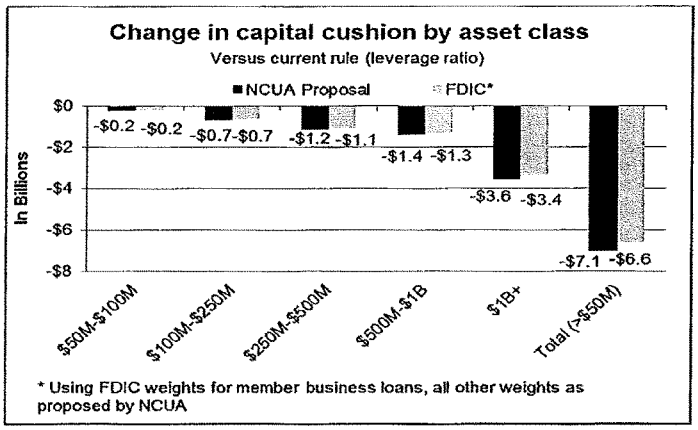
NAFCU notes that the risk weighting for FHLB consolidated obligations (highly liquid and safe – generally rated AAA and track treasuries) and FHLB stock (statutorily mandated to be redeemed at par and no member has ever lost a cent on stock) are weighted at 20 percent under Basel and by the other banking regulators. NCUA should weight FHLB consolidated obligations and stock at 20 percent to be comparable to other banking regulators.

Member Business Lending

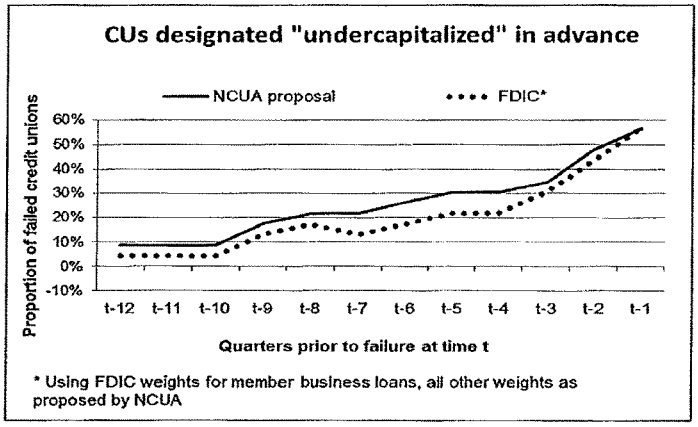
The proposed rule factors concentration risk into the proposed risk-weighting for MBLs by setting the risk-weights to correspond with the percent of assets in MBLs held by the credit union. As mentioned above, NAFCU believes that concentration risk should be controlled through the supervision and examination process and not a one-size-fits-all capital regime that requires credit unions to hold more capital without allowing those credit unions with less risk to hold less capital. The FDIC does not take concentration risk into consideration and risk-weights all business loans at 100 percent. NAFCU believes that NCUA should follow the FDIC and risk-weight MBLs at 100 percent regardless of the concentration of credit union's assets in MBLs as seen in the chart below.

MBL's as % of CU Assets	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-15% percent of assets	100 percent	100 percent
>15 to 25% of assets	150 percent	100 percent
>25% of assets	200 percent	100 percent

The next chart shows that the capital cushion for credit unions would still shrink from current levels using the FDIC weights for MBLs, but the impact would not be as severe as it would be under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset level size above $250 million as compared to the proposed rule as seen in the next graph.



The next chart uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights for MBLs. This proportion is tracked over the twelve quarters prior to a credit union's failure. The chart indicates that there is very little difference between when the NCUA or FDIC weights would have designated a credit union as "undercapitalized" prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for MBLs will only slightly change the early warning system indications for troubled credit unions as compared with NCUA's proposed rule.



Furthermore, there are a number of credit unions chartered historically for business-loan purposes that will be significantly hurt by this proposed rule. The risks to the portfolios of these special credit unions, including concentration risk, should be managed through the examination and supervision process, not through these capital risk-weights. NAFCU

believes that credit unions with proven minimal losses in business lending should be given credit for diversified portfolios and proven underwriting standards. Additionally, the proposed risk-weights would negatively impact credit unions with the low income credit union designation (LICUs), which are not subject to the statutory MBL cap. These LICUs would have a disincentive to utilize their ability to exceed the MBL cap in order to provide business loans to their members due to the restrictive requirements to hold more capital.

The proposed rule states that "MBLs that are government guaranteed at least 75 percent, normally by the Small Business Administration (SBA) or U.S. Department of Agriculture, would receive a lower risk-weight of 20 percent under the proposed rule."[35] This 75 percent threshold does not include beneficial programs that are guaranteed at between 50 percent and 75 percent such as the SBA Express program which helps many member small businesses. NCUA should factor in all guarantees made by the SBA or U.S. Department of Agriculture when determining risk-weighting for MBLs.

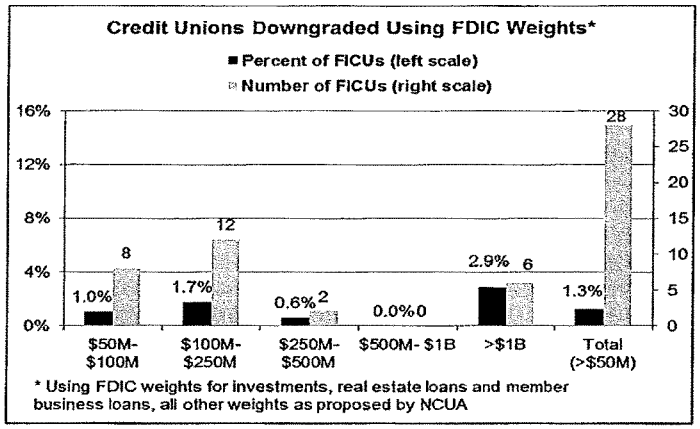
Another issue that NCUA has failed to address with this proposed rule is the difference risks based on the types of MBL loans by category. For example, risk-weights could also be broken down into types of loans using call report data and given appropriate risk-weights based on actual risk for the following categories: (1) agricultural MBLs; (2) construction and development; (3) non-farm, non-residential; (4) commercial and industrial loans; and (5) unsecured business loans. At this time the call report does not collect information on write-offs for different types of MBLs, but NCUA could modify the call report to collect this information.

The Effects of Combined FDIC Weights

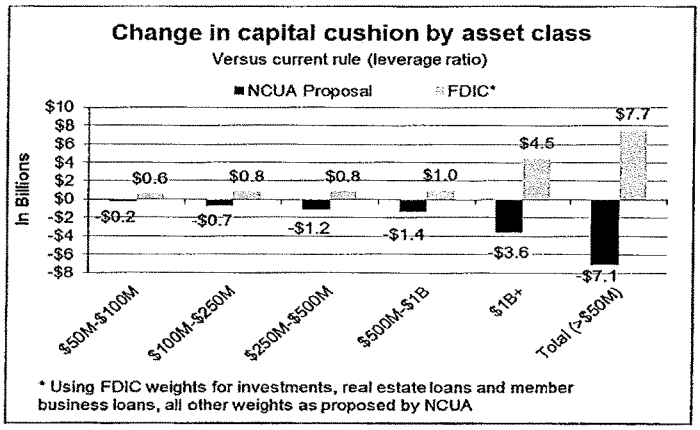
As shown in the sections above, NAFCU believes that NCUA should use the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs rather than the NCUA's proposed risk-weights that incorporate interest rate and concentration risk. While previous graphs show the industry wide benefits to credit unions of changing the individual risk-weights from what was proposed by the NCUA to the FDIC risk-weights, the following graphs show the *combined* benefit of changing the proposed risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs to FDIC risk-weights.

This first graph shows the number and percent of credit unions that will be downgraded by asset class as a result of changing non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs to FDIC risk-weights. 28 federally insured credit unions will be downgraded as opposed to more than 200 which would be downgraded under the proposed rule. NAFCU believes that this is a more appropriate result and represents a more balanced system.

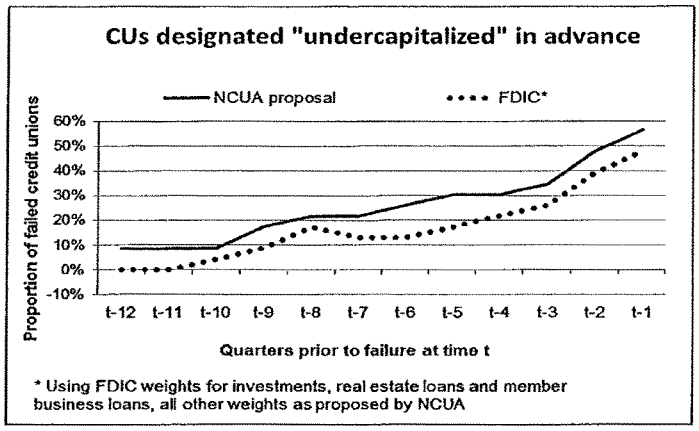
[35] Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11196.



The next graph shows the change in capital cushion by asset class as a result of changing the individual risk-weights from what was proposed to the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs. It shows a benefit to credit unions capital cushion for credit unions in every asset category as compared to the proposed rule.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs. This proportion is tracked over the twelve quarters prior to a credit union's failure. The chart indicates that there is very little difference between when the NCUA or FDIC weights would have designated a credit union as "undercapitalized" prior to its failure.



Importantly, changing the risk-weighting for these assets to the FDIC risk-weights does not compromise the NCUA's stated intent for the proposed rule to serve as an early warning system for troubled credit unions. Using the FDIC risk-weights will still accomplish this essential function of a balanced risk-based capital system. NAFCU strongly believes that NCUA should align the risk-weights for these assets with the FDIC risk-weights.

Credit Union Service Organizations (CUSOs)

The proposed rule sets a 250 percent risk-weight for investments in CUSOs and 100 percent for loans to a CUSO. In the proposed rule, NCUA does not include rationale as to why investments in CUSOs should get a proposed risk-weight of 250 percent except to say that a CUSO is an unsecured equity investment with no secondary market. Any final rule should include more detailed rationale, as well as any data used to support the final risk-weight.

The proposed rule also fails to explain the difference in proposed risk-weights between the 250 percent for investments in CUSOs and 100 percent for loans to CUSOs. This would suggest that loans to CUSOs are 2.5 times safer than investments in CUSOs, or in the reverse, that investments in CUSOs are 2.5 times riskier than a loan to a CUSO. Consumer debt that is over sixty days delinquent is currently rated at 150 percent while investments in a CUSO are rated at 250 percent.

Although there have been a couple of high-profile credit union losses partially driven by bad CUSO investments, the overwhelming majority of CUSOs are performing very well, generating considerable savings through economies of scale, and providing much needed non-interest income to the credit union owners. During a time of increased regulatory costs, shrinking fee income, and artificially depressed interest rates, it is imperative that credit unions are able to use CUSOs to decrease overhead costs while increasing business.

NCUA's argument that CUSOs represent a safety and soundness threat to the NCUSIF is also without merit. Less than 22 basis points of credit union assets are invested in CUSOs

and do not represent a systematic risk that could take down the share insurance fund. Those same 22 basis points are less than what credit unions have paid in annual corporate assessments in 2012. Each credit union may only invest less than 1 percent of its assets into CUSOs.[36] For example, suppose that in an unlikely scenario a credit union lost its entire investment in a CUSO. This loss alone would not be material and the consequences of requiring a disproportionate amount of capital, as compared with actual risk, are more far reaching as credit unions will not enjoy those cost savings made available only through the collaborative model of CUSOs.

NCUA is making policy decisions that affect business decisions for credit unions through these proposed risk-weights. This proposed rule could force credit unions to reconsider current and future investments in CUSOs. Credit unions might divest currently held investments and not invest in future CUSOs. This will hurt members and credit unions alike.

If NCUA declines to lower the risk-weighting to a reasonable level for investments in CUSOs, NCUA should at least consider differentiating between different types of CUSOs and assessing a risk-weight that accurately measures the risk of loss. Some of the possible factors to consider would be the types of services provided by a given CUSO (mortgage servicing, IT, compliance, etc.), whether the amount of investment is material, whether the CUSO has a history of profitability or loss, or whether the investment has already been recovered by the credit union through income or savings. Then NCUA could provide lower risk weights for CUSOs that present less of a risk to credit union assets.

Mortgage Servicing Assets (MSA)

The proposed rule would set the risk-weight at 250 percent for mortgage servicing assets (MSAs). This is an artificially high and excessive risk-weight relative to the actual risk presented by the underlying assets. The 250 percent weight is punitive and indicates a change in NCUA's view regarding loan participations.

Last year NCUA finalized a rule on loan participations that was intended to help credit unions and NCUA better manage the potential concentration risk in loan participations. The loan participation rule is working and should be allowed to continue to do so instead of assigning artificially higher risk-weights for mortgage servicing assets.

The proposed rule does not include a mechanism for NCUA to differentiate between an asset that is sold with recourse versus one that is sold without recourse. This would change the actual risk to a credit union depending on the underlying loans in a mortgage servicing asset. This one-size fits all approach does not appropriately measure actual risk.

MSAs are fairly liquid and gain value as rates rise. These present excellent opportunities to gain income and help prevent against some forms of interest rate risk. Also, credit unions do a great job servicing loans and want to continue to serve members. Many credit unions originate loans and then sell those loans to reduce interest rate and liquidity risk, yet retain

[36] 12 CFR 712.2(a).

the servicing due to the relationship with the member and because these are valuable assets. This arbitrary risk-weight provides a disincentive to retain those servicing rights.

NAFCU believes that NCUA should set the risk-weights for mortgage servicing assets at 150 percent. NCUA should also find a way to consider whether the loan is a recourse loan and assign those a 150 percent risk-weight. NCUA could then allow a lower weighting of 100 percent if the loans are sold without recourse but are serviced by the credit union.

Corporates Paid-In Capital

The proposed rule would set a risk-weight for paid-in corporate capital at 200 percent. This is one of the higher risk-weights proposed by this rule and does not appear to accurately represent the unique nature of corporate credit unions.

The corporate credit unions have had more regulatory changes over the past five years than any other sector of the credit union system including additional capital requirements. These changes include: stricter investment limits, concentration risk prohibitions, and governance changes. These prior regulatory changes to the corporate credit union system and the eliminated risks should be represented through a lower risk-weight.

The proposed risk-weight does not reflect the actual risk of this asset. The proposed rule suggests that corporate paid-in capital is two times as risky as a dollar invested in a mortgage loan in excess of 35 percent of assets. This could also serve as a disincentive to credit unions to invest in corporate credit unions and thereby endanger the current corporate credit union structure.

A weight that reflects the actual risk for paid-in capital to corporate credit unions would benefit natural person credit unions, corporate credit unions, and the share insurance fund. Paid-in capital would be more appropriately weighted at 125 percent to recognize that the corporate credit union structure is different than it once was, and now presents less risk to the credit union system. The 125 percent also recognizes that the corporates paid-in capital is riskier than safer investments such as treasuries or consumer loans.

Individual Minimum Capital Requirements

The proposed rule provides NCUA with the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where the Agency determines the circumstances, such as the level of risk of a particular investment portfolio, the risk management systems, or other information, indicate that a higher minimum risk-based capital requirement is appropriate. This means NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is, or may become, inadequate in light of the credit union's circumstances, regardless of the actual risk-based capital ratio of the credit union.

In other words, NCUA can increase a credit union's individual risk-based capital requirement by subjective action through the examination process or "supervisory assessment" based on the determination that the credit union needs additional capital based

on the credit union's balance sheet risk. A survey of NAFCU's membership taken in April 2014 found that over 65 percent of respondents have serious concerns about this portion of the rule.

NAFCU believes there are serious concerns regarding the legal authority of NCUA to enact this portion of the rule, as discussed above.

In addition to potential legal issues, this portion of the proposal seems to undermine the stated purpose of the rule. On the one hand, credit unions are led to believe that the proposal is designed to factor in a number of different risks including interest rate and concentration risk. On the other hand, if the risk-based capital ratios laid out in the proposal do not result in the numbers NCUA examiners would like to see, NCUA can change the rules for an individual credit union. This makes it nearly impossible for a credit union to make a sound business decision concerning its portfolio makeup, leading to even more uncertainty for credit unions and credit union members.

Individual Minimum Capital Requirement Appeals Process

The proposed appeals process does not alleviate any of the underlying concerns with the individual minimum capital requirements portion of the rule. The process itself lays a great deal of burden on individual credit unions to prove that the NCUA action was not an appropriate exercise of discretion by the Agency. The process also requires credit unions to appeal to the same NCUA Board that, according to statute, is required to make the judgment in the first place.

While the proposed rule allows credit unions to seek the opinion of the NCUA's Ombudsman, the NCUA Board is not bound by, or required to give deference to, the Ombudsman's recommendations. NAFCU believes that NCUA should enact an independent appeals process free of examiner retaliation. It is important that the independent appeals process include appeals to non-interested parties that do not have an opportunity to retaliate against individual credit unions that make appeals.

Goodwill and Other Issues

The proposed rule fails to include a number of components to the numerator portion of the risk-based capital ratio including goodwill, other intangible assets, and identified losses not reflected as adjustments to components of the risk-based numerator.

The loss of goodwill within the risk-based capital ratio numerator presents two significant issues to consider. First, it penalizes credit unions for past actions. Goodwill is present on the balance sheets of credit unions recently involved in mergers. Without goodwill, credit unions will be unable to fully realize the benefit of merging in troubled credit unions.

Secondly, this can present significant problems in the future. The credit union industry has seen increased consolidation in the past few years and this is a trend that is likely to continue. Without goodwill as a component of the numerator, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at the request of

NCUA). This is going to make it harder and more expensive for NCUA (and the industry as a whole) to find merger partners for troubled or failing credit unions that will ultimately lead to more expensive liquidations for the NCUSIF.

NAFCU believes that NCUA should reconsider removing goodwill from the numerator portion of the risk-based capital ratio.

Allowance for Loan and Lease Losses

In the capital elements of the risk-based capital ratio numerator, the proposed rule limits ALLL to 1.25 percent of risk assets. The discussion in the rule states this limitation is proposed to provide an incentive for granting quality loans and recording loan losses timely. The disregard for excess ALLL does not provide an equitable solution.

Credit unions are generally more conservative than banks when it comes to ALLL. This cap of 1.25 percent will penalize a credit union for being conservative with its allowance and provide a disincentive for holding ALLL above the 1.25 percent cap.

NAFCU encourages NCUA to consider changing the 1.25 percent cap to 1.50 percent of risk assets to provide a better incentive for fully funding ALLL above 1.25 percent. In addition, in the most recent Financial Accounting Standards Board (FASB) proposal on ALLL (the Current Expected Credit Loss model), issued in December 2012, if put into place, has the potential to significantly increase ALLL reserves by as much as 20-50 percent. If those changes are put into place, NCUA should increase the limit of ALLL to be included in the risk-based capital numerator comparable to the additional levels of ALLL required.

Supplemental Capital

Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule. NCUA should continue to call on Congress to pass a legislative solution that modernizes capital standards to allow supplemental capital.

Currently, a credit union's net worth ratio is determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth — such as growth resulting from taking deposits — can dilute a credit union's regulatory capital ratio and trigger non-discretionary supervisory actions under PCA rules. Allowing eligible credit unions access to supplemental capital, in addition to retained earning sources, will help ensure that healthy credit unions can achieve manageable asset growth and continue to serve member-owners efficiently.

While supplemental capital authority is important for those credit unions that are able to raise it, it is important to understand that supplemental capital authority is not the answer to all of the problems with this proposed rule. There is a difference between the authority to raise supplemental capital and the ability of individual credit unions to actually obtain it.

Not every credit union would be able to use that important tool to actually raise significant capital even if the credit union were given the authority to do so.

Implementation Date

NCUA has proposed an implementation time period and effective date of 18 months after the passage of a final rule and its publication in the *Federal Register*. During that 18 months implementation period, credit unions would need to prepare balance sheets for the new risk-based capital ratio requirements, and would also be required to continue to comply with the current PCA requirements of part 702 on NCUA's rules and regulations.

NAFCU believes that the proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule. The proposed revisions to net-worth and capital requirements will vastly affect a credit union's decision making and it will take time for a credit union to adjust its balance sheets related to this new regulation. Credit unions will also need to adjust internal systems and operations well in advance of the effective date.

Credit unions will be faced with difficult decisions when attempting to raise risk-based capital ratios under the proposed rule. Credit unions will have to either divest assets that are more heavily risk weighted or generate retained earnings. It is difficult to generate retained earnings in a short period of time when credit unions are being forced to divest the assets that have the largest returns and produce the most retained earnings.

When comparing NCUA's proposed timeframe and the time frame afforded to banks during the implementation of BASEL standards, it is evident that the proposed implementation timeframe is insufficient. Given the difficulties that credit unions will face to accumulate additional capital through retained earnings, a longer time frame for the implementation of this rule is necessary.

NAFCU believes any implementation period should be no less than three years after passage of any final rule. Credit unions will need at least that long to make safe and sound decisions about potentially fundamental changes to core business decisions including investments and product offerings. This would also be more consistent with the time frame given to the banking industry during the BASEL standards implementation. On September 10, 2013, the FDIC issued a consolidated interim final rule (Basel III interim final rule) and its final rule was issued on April 14, 2014. While some portions of the rule take effect as soon as two years after the final rule, all portions of the rule do not become fully effective until January 1, 2019, almost five years after the rule was finalized.

Conclusion

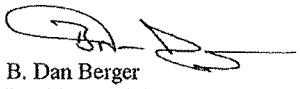
In conclusion, NAFCU is supportive of the idea of a risk-based capital regime for credit unions; however, the current NCUA proposal does not achieve the desired system and would ultimately harm credit unions. If it were to be implemented as proposed, credit unions would be at a significant competitive disadvantage to banks. As proposed, the rule is one-size-fits-all and would serve to stifle growth, innovation, and diversification at

credit unions. NAFCU hopes that the NCUA Board will ultimately withdraw the proposal and work with Congress to modernize capital standards in accordance with the recommendations in NAFCU's "Five Point Plan for Regulatory Relief"

Alternatively, should the NCUA Board fail to withdraw the proposal, it should remove the interest rate and concentration risk components that are currently incorporated into the risk weightings and lower the risk-weights to accurately reflect the risk associated with specific assets and to become comparable to the standards of other banking regulators. The NCUA Board should also remove the provision regarding individual capital requirements as this authority rests on questionable legal grounds and its inclusion increases uncertainty for credit unions.

Thank you for your continued commitment to listen to feedback from credit unions on this important issue. Should you have any questions or would like to discuss these issues further, please feel free to contact me or PJ Hoffman, Regulatory Affairs Counsel, at PJHoffman@nafcu.org or (703) 842-2212.

Sincerely,



B. Dan Berger
President and CEO
National Association of Federal Credit Unions

NAFCU Board of Directors:

Michael J. Parsons, Chairman
President/CEO
First Source FCU
Assets: $371,264,380

Ed Templeton, Vice Chairman
President/CEO
SRP FCU
Assets: $654,084,919

Richard L. Harris, Treasurer
President/CEO
Caltech Employees FCU
Assets: $1,253,020,681

Jeanne Kucey, Secretary
President/CEO
JetStream Federal Credit Union
Assets: $156,143,673

Martin Breland
President/CEO
Tower FCU
Assets: $2,609,559,081

Rod Taylor
President/ CEO
Barksdale FCU
Assets: $153,707,628

Cutler Dawson
Chairman, NAFCU Regulatory Committee
President/CEO
Navy FCU
Assets: $55,502,976,265

Michael N. Lussier
NAFCU Regulatory Committee Member
President/CEO
Webster First FCU
Assets: $646,079,823

Jan N. Roche
President/CEO
State Department FCU
Assets: $1,520,520,032

Debra Schwartz
NAFCU Regulatory Committee Member
President/CEO
Mission FCU
Assets: $2,449,729,632

Daniel Weickenand
NAFCU Regulatory Committee Member
CEO
Orion FCU
Assets: $527,592,209

NAFCU Regulatory Committee Members:

Dan Berry
Chief Operating Officer
Duke University FCU
Assets: $109,877,949

John Buckley
President/CEO
Gerber FCU
Assets: $121,916,895

Joe Clark
Chief Legal Officer
Truliant FCU
Assets: $1,667,349,920

Connie Dumond
Manager
Greater Woodlawn FCU
Assets: $110,670,295

John Farmakides
President/CEO
Lafayette FCU
Assets: $396,760,547

John Harwell
AVP Risk Management
Apple FCU
Assets: $1,845,999,114

Mitchell Klein
Chief Risk Officer
Citadel FCU
Assets: $1,880,414,011

Jim Laffoon
President/CEO
Security Service FCU
Assets: $7,679,605,307

Janet Larson
Director
SunState FCU
Assets: $297,621,812

Leanne McGuinness
SVP/CFO
The Summit FCU
Assets: $719,691,062

Michael Pardon
President/CEO
Sea Air FCU
Assets: $146,830,582

Jane Verret
Chief Administration
Campus FCU
Assets: $509,914,856

Susan Lezotte
AVP Compliance
Eli Lilly FCU
Assets: $1,033,855,869

Jim Mooney
President/CEO
Chevron FCU
Assets: $2,352,852,646

Wayne Schulman
SVP, Corporate Counsel
Logix FCU
Assets: $3,703,062,025

Attachment B: Dover Federal Credit Union's May 14, 2014, comment letter on the NCUA's Prompt Corrective Action/ Risk-Based Capital proposal

Dover Federal
CREDIT UNION
1075 Silver Lake Blvd., Dover, DE 19904

May 14, 2014

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Prompt Corrective Action; Risk-Based Capital, 12 CFR Parts 700, 701, 702, 703, 713, 723 and 747

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed Prompt Corrective Action; Risk Based Capital Regulation.

Dover Federal Credit Union (Dover Federal, Credit Union) was formed to serve the men and women on Dover Air Force Base, both active duty and civilians in 1958. Over the years, the field of membership has expanded to over 300 select groups. Currently, Dover Federal serves 39,403 members and has $403 million in assets.

While there is no doubt that the current capital regulations need to be updated, I believe that the National Credit Union Association has reacted over aggressively to past financial conditions and as a result created a regulation that places credit unions at a disadvantage in the financial services industry. Additionally, there has not been sufficient evidence or losses to prove a need to replace the current leverage ratio methodology with a risk based methodology.

Complex Credit Union

Under current §702.103 of NCUA's regulations, [1]a credit union is defined as "complex" if "[i]ts quarter-end total assets exceed fifty million dollars ($50,000,000); and . . . [i]ts [RBNW] requirement, as calculated under § 702.106, exceeds six percent (6%)." Current § 702.104 of NCUA's regulations defines eight risk portfolios of complex credit union assets, liabilities, or contingent liabilities. The proposal defines a credit union as complex if its assets exceed $50 million, regardless of the composition of their balance sheet. This arbitrary level is extremely low in today's financial services industry and significantly lower than the threshold established for banks and bank holding companies of $15 billion, contingent upon their business practices and balance sheet composition. There are probably a significant number of credit unions in the $50 million to $500 million asset range that are not complex by today's qualifiers. Arbitrarily classifying them as complex based upon their asset size does not strengthened the credit union industry or protect the insurance fund. In fact, doing so will probably have the opposite impact.

[1] National Credit Union Administration (2014, February 27). Federal Register. Part II, Vol. 79, No. 39 pp. 11185, Proposed Rules

Capital Requirements Significantly Higher Than Banks

NCUA states in the proposal that "The proposed revisions would include a new method for computing NCUA's risk-based capital measure that is more consistent with the risk-based capital measure for corporate credit unions and the risk-based capital measures used by the Other Federal Banking Regulatory Agencies." and "In general, credit unions have high quality capital, with retained earnings being the predominant form of capital." In fact the proposed risk ratings are much higher than those required by Other Federal Banking Regulatory Agencies.

Investment Risk Weights		
	NCUA Proposal	Basel III
Maturities of 0 to 1 years	20%	20%
Maturities of 1 to 3 years	50%	20%
Maturities of 3 to 5 years	75%	20%
Maturities of 5 to 10 years	150%	20%
Maturities >10 years	200%	20%

First Mortgage Risk Weights (non-delinquent)		
	NCUA Proposal	Basel III
Total book balances <25% of assets	50%	100%
Book balance in excess of 25% and less than 35% of assets	75%	100%
Book balances in excess of 35% of assets	100%	100%

Other and Delinquent Real Estate Risk Weights		
	NCUA Proposal	Basel III
Total book balances <10% of assets	100%	100%
Book balance in excess of 10% of assets and less than 20% of assets	125%	100%
Book balances in excess of 20% of assets	150%	100%

Business Loans		
	NCUA Proposal	Basel III
Total book balances <15% of assets	100%	100%
Book balance in excess of 15% of assets and less than 25% of assets	150%	100%
Book balances in excess of 25% of assets	200%	100%

Delinquent loans – NCUA's proposal and Basel III both use a risk weight of 150% for delinquent loans. However, a loan at a bank is not classified as delinquent until it is more than 90 days past due while NCUA considers a loan past due at 60 days.

The above recommended risk weights are contrary to the purpose NCUA stated in the Federal Register. Furthermore, it is hard to envision why risk weights for credit unions need to be greater than their banking counterparts considering the overall performance of the credit union industry over the past five years compared to the banking industry. However, what is truly ironic is that during the FDIC's April 8, 2014, board meeting, the Bank Insurance Fund approved a new rule to strengthen the leverage capital requirements for the eight largest, most systematically important banking organizations. The new rule requires a 6% leverage ratio for the insured banks to be considered well-capitalized under prompt corrective action. Bank holding companies would need to have a leverage ratio of 5%. By comparison, the Basel framework requires only a 3% minimum leverage ratio for both levels of a banking organization. During the meeting, FDIC chairman Martin J. Gruenberg said the leverage approach "benefits the financial system as a whole and reduces the potential systemic risk these institutions pose." He supported the cooperative model's capital standard saying: "This is a rule of significant consequence. In my view, this final rule may be the most significant step we have taken to reduce the systemic risk posed by these large complex banking organizations." In a more extensive statement, FDIC vice chairman Thomas M. Hoenig [2]laid out the benefits of a leverage ratio versus the traditional risk-based approach: "The supplementary leverage ratio is a more reliable measure that is simple to calculate, understand, and enforce than the subjective risk-weighted measures, and it provides a highly useful initial assessment of a bank's balance sheet strength...Experience has shown that relying only on a risk-based capital measure serves the public poorly ... As recently as year-end 2013, reported risk-based capital ratios for the largest global banks averaged 13% while the average leverage ratio was less than 5% ... .I am confident that supervisors will rely increasingly on the leverage ratio, as the market already does, to judge a firm's capital levels, loss absorbing capacity, and balance sheet strength". A third FDIC board member, Jeremiah O. Norton, supported the rule with the following points: "There is recent economic research to support the conclusion that the leverage ratio is a statistically significant predictor of bank default while the Basel Tier I risk-based capital ratio is not."

If NCUA wishes to be more closely aligned with the Other Federal Banking Regulatory Agencies why is there an emphasis on risk based capital versus when the FDIC is moving from such standards?

Individual Minimum Capital Requirement

The proposed rule provides NCUA the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where NCUA determines that the credit union's capital is or may become inadequate in light of the credit union's circumstances regardless of the actual risk based capital ratio of the credit union. In addition to the questionable legality of this section, this portion of the regulation challenges the entire purpose of the rule. The proposed regulation and risk weights are being established to ensure that credit unions are adequately capitalized to be prepared for a number of risks including concentration risk, interest rate risk, credit risk, market risk, operational risk, and liquidity risk. However, if NCUA decides that their risk-based capital ratios are inadequate, the NCUA can create new standards for an individual credit union. In reality, doesn't NCUA already have this power through their corrective action procedures and the use of documents of resolution (DOR) or cease and desist orders?

[2] Filson, Chip. (2014, April 10). FDIC Approves A Simple Leverage Ratio to Improve Capital Adequacy Standards. www.cutimes.com

CUSOs

The proposal would set the risk-weight at 250 percent for investments in CUSOs and 100 percent for loans to CUSOs. However reasoning for the differences is not provided. Less than 22 basis points of credit union assets are invested in CUSOs. Therefore, there does not appear to be systematic risk that threatens the share insurance fund. However, this proposed rule could force credit unions to amend and/or reconsider their business plans. Risks of this nature should be managed through the examination and supervision process and not by a one size fits all approach.

Implementation Period

The proposed 18 month implementation timetable is insufficient for a rule with such broad impacts on all operations of credit unions. Furthermore, it fails to meet NCUA's stated purpose of becoming more closely aligned with the Other Federal Banking Regulatory Agencies as banks were given a three year period to prepare for the implementation of the BASEL standards.

I trust that the NCUA Board will review all of the submitted comments to create an improved capital regulation that protects the credit union industry and the share insurance fund without placing arbitrary undue hardships on credit unions that will prevent us from providing the products and services that our members want and need.

Sincerely,

David W. Clendaniel
President/CEO

Attachment C: NAFCU's "Five Point Plan for Regulatory Relief" released in February 2013

Learn How NAFCU's Five-Point Plan Will Bring Regulatory Relief to Credit Unions

In February 2013, NAFCU was the first trade association to call on this Congress to provide comprehensive broad-based regulatory relief for credit unions. As part of this effort, NAFCU sent Congress a five-point plan for regulatory relief that will significantly enhance credit unions' ability to create jobs, help the middle class, and boost our nation's struggling economy. The five-point plan is built on a solid framework of recommendations that provide regulatory relief through the following:

1. Administrative Improvements for the Powers of the NCUA

- Allow a federal credit union to petition NCUA for a waiver of a federal rule in favor of a state rule.
- Provide NCUA the authority to delay implementation of CFPB rules that affect credit unions and to tailor those rules for credit unions' unique structure.
- Require a cost/benefit analysis of all rules that includes a three-year look back and reevaluation of rules that cost 20 percent or more than their original cost estimate.
- Enact new examination fairness provisions to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation.
- Improve the Central Liquidity Facility by removing the subscription requirement for membership and permanently removing the borrowing cap.

2. Capital Reforms for Credit Unions

- Direct NCUA and industry representatives to conduct a study on prompt corrective action and recommend changes.
- Modernize capital standards by directing the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks and allows the NCUA Board to authorize supplemental capital.
- Establish special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

3. Structural Improvements for Credit Unions

- Direct NCUA, with industry input, to conduct a study of outdated corporate governance provisions in the Federal Credit Union Act and make recommended changes to Congress.
- Improve the process for expanding a federal credit union's field of membership by allowing voluntary mergers among multiple common bond credit unions, easing the community charter conversion process and making it easier to include those designated as "underserved" within a credit union's field of membership.

NAFCU

National Association of Federal Credit Unions | www.nafcu.org

4. Operational Improvements for Credit Unions

- Raise the arbitrary cap on member business loans to 27.5% or raise the exemption on MBL loans from $50,000 to $250,000, adjusted for inflation, and exempt loans made to non-profit religious organizations, businesses with fewer than 20 employees and businesses in "underserved areas."
- Remove requirements to mail redundant and unnecessary privacy notices on an annual basis, if the policy has not changed and new sharing has not begun since the last distribution of the notice.
- Allow credit unions greater authority and flexibility in how they invest.
- Provide NCUA the authority to establish longer maturities for certain credit union loans and greater flexibility in responding to market conditions.
- Provide federal share insurance coverage for Interest on Lawyers Trust Accounts (IOLTAs).

5. 21st Century Data Security Standards

- Establish national standards for safekeeping of all financial information.
- Establish enforcement standards for data security that prohibit merchants from retaining financial data, and require merchants to disclose their data security policies to customers.
- Hold merchants accountable for the costs of a data breach, especially when it was due to their own negligence; shift the burden of proof in data breach cases to the party that incurred a breach and require timely disclosures in the event of a breach.

For more information, visit **www.nafcu.org/regrelief.**

Attachment D: NAFCU's "Dirty Dozen" – Twelve Regulations to Eliminate or Amend

NAFCU's "Dirty Dozen" - Twelve Regulations to Eliminate or Amend

1. **Expand credit union investment authority** to include permissible investments in derivatives, securitization and mortgage servicing rights. NAFCU strongly pushed for the expansion of credit unions' investment authority to include the ability to engage in limited derivatives activities. NAFCU will continue to seek this authority for qualified credit unions. In addition, NAFCU will push for the authority to securitize loans and expanded ability to invest in mortgage servicing rights.

2. **Seek updates and modernization of the NCUA's fixed assets rule.** In particular, the NCUA should: (1) increase the current 5 percent aggregate limit; (2) re-define what constitutes "fixed assets"; and, (3) improve the process of obtaining a waiver.

3. **Improve the process for credit unions seeking changes to their field of membership.** Improvements should include: (1) enabling credit unions to strengthen their associational membership charter; (2) streamlining the process for converting from one charter type to another; (3) remove or greatly increase the current population limits for serving members in a metropolitan area (1 million) and contiguous political jurisdictions (500,000); and, (4) making it easier for all credit unions to add "underserved" areas within their field of membership.

4. **Increase the number of transfers allowed to be made per month from savings accounts.** The restriction on "convenience transfers" under Regulation D presents an ongoing concern for NAFCU and its members. Members are often unable to understand and remember the arbitrary limits on the number and types of transfers the regulations permit them to make from their savings account. Members expect to have the ability to transfer their funds with ease to and from particular accounts, and the regulation's six-transfer limitation from savings accounts creates an undue burden for both members and credit unions. This six-transfer limitation should be updated and increased to at least nine transfers per month, while still making a distinction between savings and transaction accounts.

5. **Seek added flexibility for credit unions that offer member business loans.** These improvements could include: (1) securing credit union-friendly changes to the waiver process; (2) increasing the general minimum loan-to-value ratio from 80% to 85%; and, (3) securing removal of the 5 year relationship requirement.

6. **Update the requirement to disclose account numbers to protect the privacy of members.** Credit unions are currently required to list a member's full account number on every periodic statement sent to the member for their share accounts pursuant to Regulation E. These requirements need to be updated to allow the credit union to truncate account numbers on periodic statements in order to protect the privacy of the member and to reduce the risks of fraud and identity theft.

7. **Update advertising requirements for loan products and share accounts.** The regulatory requirements for advertisement of credit unions' loan products and share accounts have not kept pace with technological changes in the current market place. The requirements of Regulation Z and Truth in Savings should be updated to reflect these changes and advances in practical advertisements and the disbursement of information, while maintaining the integrity and accuracy of the information that the member truly needs to know from the advertisement.

8. **Modernize NCUA advertising requirements** to keep up with technological changes and an increasingly mobile membership. Update NCUA regulations to clarify that the official sign is not required to be displayed on (1) mobile applications, (2) social media, and (3) virtual tellers.

9. **Seek improvements to the Central Liquidity Facility** by reducing the amount of time that it takes for a credit union to secure access to liquidity. In addition, work with the NCUA to secure changes the Central Liquidity Facility by removing the subscription requirement for membership and permanently removing the borrowing cap.

10. **Obtain flexibility for federal credit unions to determine their choice of law.** Federal credit unions should be allowed the opportunity to choose the jurisdiction under which they operate without surrendering their federal charter. To this end, NAFCU will work with the NCUA to establish a waiver process under which a federal credit union, taking into account safety and soundness considerations, would choose the state law under which it wants one or more of its operations.

11. **Update, simplify and make improvements to regulations governing check processing and funds availability.** These enhancements should include: changing outdated references (i.e., references to non-local checks); changes that are required by statute and are already effective and incorrectly stated in the regulation; and changes that enable credit unions to address fraud.

12. **Eliminate redundant NCUA requirements to provide copies of appraisals upon request.** Credit unions are required to provide copies of appraisals under the CFPB's final mortgage rules upon receipt of an application for certain mortgages. The NCUA's requirements to provide a copy upon request should be amended to remove this duplicative requirement.

TESTIMONY OF

SARA M. CLINE

COMMISSIONER

WEST VIRGINIA DIVISION OF FINANCIAL INSTITUTIONS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS, PART II"

Before the

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

Tuesday, July 15, 2014, 2:00 pm

Room 2128 Rayburn House Office Building

INTRODUCTION

Good afternoon, Chairman Capito, Ranking Member Meeks, and distinguished Members of the Subcommittee. My name is Sally Cline, and I serve as the Commissioner of the West Virginia Division of Financial Institutions (DFI).

Thank you for holding this hearing and considering H.R. 4626, the SAFE Act Confidentiality and Privilege Enhancement Act, which will help states promote and extend smart, efficient regulation to our state-licensed, non-bank financial services providers through expanded use of the Nationwide Multi-state Licensing System and Registry (NMLS, or the System).

It is my pleasure to testify before you today on behalf of the Conference of State Bank Supervisors (CSBS). CSBS is the nationwide organization of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. For more than a century, CSBS has given state supervisors a national forum to coordinate supervision and to develop regulatory policy. CSBS also provides training to state banking and financial regulators and represents its members before Congress and the federal financial regulatory agencies.

State banking regulators supervise over 5,100 state-chartered banks. Further, most state banking departments also regulate a variety of non-bank financial services providers, including mortgage lenders, money transmitters, payday lenders, and check cashers. In my state of West Virginia, my department is responsible for regulating state-chartered banks, state-chartered credit unions, mortgage lenders, consumer lenders, and money services businesses.

H.R. 4626 is just one example of Congress and state regulators' shared interest in promoting smart and efficient financial regulation. More broadly, state regulators advocate for "right-sized" regulations that are appropriately tailored to a financial institution's size, risk, complexity, and scope. This tailored regulatory approach is especially crucial for community banks, whose portfolio lending and relationship-based business model unduly suffers under the burden of what we might call "one-size-fits-all" regulations. One-size-fits-all regulations treat all bank business models the same, ignoring the vast differences between complex global financial conglomerates and small community banks. State regulators support and thank the Committee for its efforts to alleviate community bank regulatory burden.

We appreciate your consistent and long-standing support for state banking and financial regulation, and I thank you for introducing H.R. 4626 and the many members of the Committee who support this bill.

ABOUT NMLS

Almost 10 year ago, in the lead up to the financial crisis, state regulators recognized the need to oversee the mortgage industry more comprehensively and efficiently. State regulators also wanted to effectively and efficiently streamline the licensing process across state lines. For instance, regulators from West Virginia and my neighboring state, Kentucky, should be able to seamlessly share information and communicate regarding a financial services provider licensed in both of our states. Similarly, a financial services provider should enjoy a streamlined licensing

process between West Virginia, Kentucky, and all other states in which it is licensed to do business. Furthermore, state regulators wanted to ensure that a bad actor could not have his or her license revoked in one state, only to go set up shop in another. To achieve this simple concept, the states collectively developed an electronic system for mortgage licensing, known as NMLS. The System gives regulators the ability to keep track of bad actors and provide responsible mortgage providers with greater efficiency and consistency in the licensing process. After two years of development, state regulators launched NMLS on January 2, 2008.

When Congress sought to pursue mortgage market reform in 2008, you recognized the benefit of state supervision and NMLS and codified the System into federal law through the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). The SAFE Act required all residential mortgage loan originators (MLOs) be either licensed or registered through NMLS. This web-based system, administered by the states through CSBS, allows state-licensed mortgage companies, their branches, and individuals to apply for, amend, update, or renew a license online for all participating state agencies using a single set of uniform applications.

The SAFE Act also established a framework that clarified state and federal roles and a mechanism for state and federal coordination and information sharing. Under this state-federal cooperative structure, state regulators are given primary responsibility for implementing the law's requirements, with a federal agency serving as a backstop and arbiter of the SAFE Act. All 50 states enacted laws to implement the mandates of the SAFE Act within one year of its passage. The states responded in record time to adopt NMLS, quickly putting in place a uniform and seamless system of mortgage licensing and supervision across the nation. With the success of NMLS, state regulators are increasingly able to share information across state lines and with their federal counterparts, leveraging collective resources and making the examination environment more efficient.

NMLS also serves as a resource for consumers and promotes greater transparency concerning the companies providing financial services to consumers through the NMLS Consumer Access website (www.nmlsconsumeraccess.org). NMLS Consumer Access enables consumers to verify whether a mortgage lender is in fact properly licensed.

The simplicity of the concept underpinning NMLS has been key to its success – via NMLS, a mortgage lender can easily apply for a license in one state or across multiple states using a uniform, electronic license application form. This uniformity cuts bureaucratic red tape and reduces regulatory burden for state-licensed companies with operations in numerous states. NMLS provides similar streamlining benefits to state regulators by providing back-office services. States that license the same entity are able to share pertinent information and collaborate with colleagues across state lines regarding multi-state entities, thereby reducing duplicative efforts and costs and promoting more efficient supervisory processes at state regulatory agencies. NMLS complies with the Federal Information Security Management Act's (FISMA) stringent data security standards.

EXPANSION AND WIDESPREAD SUPPORT OF NMLS

NMLS was designed in a forward-thinking manner to provide functionality for all state licensing regimes. NMLS proved to be such a successful and integral regulatory tool in the mortgage licensing arena, my fellow state regulators and I decided to expand its use to serve as a licensing system for other state-licensed, non-bank financial services providers. Starting in April 2012, state regulators began voluntarily using NMLS on this expanded basis to include licensees such as check cashers, debt collectors, and money transmitters. My own state legislature in West Virginia decided to expand use of NMLS, and beginning this month, my department will utilize the System to license money services businesses. As another example, I know that Texas also plans to expand use of NMLS for money transmitters later this year, as well as for currency exchangers. Other states are rapidly expanding their use of NMLS to achieve these synergies. As of year-end 2013, 24 state agencies were using NMLS to license consumer lenders, money services businesses, and debt companies. By the end of this year, 27 states will use NMLS to license and track money services businesses, eight states for payday lenders, five for debt collectors, 12 for consumer finance companies, and another eight for debt settlement and management businesses.

The expanded use of NMLS has streamlined the licensing process for both licensees and regulators. It enables licensees to manage their licenses for multiple states, while states are able to track the number of unique companies and individuals, as well as the number of licenses they hold in each state. As a system of record for state regulatory authorities and a central point of access for licensing, NMLS brings greater uniformity and transparency to these non-depository financial services industries while maintaining and strengthening the ability of state regulators to monitor these industries.

Non-bank financial services companies have also supported the efficiencies that NMLS provides. In a June 2012 House Financial Services Committee hearing on money services businesses, industry representatives testified that widespread adoption of NMLS "would eliminate duplication of effort and opportunities for error" and "urge[d] any changes at the federal level to accommodate and encourage its further development."[1] In another House Financial Services Committee hearing that same month, appraisers, money transmitters, and regulators alike testified to their interest in using NMLS as a licensing platform.[2]

Federal regulators have also benefitted from NMLS efficiencies and are examining advantages to expanded use in other non-mortgage industries. In fact, the Dodd-Frank Wall Street Reform and Consumer Protection Act specifically required the Consumer Financial Protection Bureau (CFPB) to consult state agencies on existing state registration systems when developing and implementing its own registration requirements.[3] The CFPB has turned to state regulators and NMLS on numerous occasions. Earlier this year, the CFPB was able to use information from NMLS in a proposed rule entitled "Defining Larger Participants of the

[1] Timothy P. Daly, Senior Vice President, Global Public Policy, The Western Union Company. Hearing before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, U.S. House of Representatives, 112th Congress, Second Session, Serial No. 112-139, 49-50 (June 21, 2012).
[2] Subcommittee on Insurance, Housing, and Community Opportunity: "Appraisal Oversight: The Regulatory Impact on Consumers and Businesses," Printed Hearing 112-140 (June 29, 2012).
[3] 12 U.S.C. § 5512(c)(7) and 12 U.S.C. § 5514(b)(7).

International Money Transfer Market."[4] Taking advantage of state-federal information sharing agreements, the CFPB used data that had been collected by the states on money transmitters to perform an analysis of money transmitters. This is exactly the kind of efficient and cooperative supervisory data sharing that state regulators originally envisioned and NMLS now enables. In November 2013, the CFPB issued an Advanced Notice of Proposed Rulemaking on debt collection practices, which specifically sought comments on using NMLS if it were ever to require registration of debt collectors.[5] State regulators appreciated that the CFPB identified NMLS as a potential registration database. As the CFPB contemplates registration requirements of various regulated entities, NMLS is an obvious solution that can efficiently meet regulators' needs while avoiding duplication.

ENHANCED PRIVILEGE AND CONFIDENTIALITY PROTECTIONS FOR AN EXPANDING NMLS

Given the desire for expanded use of NMLS among non-depository financial services companies, state regulators, and other stakeholders, the introduction of H.R. 4626 comes as a very welcome development. The SAFE Act currently provides that information shared through NMLS among mortgage industry regulators retains existing state and federal privilege and confidentiality protections. Neither the SAFE Act nor H.R. 4626 create any additional privilege or confidentiality rights. Under the SAFE Act, information contained in NMLS retains whatever privilege and confidentiality protections the information enjoyed prior to being entered into NMLS, as long as that information is shared through NMLS among mortgage regulators.

I will use my own banking department as an illustration. Since the West Virginia DFI has the authority to license and supervise entities and individuals involved in mortgage lending, my agency is considered a mortgage industry regulator, and any regulatory information that I share with other mortgage industry regulators through NMLS retains all legal protections related to confidentiality and privilege. However, if another state regulator wants to use NMLS to license a certain category of non-depository companies and that state regulator is *not* a mortgage regulator, it is not clear that the SAFE Act's protections for privilege and confidentiality would apply. In that instance, if I needed to share licensing or other regulatory information through NMLS with that state regulator, that regulator might not be bound to comply with and honor the privilege and confidentiality protections that I must follow.

This possible gap limits the states' ability to use NMLS as a licensing system for non-mortgage financial services providers. The change proposed by H.R. 4626 addresses this uncertainty and would provide me and West Virginia regulated entities with certainty that confidential or privileged information shared through NMLS would continue to be protected under state and federal law.

It is important to note that H.R. 4626 does not create any privilege or new licensing or registration requirements through NMLS. The bill simply allows for existing confidentiality or

[4] Bureau of Consumer Financial Protection. "Defining Larger Participants of the International Money Transfer Market (CFPB 2014-0003)." Federal Register. Vol. 79, No. 21, p. 5316.
[5] Bureau of Consumer Financial Protection. "Debt Collection (Regulation F) (CFPB 2013-0033)." Federal Register. Vol. 78, No. 218, p. 67879.

privilege to continue when regulatory information concerning the expanded financial services industries is shared among state and federal regulators through NMLS. It also provides regulated entities with additional assurance that their sensitive information housed in NMLS retains existing legal protections related to privilege and confidentiality.

AUTHORITY TO CONDUCT CRIMINAL BACKGROUND CHECKS FOR AN EXPANDED NMLS

In the SAFE Act, Congress mandated that MLOs undergo background checks as part of the licensing process. The Federal Bureau of Investigation (FBI) warehouses the most comprehensive and reliable database of criminal record information from both state and federal law enforcement agencies, and facilitates background checks on their behalf. The process is simple – when an individual is required to undergo a background check, he or she submits fingerprints, which are then sent to the FBI. The FBI pulls the individual's criminal history, and then sends it back to the state via NMLS.

To make this process more efficient, the SAFE Act designates CSBS as a "channeler" – an approved company that acts as an intermediary in the fingerprinting and background check process – in the mortgage context. As a channeler, CSBS streamlines an otherwise onerous process and makes it efficient. A potential MLO scans his or her fingerprints at just one location. The FBI generates that individual's criminal record and passes it to NMLS, which then directs the information to the relevant state licensing agency.

State law often requires background checks on other non-mortgage licensees, and a similar background check arrangement would need to be in place for successful NMLS expansion. The FBI has the authority to – and has – designated CSBS as a "channeler" for regulatory purposes beyond mortgage regulation. Unfortunately, despite the FBI's approval of CSBS as a channeler and our successful track record in processing background checks through NMLS, the FBI has not authorized CSBS to move forward with the use of NMLS in conducting background checks for non-mortgage financial services providers. This complicates our efforts to expand the use of NMLS. Despite engagement with the FBI over the course of two years, there still has been no resolution. With passage of H.R. 4626 and, hopefully, progress on implementing CSBS's channeling authority, state regulators will be well-positioned to provide efficient and effective regulation through expanded use of NMLS.

COMMENTS ON OTHER LEGISLATIVE PROPOSALS

I appreciate the opportunity to offer, on behalf of CSBS, general comments on the other proposals being discussed today. I referred previously to the diverse financial services ecosystem that I and my fellow state regulators oversee in our home states. Community banks are a vital part of this marketplace, and, individually and through CSBS, state regulators are very focused on commonsense regulations and supervisory practices that reflect the community bank business model.

Our focus is not necessarily on less regulation, but on "right-sized" regulations that recognize most community banks engage in traditional portfolio and relationship-based lending.

For most community banks, risk management is based on an inherent understanding of the underlying credit risk, a deep knowledge of its customer base, and an alignment between the success of the bank and its customers. As this Committee has recognized, policy efforts that encourage portfolio lending by community banks will help these institutions capitalize on the strengths of this time-tested business model. Portfolio lending has been the focus of Congressman Barr's bills addressing the Ability-to-Repay rule's treatment of rural areas and loans held in portfolio; Similarly, H.R. 4521 recognizes that community banks take taxes and insurance into consideration before deciding whether to offer escrow services to customers. At its core, these policies reflect the incentives inherent in a community bank's decision to make a mortgage loan.

Given the centrality of housing and mortgage lending to the economy, ongoing oversight of mortgage regulation is important to ensure a diverse and well-functioning marketplace for mortgage credit. CSBS praised the final Basel III rule for its efforts to respond to the concerns of Congress, industry, and state regulators, including in the rule's treatment of residential real estate loans. However, as CSBS noted when the final rule was released, "[w]hile the framework approved today significantly reduces the complexity and the number of issues banks need to address, the rule still represents a significant change and burden for the industry."[6] Accordingly, further study such as that called for in H.R. 4042 should provide important oversight and perspective.

Similar to H.R. 4626, Congressmen Barr and Perlmutter's bill, H.R. 5062, ensures the protection of privileged state supervisory information that is shared with the CFPB. This bill provides regulators and regulated companies with greater certainty about the protections that apply when information is shared with and among regulators. As the Committee considers H.R. 5062, we urge you and the bill's sponsors to include a reference to confidentiality as well as the bill's existing reference to privilege. Because state laws frequently refer to confidential and/or privileged information when describing the legal protections applicable to information shared with or among regulators, adding a reference to confidentiality will provide state regulators and regulated entities with greater certainty that information shared with and among state and federal regulators will retain any and all privilege and/or confidentiality protections conferred by existing state or federal law.

CONCLUSION

As locally based and locally accountable regulators, state banking regulators continually strive for better ways to regulate the diverse system of financial services businesses that serve our communities and consumers. Our proximity to both businesses and consumers and our diverse regulatory portfolio gives us a unique, firsthand perspective of the benefits a smarter, more efficient, non-depository regulatory framework would bring. Such benefits include promoting sound business practices and responsible lenders, reducing regulatory burden, and strengthening consumer protection.

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[6] Ryan, John W. "Approach to Basel III Respects Industry Diversity." Conference of State Bank Supervisors. July 2, 2013. Available at: http://www.csbs.org/news/press-releases/2013pr/Pages/pr-070213.aspx

H.R. 4626 promotes all of these goals through an existing and successful regulatory tool, NMLS. H.R. 4626 will cut regulatory burden, streamline the licensing process, and promote regulatory coordination at the state and federal level. My colleagues and I appreciate the work Chairman Capito has done in sponsoring H.R. 4626, and the many members of this Committee who support it.

The Senate has also recognized the importance of protecting the privilege and confidentiality of supervisory information, and passed identical companion legislation, the SAFE Act Confidentiality and Privilege Enhancement Act (S. 947), by unanimous consent in December 2013. In a show of overwhelming bipartisan support, Senate Banking Committee Chairman Tim Johnson and Ranking Member Mike Crapo, representing the Committee of jurisdiction, both co-sponsored the bill. My fellow state regulators and I urge the House to expeditiously pass H.R. 4626 in a similar bipartisan manner. This would signal to the federal agencies, state regulators, non-depository financial institutions, and consumers that Congress supports and promotes smart, proven, and efficient regulation.

Thank you for the opportunity to testify before you today on state regulators' support for H.R. 4626. I look forward to answering to any questions you might have.

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TESTIMONY

OF

DOUGLAS A. FECHER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
WRIGHT-PATT CREDIT UNION
ON BEHALF OF
THE CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING ON
EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS, PART II

JULY 15, 2014

Testimony of
Douglas A. Fecher
President and Chief Executive Officer
Wright-Patt Credit Union
On Behalf of the
Credit Union National Association
Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on
Examining Regulatory Relief Proposals for Community Financial Institutions, Part II
July 15, 2014

Chairman Capito, Ranking Member Meeks and members of the Subcommittee, thank you very much for the opportunity to testify at today's hearing. My name is Doug Fecher, and I am President and Chief Executive Officer of Wright-Patt Credit Union in Beavercreek, Ohio. Wright-Patt is a federally-insured, state chartered credit union with total assets of $2.8 billion, serving more than 279,000 members. The majority of these members live and work in the following Ohio counties: Greene, Montgomery, Butler, Hamilton, Champaign, Miami, Darke, Warren and Franklin. I am testifying today on behalf of the Credit Union National Association (CUNA), the national trade association for America's credit unions, representing 6,600 state and federally chartered credit unions and their 99 million members.

Nearly two years ago, I had the privilege of testifying before the Committee on Oversight and Government Reform at a hearing exploring whether financial regulation was restricting access to credit. I say now what I said then: *Credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not just one new law or revised regulation that challenges credit unions, but the cumulative effect of all regulatory changes. The frequency*

with which new and revised regulations have been promulgated in recent years and the complexity of these requirements is staggering.

Two years later, the situation has not improved; instead, it is worse. Since 2008, CUNA estimates that credit unions have been subjected to more than 180 regulatory changes from at least 15 different federal agencies.

The burden of complying with ever-changing and ever-increasing regulatory requirements is particularly onerous for smaller institutions, like credit unions. Although my credit union, at $2.8 billion, is a large credit union, we are a small financial institution. In fact, the combined assets of the entire credit union system are smaller than those of each of the largest four banks in the United States.

When a regulation is changed, there are certain upfront costs that must be incurred no matter the size of the institution: staff time and credit union resources must be applied in determining what is necessary in order to comply with the change; forms and disclosures must be changed; data processing systems must be reprogrammed; and staff must be retrained. It also takes time to discuss these changes with credit union members, and at times members get frustrated because of the change.

Because most compliance costs do not vary by size, regulatory burden is proportionately greater for smaller institutions than for larger institutions. If a credit union offers a service, it has to be concerned about complying with virtually all of the same rules as a larger institution, but they have no choice but to spread those costs over a much smaller volume of business and have fewer human resources available to implement the changes. Today there are approximately 800 credit unions operating in the U.S. with one or fewer full-time equivalent employees. Over 30% of all credit unions operate with three or fewer

full-time equivalent employees and just under 45% operate with five or fewer full-time equivalent employees.

Not surprisingly, smaller credit unions consistently say that their number one concern is regulatory burden. Anecdotally, many of these folks tell us they put in 70- and 80-hours a week trying to keep up with regulations and the constant barrage of regulatory changes. Difficulties in maintaining high levels of member service in the face of increasing regulatory burden are undoubtedly a key reason that roughly 300 small credit unions merge into larger credit unions each year.

Every dollar a credit union spends complying with these changes is a dollar that is not spent to the benefit of credit union members. Because credit unions are member-owned financial cooperatives, the entire cost of compliance is ultimately borne by credit union members. Greater compliance costs reduce net income, which is credit unions' only source of net worth.

Without question, regulatory burden is one of the greatest threats to community based financial institutions. It is driving consolidation within both the credit union and small bank sectors, leaving consumers with fewer choices in the financial services marketplace. That is why today's hearing is important – the legislation under consideration will help improve the situation for credit unions and other financial institutions. These bills do not represent a complete solution to the challenges we face, but they are a small step in the right direction. We are pleased to share our views on these bills and also to raise additional concerns with respect to regulatory burden.

The affinity for community based financial institutions is strong among consumers and policymakers. Consumers and small businesses like the familiarity of and the service they receive from locally based financial

institutions. Across the country, credit unions are a critical component of the fabric of the communities they serve. However, if Congress wants credit unions and other small community based financial institutions to survive, the never-ending wave of regulatory changes must end. Through the laws it enacts, Congress must do a better job to differentiate between credit unions and community banks that work hard to help consumers, and other financial institutions that seek to maximize profits in ways that at times take advantage of consumers. The oversight of those writing the rules with which credit unions and small banks must comply needs to intensify. When regulation makes it too expensive for small financial institutions – credit unions and community banks – to offer products and services to their members or customers, consumers are not being protected – they are being harmed.

Regulatory Relief Legislation

We have been asked to provide our views on the following bills: H.R. 3240, the *Regulation D Study Act*; H.R. 3374, the *American Savings Promotion Act*; H.R. 3913, a bill to amend the Bank Holding Company Act of 1956 to require agencies to make considerations relating to the promotion of efficiency, competition and capital formation before issuing or modifying certain regulations; H.R. 4042, the *Community Bank Mortgage Servicing Asset Capital Requirements Study Act*; H.R. 4626, the *SAFE Act Confidentiality and Privilege Enhancement Act*; and, H.R. 4986, the *End Operation Choke Point Act of 2014*.

In addition, we have been asked to provide our views on three discussion drafts. These include a bill that would require the Office of Financial Research to consult with federal financial regulators, and incorporate their recommendations before publishing their report and taking public comments; a bill to require federal financial regulators to establish a threshold at or below which a certified or licensed appraiser is not required to perform appraisals in

connection with federally regulated transactions; and a bill to allow State bank supervisors and State non-bank supervisors be considered "covered agencies" when sharing information with another covered agency or any other federal agency without waiving any privilege applicable to the information.

H.R. 3240 – The Regulation D Study Act

H.R. 3240, bipartisan legislation introduced by Representatives Robert Pittenger (R-NC) and Carolyn Maloney (D-NY), directs the Government Accountability Office (GAO) to study the impact of the Federal Reserve Board's monetary reserve requirements, implemented through Regulation D, on depository institutions, consumers and monetary policy. Credit unions became subject to monetary reserves in 1980.

Regulation D impacts credit union members by limiting the number of automatic withdrawals from a member's savings account to six transactions per month. The impact of this limit is to unnecessarily cause credit union members to overdraft their checking accounts when a debit draws the checking account balance below zero and the member has already had six automatic transfers during the month. When this happens, members who may have the funds in a savings account to cover the debit are hit with nonsufficient fund fees (NSF) from their financial institution and, when a check is involved, a returned check fee from the merchant. This is not a result of an overdraft protection program – this happens because of a regulatory cap on automatic transfers. It is difficult for credit union members affected by the cap to understand that this is out of the control of the credit union when the funds to cover the debit are sitting in their account at the credit union.

We would like to see this cap increased or eliminated altogether, but we understand that one of the reasons the regulation is in place is because the Federal Reserve uses it as a tool to conduct monetary policy. So, as a first step

toward the possible change in this cap, the legislation directs the Government Accountability Office (GAO) to study the issue so that more information will be available for Congress to determine whether an increase of or the elimination of this cap would substantially affect their ability to conduct monetary policy.

Specifically, H.R. 3240 directs the GAO to examine and report within one year of enactment on the following topics: an historic overview of how the Federal Reserve has used reserve requirements to conduct monetary policy; the impact of the maintenance of reserves on depository institutions, including the operations requirements and associated costs; the impact on consumers in managing their accounts, including the costs and benefits of the reserving system; and, alternatives to required reserves the Federal Reserve may have to effect monetary policy. The bill also directs the GAO to consult with credit unions and community banks.

This bill is timely. According to former Federal Reserve Chairman Ben Bernanke, "...reserve balances far exceed the level of reserve requirements and the level of reserve requirements thus plays only a minor role in the daily implementation of monetary policy."[1] A GAO study will allow an objective assessment of whether the rarely changed monetary reserves imposed on depository institutions and consumers are necessary in order for the Fed to implement monetary policy in the 21st century. CUNA strongly supports this bill.

H.R. 3374 – the American Savings Promotion Act

H.R. 3374, the *American Savings Promotion Act* was introduced by Representatives Kilmer (D-WA) and Cotton (R-AR). This legislation seeks to offer

[1] Letter from Federal Reserve Chairman Ben Bernanke to Representative Robert Pittenger, September 20, 2013.

parity to financial institutions wishing to offer raffle based prize-linked savings accounts to their members or customers.

Nine states currently allow financial institutions to offer prize-linked savings accounts. Credit unions in four states (Washington, Michigan, North Carolina and Nebraska) participate in the "Save to Win" program, which offers credit union members a chance to win prizes through a raffle for every $25 deposited into a special savings account. These credit unions have seen positive results when offering these accounts to their members. To date, members participating in "Save to Win," have saved tens of millions of dollars. Most of these savings have come from first-time members and under-banked members.

The National Credit Union Administration (NCUA) currently authorizes federally chartered credit unions to offer raffle based activities, such as prize-linked savings accounts.[2] However, current Federal law prohibits other types of federally chartered financial institutions from offering raffle based accounts. H.R. 3374 would remove this Federal prohibition by making an exception for savings promotion raffles. CUNA is supportive of removing this barrier for federally chartered institutions, leaving the question to the States for the purposes of State chartered institutions.

H.R. 4042 – the Community Bank Mortgage Servicing Asset Capital Requirements Study Act of 2014

H.R. 4042, the *Community Bank Mortgage Servicing Asset Capital Requirements Study Act of 2014*, has been introduced by Representatives Luetkemeyer (R-MO), Perlmutter (D-CO), Cotton (R-AR), Lucas (R-OK) and Womack (R-AR), and directs the Federal banking agencies to conduct a study of

[2] 12 CFR 721.3(h)

appropriate capital requirements for mortgage servicing assets for nonsystemic banking institutions.

Earlier this year the NCUA issued a proposed rule revising their risk-based capital standards for credit unions. The proposed rule would implement Basel-style capital standards on "complex" credit unions. As discussed in greater detail below, CUNA has significant concerns with the proposed rule and has asked the NCUA to withdraw it. Of particular note for purposes of H.R. 4042 are the risk weightings that NCUA has proposed for mortgage servicing rights (MSRs). The proposed rule includes a 250% risk weighting on MSRs. We believe this level would be punitive and unnecessary, and we have recommended it be reduced to 100%, which is similar to the level in the Basel III requirements for small banks.

An active market exists for MSRs, which allows for the establishment of current market values of such rights during changing economic and interest rate environments. This allows for frequent "marking-to-market" of servicing rights, which prevent losses from accumulating.

We certainly understand the concerns expressed by the banking trade associations with respect to capital requirement related to mortgage servicing rights, because we have similar concerns regarding the much more stringent requirement that NCUA has proposed for credit unions. Further, we note that H.R. 4042 was introduced prior to the publication of NCUA's proposed rule in the Federal Register, and the sponsors could not have contemplated the need to include NCUA as part of this legislation. Therefore, we request the Subcommittee amend H.R. 4042 to include NCUA among the agencies conducting the joint study and to delay the implementation of the NCUA's proposed rule until an appropriate period of time after the study has been

completed. In any case, credit union capital requirements on MSRs should be no higher than those imposed on small banks.

H.R. 4626 – the SAFE Act Confidentiality and Privilege Enhancement Act

H.R. 4626, the *SAFE Act Confidentiality and Privilege Enhancement Act*, introduced by Chairman Capito (R-WV), would allow state and federal regulatory officials with mortgage or financial services industry oversight authority access to any information provided to the Nationwide Mortgage Licensing System and Registry without the loss of confidentiality protections provided by federal and state laws. We support the legislation as a technical correction to Section 1512 of the SAFE Act, which currently only grants such access to mortgage industry regulators.

H.R. 4986 – the End Operation Choke Point Act of 2014

H.R. 4986, *the End Operation Choke Point Act of 2014*, has been introduced by Representative Luetkemeyer (R-MO), and would amend the federal banking statutes in an effort to end a United States Justice Department investigation known as "Operation Choke Point."

The goal of Operation Choke Point is to deny businesses with a high risk of engaging in money laundering operations or predatory activity access to the banking system and the payment networks. According to the May 29, 2014, House Committee on Oversight and Government Reforms' staff report on Operation Choke Point, some of the targeted merchant categories associated with high-risk activity include: ammunition sales, coin dealers, credit repair services, dating services, debt consolidation services, home-based charities, escort services, fireworks sales, lifetime memberships, mailing lists, money

transfer networks, online gambling, payday loans, telemarketing, and travel clubs.[3]

To be clear: we do not condone illegal or illegitimate business practices but this program raises serious constitutional issues. If not contained, it would divert credit unions even more from their mission and purpose of serving members. As CUNA and other financial services trade groups indicated in a joint statement to the House Financial Services Committee on April 8, 2014, "Operation Choke Point threatens to close access to the financial system to law-abiding businesses, because the mere prospect of an enforcement action is sufficient to cause financial institutions to restrict access to their payment systems to only established companies that present low risks. While preventing fraud is a top concern, it needs to be balanced with ensuring that businesses and consumers that operate in accordance with applicable laws can still access payment systems."[4]

H.R. 4042 would amend the appropriate federal banking statutes, including the Federal Credit Union Act, to bar regulators from prohibiting, restricting or discouraging insured depository institutions from serving entities that are licensed or authorized to provide products and services, is a registered money transmitting business or has a reasoned legal opinion that demonstrates the legality of the entity's business. We support what this legislation is trying

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[3] Staff Report of the Committee on Oversight and Government Reform. United States House of Representatives. "The Department of Justice's 'Operation Choke Point': Illegally Choking Off Legitimate Businesses?" May 29, 2014. 2. http://oversight.house.gov/wp-content/uploads/2014/05/Staff-Report-Operation-Choke-Point1.pdf.

[4] Statement of the Consumer Bankers Association, Credit Union National Association, Electronic Funds Transfer Association, The Electronic Transfer Association, Independent Community Bankers of America, National Association of Federal Credit Unions and Third Party Payment Processors Association before the House Financial Services Committee Hearing entitled, "Who's in Your Wallet: Examining How Washington Red Tape Impairs Economic Freedom." April 8, 2014. 6.

to accomplish, which is to prevent situations where financial institutions are used to police those whom they serve. We note that the legislation, as introduced, requires a technical correction on page 4, line 16, where the word "and" should be "or." As the legislation works its way through the legislative process, we would be happy to work with the sponsors to perfect it.

Financial institutions should not be put in the position of policing those whom they serve. To the extent that regulation or law enforcement activity is designed to discourage legitimate businesses from accessing mainstream financial services, it is a disservice to these lawful businesses and could create a public safety issue.

Appraisal Discussion Draft

We support the goals of the "Access to Affordable Mortgages Act of 2014," which would amend the Truth in Lending Act (TILA) to exempt certain higher-risk mortgages from property appraisal requirements. By providing an exemption from the *Truth in Lending Act* appraisal requirements for properties with transaction values of $250,000 or less for loans held on portfolio for at least three years, the bill would provide both regulatory relief to mortgage lenders as well as increase access to mortgage credit availability for borrowers purchasing lower cost dwellings. The bill would also amend the *Financial Institutions Reform, Recovery, and Enforcement Act of 1989* to exempt this same category of higher-risk mortgages from the standards prescribed by the federal interagency appraisal requirements, as long as such mortgage loans are held on a lender's portfolio for at least three years. Again, the bill would allow credit unions that offer mortgage loans secured by covered properties to better serve their middle to lower income members.

Other Legislation

We have been asked to present our views on several other bills including, H.R. 3919, a bill to amend the Bank Holding Company Act of 1956 to require agencies to make considerations relating to the promotion of efficiency, competition and capital formation before issuing or modifying certain regulations; a discussion draft that would require the Office of Financial Research to consult with federal financial regulators, and incorporate their recommendations before publishing their report and taking public comments; and a discussion draft to allow State bank supervisors and State non-bank supervisors be considered "covered agencies" when sharing information with another covered agency or any other federal agency without waiving any privilege applicable to the information. These bills do not directly impact credit unions, and we have no position on them at the present time.

Additional Concerns

We greatly appreciate the Subcommittee's attention to the legislation on the roster of today's hearing; however, as we noted earlier in our testimony, these bills are not a complete solution to the challenges credit unions face in terms of regulatory burden; in fact, some of them would not directly impact credit unions. We would like to bring additional concerns to the attention of the Subcommittee.

NCUA's Proposed Rule on Risk-Based Capital

Earlier this year, NCUA issued a proposed rule related to risk-based capital standards for credit unions.[5] The agency has indicated that it was prompted to update its standards following a 2012 GAO study, a report from its

[5] Proposed rule on prompt corrective action; risk based capital (12 CFR Parts 700, 701, 702, 703, 713, 723 and 747) issued by NCUA on January 23, 2014. http://www.ncua.gov/Legal/Documents/Regulations/PR20140123PCA.pdf

Office of Inspector General and lessons learned from the financial crisis. CUNA is a strong, historic supporter of risk-based capital for credit unions, but we ardently oppose this proposal and have urged NCUA to withdraw it.

We believe that the proposed rule exceeds the NCUA's statutory authority under the *Federal Credit Union Act* in several areas. The *Federal Credit Union Act* directs the NCUA to establish risk-based net worth requirements for the purposes of determining whether a credit union is adequately capitalized; however, the proposed rule would impose a risk-based capital standard for the purposes of determining whether a credit union is well-capitalized. [6] Furthermore, the proposed rule would permit the NCUA to establish individual capital standards for credit unions on a case-by-case basis; our reading of the Federal Credit Union Act suggests that this is an authority that Congress has not conveyed to the agency, and it would be inconsistent with the recommendations of the Department of Treasury and the Governmental Accountability Office. [7,8] Credit unions face too many uncertainties already without having to contend with whether NCUA will impose additional capital beyond what they have planned to provide in order to meet specific risk-based requirements.

As we discuss in our comment letter, we have many other issues with the proposed rule. We object to the proposal's interest rate risk scheme, because it completely ignores liabilities. We also have expressed concern that the proposed rule discounts the 1% deposit credit unions place in the NCUSIF; and with the proposed rule's one-dimensional, asset-based definition of a "complex" credit union.

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[6] 12 U.S.C. § 1790d(d).
[7] U.S. Treasury Report to Congress, Credit Unions, at 8 (December 1, 1997)
[8] GAO-12-247.

In addition, we believe the risk-weights in the proposed rule are misaligned given the *Federal Credit Union Act's* mandate that NCUA develop a system that takes into consideration the unique characteristics of the credit union system, and would have unnecessarily harsh consequences on credit unions, their members and communities. In many cases, the proposed risk-weights, including escalators for concentration risk, are substantially more stringent than similar risk-weights in the Basel III rules for small banks, even though credit union performance on these assets is generally stronger. If implemented as proposed, it would lead to a contraction in credit union leading, particularly mortgage lending and small business lending, at a time when the economy is recovering from a very significant financial crisis. The last thing we need during this fragile recovery is for regulators to make it more difficult for credit unions to lend to their members, but that would be an impact of the proposal.

In fact, the commentary accompanying the proposed rule significantly underestimates the impact of the proposal on credit unions, their members and the communities that they serve. NCUA indicates that less than 10% of covered credit unions would be affected by the proposal – only 189 would be reclassified from well-capitalized to adequately capitalized and only 10 would be reclassified to undercapitalized – and that these credit unions would be required to raise a total of $63 million of additional capital to become adequately capitalized, given no changes in their balance sheets.[9] This estimate ignores several operational realities. First, very few credit unions seek to maintain capital levels precisely at the required amount. They generally want to maintain a buffer so that they can manage unexpected changes in their balance sheets; and, their examiners

[9] 79 Fed. Reg. 11, 188.

generally prefer that they maintain the buffer. The NCUA estimate calculates only the amount that the reclassified credit unions would need to achieve the higher classification; it does not take into consideration the capital buffer that the credit unions would seek to maintain. CUNA estimates that these credit unions would need to raise a total of $480 million in additional capital to maintain their buffers.

NCUA's estimates also disregard the impact the proposal would have on the nearly 1,700 credit unions for which the proposed rule would increase the amount of capital required to be well-capitalized above the current level of 7% of total assets. A detailed analysis of the impact of the proposal on these credit unions is included in CUNA's comment letter, but suffice to say, on net, across all potentially affected credit unions, the total amount of capital necessarily to be well-capitalized would increase by $7.6 billion.[10] We conservatively estimate that this increase would compel credit unions to add an additional $3.5 - $4.5 billion in capital in an effort to maintain or manage buffers above the higher requirements.

In our comment letter, we urged NCUA to pursue risk-based capital standards as part of a multi-faceted capital reform strategy, which would include statutory capital reform. Representatives King (R-NY) and Sherman (D-CA) have introduced a bill, H.R. 719, the *Capital Access for Small Businesses and Jobs Act.* This legislation has the support of the NCUA Chairman and enjoys the cosponsorship by an additional 49 bipartisan members of the House of

[10] Letter from Bill Cheney, CUNA, to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014. 17-19.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140528BCheney.pdf

Representatives.[11] It would be a good place to start the conversation regarding credit union capital reform.

CUNA also urged NCUA to undertake major improvements in the training of examiners to address deficiencies than have contributed significantly to the failures of credit unions. We also urged the NCUA to address a number of the proposed rule's deficiencies, including ones we have already identified in this testimony as well as the following additional deficiencies and others:

- There were 8,100 federally-insured credit unions at the start of the worst financial crisis in this nation's history. In total, only 25 of those deemed "complex" by the proposal failed. If in place at that time, the proposal would not have prevented any of those failures nor would it have significantly reduced losses to the National Credit Union Share Insurance Fund. It would have caused substantial overcapitalization of thousands of other healthy credit unions thus substantially reducing service to members when many needed it the most.
- The proposal does not reflect credit unions' historical financial performance including during times of severe financial market distress. NCUA cannot justify the proposal in light of the vigorous health of federally insured credit unions in general; and
- The overall negative impact of the proposal would be far greater than the agency has anticipated and would result in a much smaller credit union system over the long term.

Finally, we urged the NCUA to withdraw the proposal because, given the major weaknesses in the proposed rule—which would seriously constrict credit union growth and financial performance—we believe it would be far better to maintain the current risk-based rule than to move forward with the NCUA's proposed rule. If implemented without change, the proposed rule would doom credit unions to a marginal role in the financial marketplace without effectively achieving the objectives NCUA has identified. It would clumsily identify credit

[11] Letter from NCUA Chairman Debbie Matz to Representative Peter King. May 30, 2014. 3.

unions in need of additional capital at the expense of overcapitalizing many other well-managed credit unions. Member service and credit availability from credit unions would suffer, because credit unions will move away from decision making based on the best interest of the members and communities that the credit union serves and toward managing "capital at risk," as if they operated the same as a for-profit banking institution. Short of withdrawing the proposal, we have urged NCUA to reissue a revised proposal for comment.

For these reasons and others, the proposed rule has received a historic amount of interest from stakeholders. As noted above, CUNA expressed concerns to the agency in a comprehensive comment letter filed in May, as did Wright-Patt Credit Union.[12,13] These letters were among the more than 2,200 comment letters the agency received. We greatly appreciate the leadership of Representatives King (R-NY) and Ranking Member Meeks (D-NY) who organized a letter to NCUA which was signed by 322 other Members of the House of Representatives including most members of the Financial Services Committee.[14,15] We also appreciate the leadership of Chairman Hensarling and Chairman Capito who recently sent a letter to the NCUA on this matter. The level of continuing interest and concern regarding this proposed rule can be clearly appreciated through the stream of letters going from Capitol Hill to the

[12] Letter from Bill Cheney, CUNA, to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140528BCheney.pdf
[13] Letter from Doug Fecher, Wright Patt Credit Union to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140513DFecher.pdf
[14] Comment letters received by NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/Regs/Pages/PR20140123RiskBasedCapital.aspx
[15] Letter from Representatives Peter King, Gregory Meeks and 322 Members of the House of Representative to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140515Congress.pdf

NCUA urging them to take the concerns credit unions have with this proposal into consideration as the rule is finalized.

We commend the NCUA for its diligent effort to review these comments and to solicit additional feedback on the proposal through the establishment of a credit union advisory group, a series of listening sessions across the country and a continued willingness to meet with stakeholders to discuss ways to improve the rule. We look forward to sharing our views on this proposal with the newest member of the NCUA Board, J. Mark McWatters, after he is sworn into office later this month.

America's credit unions – since their inception – have been the model of risk management in the U.S. financial system. No other class of financial institution has been as resilient to risk as credit unions. The absence of a profit motive, a mission of service and a cooperative ownership structure, are all reasons for this performance. That fewer credit unions have failed throughout their history than any other types of financial institution is no accident – it is because credit unions are different.

NCUA should be encouraging credit unions to do more of what they do now to serve their members and communities—not limiting them so they can only do less. We strongly encourage the Subcommittee to continue to monitor this rulemaking, and exercise appropriate oversight of NCUA, to ensure that the rule that is finally implemented balances the best interests of members with the safety of the money they entrust to their credit union, and recognizes that credit unions are cooperative institutions formed to serve their members on a not-for-profit basis.

H.R. 4226 – The Credit Union Residential Loan Parity Act

We support H.R. 4226, the *Credit Union Residential Loan Parity Act.* This legislation, introduced by Representatives Royce (R-CA) and Huffman (D-CA), addresses a disparity in the treatment of certain residential loans made by banks and credit unions. When a bank makes a loan to purchase a 1-4 unit non-owner occupied residential dwelling, the loan is classified as a residential real estate loan; however, if a credit union were to make the same, it would be classified as a business loan and therefore would be subject to the cap on member business lending under the *Federal Credit Union Act.*

H.R. 4226 would amend the *Federal Credit Union Act* to provide an exclusion from the cap for these loans. In addition, H.R. 4226 would authorize NCUA to apply strict underwriting and servicing requirements for the loans.

Enactment of this legislation would not only correct this disparity but it would also enable credit unions to provide additional credit to borrowers seeking to purchase residential units, including low-income rental units. Credit unions would be better able to meet the needs of their members, if this bill was enacted, and it would also contribute to the availability of affordable rental housing. We encourage the Subcommittee to consider H.R. 4226 soon.

CFPB's Examination Thresholds

As the Subcommittee considers improvements and reforms to the *Dodd-Frank Wall Street Reform and Consumer Financial Protection Act,* we encourage the consideration of legislation to increase the threshold for CFPB examination from $10 billion to $50 billion in assets for credit unions, thrifts and banks and index that amount to take into account inflation.

Increasing this threshold would provide significant regulatory relief to the affected institutions and direct Bureau resources to the examination of the institutions that serve the greatest number of consumers. While this change

would not significantly change the number of institutions and percentage of assets presently subject to examination by the Bureau, it would allow the Bureau to more efficiently use its examination resources in the coming years. The number of financial institutions approaching $10 billion in total assets is increasing. As these institutions cross the threshold, the Bureau will be required to spend more of its resources examining these newly covered institutions at the expense of other activities.

Institutions affected by this change would continue to be subject to the Bureau's rules and regulations, and they would be examined for compliance with these rules by their prudential regulator. In addition, the Section 1026 of the *Dodd-Frank Act* provides the Bureau authority to examine on a sampling basis credit unions, thrifts and banks for which it does not have examination authority and includes language directing coordination between the prudential regulators and the Bureau.

CFPB's Exemption Authority

As the Subcommittee considers additional ways to address the regulatory burden facing credit unions, we urge the Subcommittee to ask the Bureau to conduct a review of its regulations to identify and address outdated and unnecessary regulations with an eye toward reducing unwarranted regulatory burden, as directed by Section 1021(b)(3) of the *Dodd-Frank Act.*

Further, we ask the Subcommittee to encourage the Bureau to use the exemption authority Congress conveyed to it under Section 1022(b)(3) of the *Dodd-Frank Act* with alacrity. We believe the Bureau has more authority than it has been exercising to extend relief to credit unions and others from certain compliance responsibilities. We are very concerned that the Bureau seems to be picking and choosing when to use the statutory flexibility Congress provided to the Bureau in the *Dodd-Frank Act.* It is important that Congress aggressively

urge the Bureau to utilize the exemption clause so that the weight of compounding regulations that are intended for abusers and the largest of financial institutions do not overburden credit unions and other smaller financial institutions. The Bureau's failure to use this authority as Congress intended may ultimately drive good actors out of markets, forcing consumers to do business with those entities that remain – we have seen this already in the remittance transfer market. We encourage Congress to urge that the Bureau exercise its authority as broadly as possible to protect credit unions from burdensome overregulation, which ultimately impacts consumers. Further, CUNA has urged the Bureau to include an analysis of its exemption authority with every proposal and final rule so that every time the Bureau considers a new regulation, it will also consider whether institutions such as credit unions that are already heavily regulated should be exempted. The default should be exclusion unless an actual need is demonstrated.

Along these lines, we strongly encourage the Subcommittee as it considers additional regulatory relief legislation to consider ways to more directly exempt credit unions and small banks from the Bureau's rulemaking.

Impact of Unreasonable Effective Dates on Credit Unions

Credit unions are also facing what seems to be an emerging regulatory problem with unreasonable effective dates. In January 2014, a vast number of mortgage lending regulations required under the *Dodd-Frank Act* went into effect. The Consumer Financial Protection Bureau refused to extend the compliance period – even though it issued numerous changes as late as in October 2013 to its regulations that were "finalized" in January 2013. In the past when the Federal Reserve Board had rulemaking jurisdiction over these types of regulations, the Fed often had an effective date but with a mandatory compliance date six or nine months later.

NCUA and the federal banking agencies recognized that many mortgage lenders simply could not have all their systems changed and training completed, and publicly announced in early 2014 that their examiners would take "good-faith efforts to comply" into account. However, since the regulations were effective in January 2014, lenders are not protected from private *Truth in Lending Act* lawsuits down the road for any disclosures and procedures that don't comply with the language of the January 2014 regulations.

While not a matter under the jurisdiction of the Financial Services Committee, another example of compliance burdens created with unmovable effective dates is the *Foreign Account Tax Compliance Act* (FATCA) which was effective July 1, 2014. The IRS did not even issue regulations until March 2014 which changed provisions on reporting about nonresident aliens (impacting W-8BEN forms and procedures), and there are still many questions from credit unions on how FATCA might impact their operations.

Acknowledging that it still had more regulations, forms, instructions and guidance to issue (and much of it probably wouldn't even be out until after the effective date), instead of postponing the July 1, 2104 effective date, in May the Internal Revenue Service announced it was allowing for "a transition period" until December 2015 – taking into consideration financial institutions "good faith efforts" to comply with the new requirements before enforcing penalties. On June 30, 2014 (the day before the "effective date") the IRS issued additional regulations, some of which appear to contradict previous provisions. It is certainly difficult to be held to a "good faith compliance effort" standard for "moving target" regulations.

We urge the Subcommittee to work closely with the regulators to ensure that the effective dates of their rulemakings provide credit unions and other covered entities sufficient time to come into compliance.

Conclusion

The crisis of creeping complexity with respect to regulatory burden is severe. We welcome the steps that the Subcommittee, the full Committee and the House of Representatives have taken in recent months to try to address the challenges facing credit unions and other community based lenders. The bills under consideration today are a small step in the right direction, but much more needs to be done. We encourage you to move forward with additional measures in the near future, and we stand ready to work with you on these issues.

On behalf of America's credit unions and their 99 million members, thank you very much for holding today's hearing and providing me the opportunity to testify. I am happy to answer any questions the Members of the Subcommittee may have.

TESTIMONY

of

WILLIAM M. ISAAC

SENIOR MANAGING DIRECTOR,
FTI CONSULTING, INC
FORMER CHAIRMAN,
FEDERAL DEPOSIT INSURANCE CORPORATION

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
WASHINGTON, DC

July 15, 2014

Mr. Chairman, Ranking Minority Member, and members of the Subcommittee, I am profoundly grateful that you are holding this hearing on "Operation Choke Point." The opinions I express today are my own, and I do not purport to speak on behalf of my firm, FTI Consulting, Inc. In the interest of full disclosure, some of FTI's clients have an interest in the matters before the Subcommittee today.

By way of background, I was appointed to the FDIC board of directors at age 34 by President Carter in 1978 and was named Chairman by President Reagan in 1981. I returned to the private sector at the end of 1985 after serving nearly two years beyond my six-year term at the FDIC. I also served during my term at the FDIC as Chairman of the Financial Institutions Examination Council (the coordinating body for the federal regulators of depository institutions) and as a member of the Basel Committee. My CV is attached at the end of this statement.

In my view, Operation Choke Point is one of the most dangerous programs I have experienced in my 45 years of service as a bank regulator, bank attorney and consultant, and bank board member. I fully support the bill introduced by Representative Luetkemeyer, HR 4986, to rein in this program.

Without legal authority and based on a political agenda, unelected officials at the Department of Justice (DOJ) are coordinating with some bank regulators to deny essential banking services to companies engaged in lawful business activities

that some government officials don't like. Bankers are being cowed into compliance by an oppressive regulatory regime.

History teaches that when government bureaucracies try to direct economies the inevitable results are stifled creativity, distorted markets, and lower economic growth. One of the most insidious ways for government employees to control the U.S. economy is through the banks – directing who gets, and who can't get, loans and other essential banking services.

Perfectly lawful businesses are being denied access to essential banking services because they offer products or services unelected government officials do not like. This ought to alarm and frighten each of us irrespective of our ideology, party affiliation, or view of the particular products or services being cut off.

Operation Choke Point is a particularly egregious example of an un-Constitutional abuse of power. It is driving lawful businesses out of the banking system, denying them not only loans but also deposit accounts, payments processing services, payroll accounts, and other services critical to operating any business.

According to the Six Month Status Report [HOGR-3ppp00320, 339-340] issued on Operation Choke Point by the House Oversight and Reform Committee, the DOJ launched Operation Choke Point in 2013, working in concert with a wide range of regulators including the FTC, FDIC, OCC, CFPB, and FBI. The

Operation targeted "undesirable" industries. The stated goal of Operation Choke Point was to "sensitize" the banking industry to the risk of doing business with these legal but "undesirable" businesses through the issuance of non-public FIRREA subpoenas (as opposed to using enforcement actions where the authority and tactics could be challenged).

Regulators and the DOJ highlight some two-dozen businesses that they consider "high risk" or "undesirable", including ammunition dealers, producers of adult films, check cashers, short-term unsecured loans (commonly called "payday loans"), telemarketers, firearms/fireworks vendors, raffles, pharmaceutical firms, life-time guarantees, surveillance equipment firms, and home-based charities. I have spent my entire professional career in banking and bank regulation, and I do not discern any meaningful increase in risk in providing basic banking services such as deposit accounts, payroll processing, or check clearing services to any of these businesses compared to a host of other legitimate businesses.

By the end of 2013, the DOJ had issued more than 50 subpoenas and entered into one high profile settlement with a depository institution. While the DOJ and other participants in Operation Choke Point were aware of the impact on legal businesses, they did nothing to address this problem or to limit the scope of the program. In fact, they considered this to be a collateral benefit of the Operation.

The DOJ claims it is interested only in fighting consumer fraud and other illegal activities. If that is the case, why are banks being encouraged to refuse to provide basic banking services to companies that are in compliance with state and federal laws? And why are the DOJ and regulators pushing banks to cease doing business with companies engaged in lawful businesses rather than focusing all of their energies on prosecuting the people and businesses actually engaged in criminal behavior?

Operation Choke Point is fundamentally unfair to the banks and legal businesses that find their banking services cut off. By using what it recognizes as an aggressively creative reading of FIRREA's civil subpoena authority, the DOJ contorted the authority granted it in FIRREA to protect banks from fraud into a weapon to use against the banks. Once banking services are cut off to a legal business as a result of subpoena or the threat of a subpoena, there is no chance for the business to appeal the decision. The DOJ seems to think the business can argue with the bank to restore the services. However, there is no allegation of wrong doing by the business that can be disproved. The company is simply in a business that, while legal, has been determined "undesirable" and therefore "high risk" by the federal bureaucracy. This Orwellian result is frightening.

If government employees, acting without statutory authority, can coerce banks into denying services to firms engaged in lawful behavior that the

government does not like, where does it stop? The same power that DOJ uses today to choke off payday lenders or check cashers from banking services could tomorrow be used on convenience stores selling sugary sodas, restaurants offering foods with high trans-fat content, gun manufacturers, gambling casinos, adult film companies, or family planning clinics.

The point is simple and incredibly important. Under our constitutional republic and market-based economic system, unelected government employees should not decide which lawful businesses may have access to banking services and which are to be denied. Those who have serious concerns about payday loans, check cashing services, adult films, family planning clinics, or other products and services should take their concerns to state or federal legislatures and attempt to enact reforms.

It doesn't seem to count for anything at the DOJ, but Congress specifically debated payday lending during the Dodd-Frank deliberations and concluded it is a service utilized and much needed by millions of people, so it should not be eliminated and instead should be regulated by the Consumer Financial Protection Bureau.

The DOJ should not be involved in bank regulation to any extent whatsoever. Its job is to prosecute crimes as defined by law. Bank regulators need to stay out of the political arena and focus all of their energy on ensuring that

banks are operating in a safe and sound manner and are complying with all laws and regulations. Neither the DOJ nor bank regulators should be allowed to dictate which lawful businesses will be granted or denied access to banking services.

When I was Chairman of the FDIC in the 1980s, the banking agencies developed the CAMELS rating system which measured Capital adequacy, Asset quality, Management capabilities, Earnings performance, Liquidity, and Sensitivity to interest rate fluctuations. The purpose of this very important endeavor was to bring greater objectivity and uniformity to bank supervision. Rather than leaving it to each agency and to each regional office within each agency to decide what prudential standards to impose on the banking industry, a uniform, objective, and measureable set of standards was developed.

The primary mission of the FDIC and other agencies prior to the 1980s was unambiguous -- to regulate and supervise the banking system so as to maintain stability and avoid depositor runs and panics. Beginning in the late 1970s, the agencies were asked to also consider how well the banking system was serving customers across the economic spectrum and across racial, ethnic, and gender lines.

In more recent years the banking agencies have increasingly lost focus on their primary reason for being and have strayed far from their core missions. One of the most notable examples is introduction to bank supervision of the concept of

so-called "reputational risk." Instead of maintaining laser-like focus on the objective CAMELS ratings, regulators decided at some point during the past two decades to use undefined, nebulous claims about risks to the reputation of banks to pursue unlegislated agendas.

No one really knows what reputational risk means beyond the fact that a bank is doing something that a regulator doesn't like but can't quantify in terms of risk under the CAMELS rating system. This development has been a major factor in shifting the banking agencies from their primary role as guardians of the safety and soundness and stability of the financial system to amorphous financial social welfare agencies.

I believe firmly that management and the board of directors, not a banking agency, should be the guardians of a bank's reputation. Banking agencies clearly have more than enough on their plates in trying to assess the CAMELS factors correctly. Regulators cannot afford to divert time, money, or energy to assessing potential reputational risks about which their expertise is limited at best – particularly when their opinions can cause irreparable harm to lawful businesses as we witness in Operation Choke Point.

If the banking agencies were properly focused on their core safety and soundness mission, they would not be involved in Operation Choke Point. I support HR 4986, the Luetkemeyer bill without reservation. I would be inclined to

add to it a provision prohibiting the banking agencies from considering reputational risk in setting CAMELS ratings or in considering enforcement actions.

Representative Luetkemeyer's bill provides a safe-harbor to promote non-discriminatory access to financial products and services offered by banks and credit unions to businesses that are licensed, registered as money services businesses, or have a reasoned legal opinion demonstrating the legality of their business. The legislation also seeks to rein in the DOJ's subpoena authority by requiring judicial oversight. Importantly, banks and credit unions would retain their legal authority and discretion in establishing or maintaining relationships with existing and potential customers. In other words, bankers would be able to return to making customer decisions based on banking considerations, not political agendas of unelected government employees.

It's time for the rest of us to join this battle before we lose the freedoms that have made our country the most successful nation in the world – with the strongest banking system. The Constitution dictates that the place to debate whether payday lending or any other lawful business should be allowed to operate and have access to the banking system is in the halls of Congress and state legislatures, not in the backrooms of government bureaucracies.

The Luetkemeyer bill is an extremely important step in reining in government agencies that are greatly overstepping their authority and breaching

the Constitutional separation of powers between the three branches of government and between the states and federal government. While some of us may applaud the attack against payday lending, ammunition distributors, or home-based charities, we will likely take a different position when a new administration decides to attack activities more near and dear to our hearts.

I urge Congress to approve the Luetkemeyer bill without delay, as Operation Choke Point is doing severe and irreparable damage to firms engaged in lawful businesses. Thank you again for addressing these important issues and for inviting me to share my views. I will be pleased to respond to any questions you may have.

BIOGRPAHY WILLIAM M. ISAAC

William M. Isaac is a senior managing director of FTI Consulting and serves as Global Head of FTI's Financial Institutions practice. The financial institutions group provides regulatory counseling and risk management services, strategy consulting, expert testimony, and corporate governance consulting.

Mr. Isaac founded The Secura Group, a leading financial institutions consulting firm, in 1986. Secura was acquired by FTI in 2011. Prior to forming Secura, Mr. Isaac headed the Federal Deposit Insurance Corporation during the banking crisis of the 1980s, serving under Presidents Carter and Reagan from 1978 through 1985. Mr. Isaac serves as a member of the board of TSYS, a leading world-wide payments system processing company and is former Chairman of Fifth Third Bancorp, one of the nation's leading banking companies.

Mr. Isaac is involved extensively in thought leadership relating to the financial services industry. He is the author of *Senseless Panic: How Washington Failed America* with a foreword by legendary former Federal Reserve Chairman Paul Volcker. *Senseless Panic* provides an inside account of the banking and S&L crises of the 1980s and compares that period to the financial crisis of 2008-2009. Mr. Isaac's articles are published in the *Wall Street Journal, Washington Post, New York Times, American Banker, Forbes, Financial Times, Washington Times,* and other leading publications. He also appears regularly on television and radio, testifies before Congress, and is a frequent speaker before audiences throughout the world. See www.williamisaac.com.

Mr. Isaac served as chairman of the FDIC during one of the most tumultuous periods in US banking history. Some 3,000 banks and thrifts failed during the 1980s, including Continental Illinois and nine of the ten largest banks in Texas. Mr. Isaac was appointed to the board of the FDIC by President at the age of 34, making him the youngest FDIC board member and chairman in history. Mr. Isaac also served as chairman of the Federal Financial Institutions Examination Council (1983-85), as a member of the Depository Institutions Deregulation Committee (1981–85), and as a member of the Vice President's Task Group on Regulation of Financial Services (1984).

Mr. Isaac was formerly a senior partner of Arnold & Porter, which was a founding partner of The Secura Group. Mr. Isaac left the firm in 1993 when Secura purchased Arnold & Porter's interest in the firm. Before his appointment to the FDIC, Mr. Isaac served as vice president, general counsel and secretary of First Kentucky National Corporation and its subsidiaries, including First National Bank of Louisville and First Kentucky Trust Company.

Mr. Isaac began his career with Foley & Lardner where he practiced general corporate law specializing in banking law (primarily regulatory affairs, including securities matters, acquisitions and branching) and antitrust law.

Mr. Isaac is a former member, board of directors of MPS Group prior to its sale to Adecco; former member of the board of directors of Trans Union Corporation; former member, board of directors of The Associates prior to its sale to CitiGroup; former chairman, board of directors, Goodwill Industries, Sarasota; former member, board of directors of Amex Centurion Bank; former member, board of directors, Community Foundation of Sarasota, Florida; former member, board of directors, Out-of-Door Academy, Sarasota, Florida; and former member, board of trustees, Miami University Foundation. Mr. Isaac received a Distinguished Achievement Medal in 1995 from Miami University and a Distinguished Alumnus Award in 2013 from The Ohio State University.

Testimony of Lauren K. Saunders

Associate Director, National Consumer Law Center

On behalf of

Americans for Financial Reform
National Consumer Law Center (on behalf of its low income clients)
Center for Responsible Lending
Consumer Federation of America
U.S. PIRG

On
"Examining Regulatory Relief Proposals for Community Financial Institutions, Part II"

Before the Before the House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

July 15, 2014

Chairman Capito, Ranking Member Meeks and Members of the subcommittee:

Thank you for inviting me to testify today on behalf of Americans for Financial Reform, the low income clients of the National Consumer Law Center, the Center for Responsible Lending, Consumer Federation of America, and U.S. PIRG.

I am here today to testify in support of Operation Choke Point and in opposition to H.R. 4986, which would undermine important efforts underway at the Department of Justice and banking regulators designed to ensure that banks do not facilitate illegal activity. I urge you to oppose any bills to weaken the ability of regulators to fight payment fraud or to insulate banks that do not comply with the law or that willfully ignore signs that they are enabling fraud, scams and other illegal conduct. We need every tool to fight data breaches, identity theft, scams, frauds, money laundering, and other illegal conduct.

I will first explain why vigilance by banks is so important to stop illegal activity. I will then discuss H.R. 4986 and will explain why it is inappropriate to immunize banks that fail to conduct due diligence or ignore red flags of illegality merely because the entity holds a state license, is registered as a money transmitter, or can find an attorney to say its conduct is legal.

In brief, merely holding a state license is no guarantee that an entity is acting legally, is not engaged in fraud or deceptive conduct, or is complying with laws designed to prevent money laundering or other illegal activity. Vigilance over money transmitters is essential to prevent fraudsters from concealing themselves and to prevent money laundering and financing for drug cartels and terrorism. Finally, fraudsters have lawyers who are willing to defend them, but the idea that a bank should be able to take a fraudster's attorney's word for the legality of payments and to ignore other signs of illegality is simply astounding.

I also join the testimony of Marcus Stanley of Americans for Financial Reform expressing serious concerns about the discussion draft of The Access to Affordable Mortgages Act of 2014, which would exempt "higher-risk mortgages" of $250,000 or under less that are held on the lender's balance sheet from new appraisal requirements included in the Dodd-Frank Act. The exemption would expose both consumers and financial institutions to the risks of an inflated appraisal.

Fraudsters Need Banks to Access the Payment System

Many scams, frauds and illegal activity could not occur without access to the consumer's bank or credit card accounts through the payment system. Banks that originate payments play a

critical role in enabling wrongdoers to debit victims' bank accounts and to move money around. Examples of unlawful activity that rely on an originating bank to process payments include the following:

- A $600 million internet pyramid and Ponzi scheme shut down by the SEC.[1]
- A telemarketing scam defrauded seniors of $20 million by lying to them to get their bank account information.[2]
- A lead generator tricked people who applied for payday loans and used their bank account information to charge them $35 million for unwanted programs.[3]
- Bogus debt relief services scammed consumers out of $8 million and made their debt problems worse.[4]
- Wachovia Bank enabled $160 million in fraud by scammers targeting vulnerable seniors.[5]
- After an enforcement action against Wachovia, scammers moved their business to Zions Bank, which allowed it to continue despite spotting suspicious activity. For example, a telemarketer calling a senior about a purported update to his health insurance card tricked him into revealing his bank account information.[6]
- Just last week, the FTC obtained a $6.2 million settlement against a payday loan broker that falsely promised to help consumers get loans and then used consumers' bank account information to make unauthorized withdrawals without their consent.[7]

The FBI estimates that mass-marketing fraud schemes cause tens of billions of dollars of losses each year from millions of individuals and businesses.[8] A MetLife study found that fraud drains $2.9 billion a year from the savings of senior citizens.[9] In addition, the data obtained in

breaches like the recent Target, Michael's and P.F. Chang breaches would be useless without a bank willing to use that data to debit bank or credit cards accounts.

Even when consumers voluntarily authorize a payment from their account to purchase a product or repay a loan, they may find that their account is repeatedly debited for fees or charges they did not authorize or additional products they did not buy. Just last month, a judge agreed with the FTC that a payday lender had deceived consumers about the cost of their loans by imposing undisclosed charges and inflated fees that were automatically deducted from their bank accounts.[10] Those deductions could not have been made without a bank to process the debits.

Banks are not expected to verify the legality of every payment they process, and they are not always aware that they are being used to facilitate illegal activity. But when they choose profits in the face of blatant signs of illegality, they become an appropriate target for enforcement action. Indeed, if regulators do not take action against banks facilitating illegal payments, they are left playing an impossible game of 'whack a mole' which makes it much too easy for fraudsters to get away with continuing to break the law, and processing institutions to continue to benefit from law-breaking.

Payment Fraud Hurts Everyone

Wrongdoers who access the payment system inflict harm on everyone. In addition to the direct victims of fraud:

- The general public spends millions of dollars on identity protection products and loses faith in the security of the payment system;
- Retailers and online merchants lose business if consumers are afraid to shop on their website or at their store;

- Consumers' banks bear the customer friction and the expense of dealing with unauthorized charges;
- The fraudsters' banks may suffer regulatory or enforcement actions, lost customers, private lawsuits, and adverse publicity; and
- American security is put at risk when banks and processors that lack know-your-customer controls are used for money laundering for drug cartels, terrorist groups, and other criminals.

DOJ's Operation Choke Point

The Department of Justice's (DOJ) Operation Choke Point is aimed at banks that "choose to process transactions even though they know the transactions are fraudulent, or willfully ignore clear evidence of fraud."[11] The focus is on illegal conduct, not activity that DOJ deems immoral.

The first, and to date only, action that DOJ has brought as a result of Operation Choke Point is U.S. v. Four Oaks Fincorp, Inc., Four Oaks Bank & Trust Co. Four Oaks enabled payments for illegal and fraudulent payday loans; an illegal Ponzi scheme that resulted in an SEC enforcement action;[12] a money laundering operation for illegal internet gambling payments;[13] and a prepaid card marketing scam that made unauthorized debits for a bogus credit line.[14] DOJ charged that the bank ignored blatant red flags of illegality, including extremely high rates of payments returned as unauthorized; efforts to hide merchants' identities; offshore entities clearly violating U.S. laws; disregard for Bank Secrecy Act obligations by foreign

entities; hundreds of consumer complaints of fraud; and federal and state law violations, including warnings by NACHA and state attorneys general.

This type of disregard for know-your-customer requirements and the legality of payments is what led to last month's$8.9 billion penalty against BNP Paribas for concealing billions of dollars in transactions for clients in Sudan, Iran and Cuba,[15] and to a $1.92 billion penalty against HSBC for helping terrorists, Iran, and Mexican drug cartels launder money.[16]

It is impossible to read the Four Oaks complaint without concluding that Operation Choke Point is essential work for which DOJ should be applauded, not criticized.[17] Calls to abandon Operation Choke Point are misguided and inappropriate.

Regulators Have Appropriately Warned Banks to be Aware of High-Risk Activities, but Banks Need Not Reject Legal Businesses

Separate from DOJ's Operation Choke Point, bank regulators have asked banks to be aware of higher-risk activities, defined as areas with a "higher incidence of consumer fraud or potentially illegal activities."[18] As with Operation Choke Point, the focus of bank regulators is on areas where fraud or illegal activity is prevalent. For example, telemarketing, credit repair services, and debt forgiveness programs have long been problematic areas plagued with fraud and deceptive conduct.

Payday lending is a high-risk activity because it is completely unlawful in 15 states, is unlawful in nearly every other state if the lender lacks a state license, and, especially for online

lending, often results in repeated debits that the consumer did not knowingly authorize. For example, the Four Oaks complaint described how many consumers were defrauded when they authorized a single payment from their bank account but found that the payday lenders debited their accounts repeatedly, without authorization, and would not stop.

Banks are permitted to provide services for entities that operate in high-risk areas as long as the bank undertakes due diligence to obtain reasonable assurances that the entity is operating legally. Regulators have made clear that banks that "properly manage these relationships and risks are neither prohibited nor discouraged" from providing services to lawful customers in high-risk areas.[19] Banks need only be aware of the potential for illegal activities; know their customers, including basic due diligence of high-risk businesses;[20] monitor payment return rates; and be alert for suspicious activity. These are not new obligations, but they are essential ones.

Some recent headlines have drawn sweeping, unsubstantiated conclusions based on individual bank account closures. Banks close accounts every day for a variety of reasons. The bank that closed the account of the adult entertainer, for example, has stated unequivocally that it was unrelated to either Operation Choke Point or any policy concerning her profession.[21] The same is true of a gun dealer who was cut off by its payment processor.[22]

Indeed, the National Rifle Association has said:

"[W]e have not substantiated that [anti-gun groups' efforts] are part of an overarching federal conspiracy to suppress lawful commerce in firearms and ammunition, or that the

federal government has an official policy of using financial regulators to drive firearm or ammunition companies out of business."

Concerns by payday lenders that they are being rejected by some banks go back a decade or longer, long before the 2013 Operation Choke Point or the FDIC's 2011 guidance on payment processing relationships. For example, in 2006, the Financial Service Centers of America (FiSCA), which represents check cashers, money transmitters and payday lenders, testified:

"For the past six years [since 2000] banks have been abandoning us - first in a trickle, then continuously accelerating so that now few banks are willing to service us ..."[23]

Anecdotes about a few closed accounts do not prove regulatory overreach. Banks close accounts for many reasons that may be unrelated to regulatory pressure or may be an appropriate response to regulatory guidance. Among other reasons, the bank could have:

- seen signs of illegality or fraud, even with a licensed entity, such as high rates of payments challenged as unauthorized;
- terminated a problematic payment processor that had both illegal and legal merchant clients;
- terminated businesses, like a payday lender that also does money transmitting, that lacked adequate controls to prevent money laundering;
- made the bank's own business decision to cut ties with payday lenders after the bank suffered adverse publicity from its own triple-digit deposit advance payday lending;

- eliminated unprofitable accounts in areas where the risks of illegality are not worth the effort to conduct due diligence; or
- misunderstood regulatory signals and inflammatory headlines.

Some bank account closures may be related to anti-money laundering (AML) and Bank Secrecy Act issues that are separate from whether the business is considered a high-risk business. Some payday lenders with state licenses are also check cashers and money transmitters, areas that require compliance with complicated but important AML rules. Recent money laundering settlements may have drawn more attention to those rules, and the fact that Operation Choke Point is now in the news does not mean that every bank account closure is related to it.

Regulators are working to clear up any misconceptions created by overreaching headlines or exaggerated lobbyist claims, while also emphasizing the importance of work to prevent payment fraud. As FDIC Vice Chairman Thomas M. Hoenig said recently:

> [I]f the bank knows its customer, takes the necessary steps, has the right controls, then they ought to be able to engage with them.... But you need to do those things like BSA [compliance].... I do believe we have an obligation to say, "If you are following these rules, [you] have to then judge the risk that [you] are willing to take on." That's the process and I'm very comfortable with that.[24]

It is irresponsible and dangerous to halt scrutiny of banks that close their eyes when they operate in areas with a high risk of illegality. There are thousands of banks in this country and

plenty that will continue to handle high risk but lawful accounts. But the tens of billions of dollars that Americans lose to fraud every year and the harms permitted by money laundering are just too great to abandon vigilance by banks that are in a position to stop illegal activity.

Small Banks are Not a Target But May be Disproportionately at Risk

Banks large and small have received subpoenas, enforcement actions and regulatory guidance related to payment fraud. But small banks may be disproportionately likely to process illegal payments and, even more so, are disproportionately likely to be harmed by payment fraud.

Some fraudsters target small banks that lack the internal controls to spot suspicious activity or that (like Four Oaks Bank) need additional revenue and are willing to look the other way in exchange for fee income. High risk activities without due diligence are especially dangerous to the safety and soundness of a smaller bank, particularly one that is undercapitalized.

On the flip side, more small banks are on the receiving end of illegal payments, not the originating end, and are themselves victims of payment fraud facilitated by other banks. When the scammer's bank submits an unauthorized charge against a consumer's account, the consumer's bank incurs expenses to resolve the issue.

Those costs can be substantial for small banks. When a consumer contests an unauthorized payment, the average bank cost for handling a return is $4.99. But for a small bank

the cost is much higher: the average is over $100 and can be as high as $509.90, according to NACHA, the Electronic Payments Association.[25]

The disproportionate impact of payment fraud on smaller banks is a reason to *continue* efforts to stop illegal activity. It is not a reason to halt such efforts.

H.R. 4986 Would Immunize Banks that Ignore Signs of Illegal Conduct and Would Undermine Essential Efforts to Fight Money Laundering, Payment Fraud and Illegal Activity

H.R. 4986 provides a highly problematic safe harbor for financial institutions that knowingly process payments for unlicensed merchants and fraudsters or willfully ignore signs of illegality. The bill also curtails the Department of Justice's ability to compel the production of important information necessary to determine if banks are facilitating illegal activity.

The bill forbids regulators from prohibiting, restricting or discouraging financial institutions from providing any product or service to an entity that:

- is licensed and authorized to offer such product or service;
- is registered as a money transmitting business; or
- has a "reasoned" legal opinion from a state-licensed attorney that purports to demonstrate the legality of the entity's business under applicable Federal and State law, tribal ordinances, tribal resolutions, or tribal-State compacts.

That is, regulators could not discourage financial institutions from providing processing services to an entity even if the institution observed alarmingly high levels of payments

challenged as unauthorized, was warned by federal or state law enforcement officials that the entity appeared to be engaged in fraudulent or deceptive conduct, knew that the entity had numerous court orders against it, or saw signs that the entity was attempting to conceal unlawful activity.

The fact that an entity holds a state license is no guarantee that it will not engage in unlawful activity. CashCall, Inc. for example, is a licensed lender in many states. But the CFPB has charged that CashCall, acting as a servicer and debt collector on payday loans made by Western Sky, debited consumer checking accounts for money they did not owe and continued debiting accounts even after Western Sky shut down its operations in response to numerous state enforcement actions and court orders.[26] CashCall has also faced prosecution by state attorneys general for its own lending activities, and California is in the process of revoking its license.

Yet, under H.R. 4986, regulators would not be permitted to advise financial institutions of the risks of processing payments for CashCall or from discouraging financial institutions from processing payments for entities facing similar government enforcement activity. The bill would not only permit continued debiting of consumer accounts for unlawful payments, it would also put financial institutions at risk of liability for chargebacks and legal action by consumers and others.

Similarly, even if an entity is registered as a money transmitting business, it could be violating the law or facilitating money laundering, consumer fraud, or other illegal activity. For example, Arizona Attorney General Tom Horne recently obtained a $94 million settlement with

Western Union, which was sending "blood wires" that permitted organized criminal cartels to smuggle money across the Arizona border. Attorney General Horne took the action to protect Arizonans from border violence, gun running, and human and narcotic smuggling along the southwest border.[27]

Under H.R. 4986, if a financial institution was serving a licensed money transmitter that was facilitating similar conduct, regulators could not discourage the activity or advise the financial institution of the risks.

Finally, virtually any criminal can find an attorney to defend its conduct, and sometimes the criminal hides the facts even from its own attorney. A legal opinion by an attorney that an activity is permissible should not absolve a financial institution from its obligation to conduct due diligence on of the third parties with which it does business and to keep its eyes open for suspicious activity. Financial institutions have clear guidance from regulators about how to manage relationships with third parties, including payments processors, and a letter from the third party's attorney cannot trump that guidance.

While this provision will aid any fraudster who has the ability to hire an attorney to write a letter on its behalf, it may have a particular impact on stopping regulators from advising financial institutions of the risks if they process payments for purportedly tribal entities that conduct activities off reservation in violation of state law. The Supreme Court's recent decision in the *Bay Mills* case should have made clear that tribes must obey state law when they act off reservation even if they have a license issued by a tribal entity to conduct business on tribal land.

A state "can shutter, quickly and permanently, an illegal casino," and the same is true of an illegal payday loan operation, by denying a license, obtaining an injunction, and even using the criminal law.[28] Yet even if the legality of unlicensed tribal payday lending is still up for debate, financial institutions that process electronic payments over the ACH system and remotely created checks over the check system provide warranties about the validity of those payments. If the payments turn out to be unlawful, the financial institution is on the hook to the consumer's bank, and a letter from the payday lender's attorney will not help. Regulators are only doing their duty to look out for the safety and soundness of financial institutions when they advise them of these high risk activities designed to evade state law.

H.R 4986 also curtails the Department of Justice's ability to issue subpoenas in connection with its investigations of financial fraud. A subpoena is merely a request for information. If a financial institution is potentially facilitating illegal activity, a subpoena is an important tool to determine the facts. Abusive practices, especially in cases of payments fraud, are hard to detect. For fraudsters, this is by design – the best scams are those that go undetected for as long as possible – so we cannot tie the hands of the regulators charged with enforcing the law. Regulators must have the ability to examine financial institutions, ensure that appropriate compliance procedures are in place, and when necessary, issue subpoenas, to detect fraud and investigate potential abuses.

Conclusion

Fighting payment fraud should not be controversial. Everyone benefits from efforts to stop illegal activity that relies on the payment system. I urge you to oppose H.R. 4986 and other

measures that would undermine efforts to ensure that banks comply with know-your-customer requirements, conduct due diligence on high-risk activities, and keep an eye out for signs of illegality. Everyone must do their part to protect the integrity of the payment system and to prevent illegal activity that harms millions of Americans, businesses and American security.

Thank you for inviting me to testify today. I would be happy to answer any questions.

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[1] *See* SEC, Press Release, "SEC Shuts Down $600 Million Online Pyramid and Ponzi Scheme" (Aug. 17, 2012), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171483920#.U8P2rpRdX9Z.

[2] *See* Federal Trade Comm'n, Press Release, "FTC Stops Mass Telemarketing Scam That Defrauded U.S. Seniors and Others Out of Millions of Dollars" (Mar. 31, 2014), available at http://www.ftc.gov/news-events/press-releases/2014/03/ftc-stops-mass-telemarketing-scam-defrauded-us-seniors-others-out.

[3] *See* Federal Trade Comm'n, Press Release, "FTC Charges Marketers with Tricking People Who Applied for Payday Loans; Used Bank Account Information to Charge Consumers for Unwanted Programs" (Aug. 1, 2011), available at http://www.ftc.gov/news-events/press-releases/2011/08/ftc-charges-marketers-tricking-people-who-applied-payday-loans.

[4] *See* Federal Trade Comm'n, Press Release, "FTC Charges Operation with Selling Bogus Debt Relief Services; DebtPro 123 LLC Billed Consumers as Much as $10,000, But Did Little or Nothing to Settle Their Debts" (June 3, 2014), available at http://www.ftc.gov/news-events/press-releases/2014/06/ftc-charges-operation-selling-bogus-debt-relief-services.

[5] *See* Charles Duhigg, "Bilking the Elderly, With a Corporate Assist," New York Times (May 20, 2007), available at http://www.nytimes.com/2007/05/20/business/20tele.html?pagewanted=all&_r=1&.

[6] Jessica Silver-Greenberg, New York Time, "Banks Seen as Aid in Fraud Against Older Consumers" (June 10, 2013), available at http://www.nytimes.com/2013/06/11/business/fraud-against-seniors-often-is-routed-through-banks.html?pagewanted=all&_r=0.

[7] See Federal Trade Comm'n, Press Release, "Phony Payday Loan Brokers Settle FTC Charges," (July 11, 2014) available at http://www.ftc.gov/news-events/press-releases/2014/07/phony-payday-loan-brokers-settle-ftc-charges.

[8] Federal Bureau of Investigation, International Mass-Marketing Fraud Working Group, "Mass-Marketing Fraud: A Threat Assessment" (June 2010), available at http://www.fbi.gov/stats-services/publications/mass-marketing-fraud-threat-assessment/mass-marketing-threat.

[9] The MetLife Study of Elder Financial Abuse (June 2011), available at https://www.metlife.com/assets/cao/mmi/publications/studies/2011/mmi-elder-financial-abuse.pdf.

[10] FTC, Press Release, "U.S. District Judge Finds that Payday Lender AMG Services Deceived Consumers by Imposing Undisclosed Charges and Inflated Fees" (June 4, 2014), available at http://www.ftc.gov/news-events/press-releases/2014/06/us-district-judge-finds-payday-lender-amg-services-deceived.

[11] The U.S. Department of Justice, "Holding Accountable Financial Institutions that Knowingly Participate in Consumer Fraud," The Justice Blog (May 7, 2014), available at http://blogs.justice.gov/main/archives/3651.

[12] S.E.C. v. Rex Ventures Group, LLC d/b/a Zeekrewards.com, et al., Civil Action 12-CV-519 (W.D.N.C.).

[13] United States v. Pokerstars, et al., 11-CV-02564 (S.D.N.Y.).

[14] Federal Trade Comm'n, Press Release, "FTC Sends Full Refunds to Consumers Duped by Marketers of Bogus '$10,000 Credit Line'" (May 12, 2014), available at http://www.ftc.gov/news-events/press-releases/2014/05/ftc-sends-full-refunds-consumers-duped-marketers-bogus-10000.

[15] Danielle Douglass, "France's BNP Paribas to pay $8.9 billion to U.S. for sanctions violations," Washington Post (June 30, 2014), available at http://www.washingtonpost.com/business/economy/frances-bnp-paribas-to-pay-89-billion-to-us-for-money-laundering/2014/06/30/6d99d174-fc76-11e3-b1f4-8e77c632c07b_story.html.

[16] Ben Protess and Jessica Silver-Greenberg, "HSBC to Pay $1.92 Billion to Settle Charges of Money Laundering," New York Times (Dec. 10, 2012), available at http://dealbook.nytimes.com/2012/12/10/hsbc-said-to-near-1-9-billion-settlement-over-money-laundering/.

[17] The complaint, which describes the fraud and the role of the bank and payment processor in detail, is available at http://www.courthousenews.com/2014/01/09/USvFourOaks.pdf. A summary of the key allegations is available at http://www.nclc.org/images/pdf/banking_and_payment_systems/letter-doj-payment-fraud.pdf.

[18] FDIC, Payment Processor Relationships, FIL-3-2012 (Jan. 31, 2012), available at http://www.fdic.gov/news/news/financial/2012/fil12003.html.

[19] FDIC, Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities, FIL-43-2013 (Sept. 27, 2013).

[20] For example, it is a simple matter to ask a payday lender in what state it lends and to show that it has licenses in those states.

[21] Dana Liebelson, "Is Obama Really Forcing Banks to Close Porn Stars' Accounts? No, Says Chase Insider," Huffington Post (May 8, 2014), available at http://www.motherjones.com/politics/2014/05/operation-chokepoint-banks-porn-stars(quoting Chase source as saying: "This has nothing to do with Operation Choke Point ... we have no policy that would prohibit a consumer from having a checking account because of an affiliation with this industry. We routinely exit consumers for a variety of reasons. For privacy reasons we can't get into why.").

[22] Red Wing Ammunition Co. "isn't sure why he was cut off" by First Data, which stated: "First Data processes transactions for merchants selling firearms and ammunition, so long as they meet our longstanding credit/risk management
policy requirements... These policies were implemented before the DOJ's Operation Choke Point and are unrelated." Jennifer Bjorhus, Star Tribune, "Federal antifraud initiative goes too far, banks say" (June 7, 2014), available at http://www.startribune.com/business/262167821.html.

[23] Gerald Goldman, General Counsel of FiSCA, "Summary Of speech before the U.S. House Committee on Financial Services, Subcommittee on Financial Institutions & Consumer Credit , Regarding Banking Services to MSBs (June 21, 2006), available at
http://www.fisca.org/Content/NavigationMenu/GovernmentAffairs/TestimonySpeeches/FiSCAHearingOralStmtGoldman_6_21_06.pdf.

[24] Kate Davidson and Zachary Warmbrodt, Q&A: Thomas Hoenig, Politico Pro (June 13, 2014).

[25] NACHA-The Electronic Payments Association, "Improving ACH Network Quality by Reducing Exceptions" at 6 (Nov. 11, 2013). The NACHA study does not give an average cost for small banks, but the un-weighted average for all banks is $100.52, so the average for smaller banks is undoubtedly higher than that. The weighted average for all banks, taking into account each bank's volume, is $4.99.

[26] "CFPB Sues CashCall for Illegal Online Loan Servicing," Consumer Financial Protection Bureau (December 13, 2013) available at http://www.consumerfinance.gov/newsroom/cfpb-sues-cashcall-for-illegal-online-loan-servicing/

[27] Arizona Attorney General, "Western Union: CUTTING OFF THE ILLEGAL CASH FLOW: $94 Million Settlement to Aid Law Enforcement in Fighting Border Crime" (Feb. 3, 2014), available at https://www.azag.gov/border-security/western-union.

[28] Michigan V. Bay Mills Indian Community et al., 134 S.Ct. 2024, 2035 (2014).

TESTIMONY OF

MARCUS M STANLEY

Policy Director, Americans for Financial Reform

On behalf of

AMERICANS FOR FINANCIAL REFORM

Re

"EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS, PART II"

Before the

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

Tuesday, July 15, 2014, 2:00 pm

Room 2128 Rayburn House Office Building

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Mr. Chairman and members of the committee, thank you for the opportunity to testify before you today on behalf of Americans for Financial Reform. AFR is a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

I will devote my time to four of the bills under discussion today. I will first discuss HR 3913, HR 5037, and "The Access to Affordable Mortgages Act of 2014". AFR opposes these three bills. I will also discuss HR 4042, on the capital treatment of mortgage servicing rights. I note that Lauren Saunders is testifying on behalf of AFR as well as the National Consumer Law Center and others in opposition to HR 4986.

HR 3913

HR 3913 would amend Section 13 of the Bank Holding Company Act (often referred to as the 'Volcker Rule') to require that prior to any rulemaking under this section, agencies consider whether the regulation will promote 'efficiency, competition, and capital formation'. This language is similar to the requirement placed on the Securities and Exchange Commission in the National Securities Market Improvement Act (NSMIA) in 1996. HR 3913 then goes well beyond the NSMIA language and bans any rulemaking under Section 13 that "would impose a burden on competition not necessary or appropriate in furtherance of the goals of this section".

AFR has consistently opposed broad statutory mandates of this type. Such mandates are an open invitation to endless lawsuits by well-funded Wall Street interests seeking to overturn rules that may reduce their profits, even if they serve the public interest. The mandate in HR 3913 is particularly vague, broad, and far-reaching. This mandate could force the courts to effectively re-litigate the Volcker rule every time regulators took action. It is also significant that the mandate appears to prioritize 'competition' over other public interest considerations such as equity and financial stability.

Existing law such as the Administrative Procedures Act already provides ample opportunity for judicial review of agency decisions. Congress should not encourage further lawsuits through vague industry-friendly directives such as bans on any regulatory action that creates a 'burden on competition'.

To the degree that HR 3913 rests on the premise that the Volcker Rule creates an excessive 'burden on competition', we would also disagree with this premise. The term 'competition' has several possible meanings. If what is meant is competitive balance in the financial markets, then we would argue that Volcker Rule limitations on the involvement of banks in proprietary trading improve competition. Bank trading activities are dominated by a small number of 'too big to fail' banks.[1] Multiple recent studies have found that these megabanks still have a funding advantage thanks to the belief that they continue to enjoy an implicit public subsidy.[2] Furthermore, as dominant dealers in a wide range of financial instruments, they play a central role in the financial markets, which gives them potentially significant informational advantages in proprietary trading. Restricting the proprietary trading activities of such banks should improve competitive balance, not harm it.

If what is meant by 'competition' is the international competitiveness of U.S. industry, we disagree with the claims of the U.S. Chamber of Commerce that Volcker Rule restrictions would harm competitiveness. Such claims ignore the 60-year period during which U.S. banks operated under Glass-Steagall restrictions which were much more far-reaching than those that apply under the Volcker Rule. This historical experience does not support the conclusion that divisions between investment and commercial banking have an impact on international competitiveness. Furthermore, important foreign jurisdictions such as the U.K. and E.U. are also moving to create new divisions between retail commercial banking and wholesale investment banking, such as the Vickers Commission ring-fencing requirements in the U.K. and the new European Commission proposals in the E.U.[3] While these differ in their details from the Volcker Rule they will also create new barriers between financial market trading and retail banking activities. This reflects the broad-based global recognition that unrestricted universal banking can create unacceptable risks to the financial system.

HR 5037

HR 5037 would impose new reporting requirements and consultative duties on the Office of Financial Research (OFR). AFR opposes this legislation as both redundant and harmful.

The requirements are redundant in that the OFR already engages in extensive public reporting and consults frequently with member agencies, and is already subject to the full range of cyber-

[1] According to a GAO analysis, just six bank holding companies account for 88 percent of trading revenues among U.S. bank holding companies. See p. 13, General Accounting Office, "Proprietary Trading: Regulators Will Need More Comprehensive Information to Monitor Compliance With New Restrictions When Implemented", Report to Congressional Committees, GAO-11-529, July, 2011.

[2] For a comprehensive list, see "TBTF Subsidy For Large Banks – Literature Review", Prepared for Thomas M. Hoenig, Vice Chairman, Federal Deposit Insurance Corporation, July, 2014. Available at http://www.fdic.gov/news/news/speeches/literature-review.pdf .

[3] The Vickers Commission recommendations were passed into law in the U.K. as the Financial Services (Banking Reform) Act of 2013, available at http://www.legislation.gov.uk/ukpga/2013/33/contents/enacted .The nature and progress of European Commission proposals are summarized at http://ec.europa.eu/internal_market/bank/structural-reform/index_en.htm .

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security requirements that apply to the U.S. Treasury through the Federal Information Management Security Act (FISMA).

They are harmful in that the specific reporting requirements in the bill would damage the OFR's ability to perform its critical mission of investigating and researching risks in the financial system. HR 5037 requires the OFR to provide a detailed advance description to the public of every report, guidance, working paper, data collection, or information request that it will conduct during the coming year, along with target dates for every meeting and information request associated with each such action. Besides being unrealistic, this requirement would provide a road map to Wall Street interests on how to lobby the OFR concerning each detail of its work in progress and each element of its information gathering.

The bill further requires OFR to make public the exact time, date, and nature of every consultation with any staffer of a member agency regarding any report, and to publish every recommendation made in such a consultation and whether this recommendation was taken. Making public each detail of every consultation would exercise a significant chilling effect on the willingness of member agency personnel to share full and frank views with the OFR regarding work in progress. The inability to provide any confidentiality regarding advice on what are often highly controversial issues would be damaging to the OFR's ability to gather information freely from member agencies. Even such powerful transparency laws as the Freedom of Information Act provide a deliberative process exemption to safeguard internal deliberation on work in progress. But HR 5037 would eliminate this basic protection for the OFR.

HR 5037 appears motivated by the assumption that OFR's current level of public transparency or consultation with member agencies is somehow inadequate. We disagree. OFR's annual reports and working papers provide significant detail on the agency's current and upcoming projects, as well as the agency's views on key risks and vulnerabilities affecting the financial system.[4] The OFR director of course presents annual reports to Congress personally, giving ample opportunity for questions and information requests. More recently, the OFR has been required to provide quarterly reports to Congress on all spending undertaken and actions by each of its units in the past quarter.[5]

With respect to consultation with member agencies, the Treasury's recent (May 13th) letter to the House regarding the OFR's asset management report provides detailed documentation of such consultation.[6] In the case of the asset management report, consultation with the Securities and

[4] See for example the OFR's 2013 Annual Report, available at http://www.treasury.gov/initiatives/ofr/about/Documents/OFR_AnnualReport2013_FINAL_12-17-2013_Accessible.pdf . The report discusses the agency's upcoming research agenda and work plan in some detail.
[5] Requirement added in Division E, Section 120(a) of the Consolidated Appropriations Act of 2014, HR 3547.
[6] Fitzpayne, Alistair, Department of the Treasury, "Letter To Darrell Issa, Chairman, House Committee on Oversight and Government Affairs", May 13, 2014, available at http://online.wsj.com/public/resources/documents/0514asset.pdf .

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Exchange Commission (SEC) included the exchange of at least 15 draft versions of the report, at least 13 separate meetings concerning the report, and additional informal consultations. SEC Chair Mary Jo White has stated that the SEC "commented extensively" on the report when it was in progress.[7]

The OFR's mission of studying potential emerging threats to the U.S. financial system is a critical one. The failure to understand such emerging threats was a crucial contributor to the disastrous financial crisis of 2008, which cost the U.S. economy some 8 million jobs and trillions of dollars in economic losses.[8] In order to perform its mission, the OFR must have and is intended to have independence from the political pressures that may affect member agencies. The way to improve the OFR's work is to support its independence and its ability to act as a warning voice concerning threats that others may choose to overlook for political reasons. The changes in HR 5037 would have the opposite effect.

The Access To Affordable Mortgages Act of 2014

This legislation would exempt 'higher-risk mortgages' of $250,000 or under from new appraisal requirements included in the Dodd-Frank Act, so long as such loans were held for at least three years on the balance of the lender.

This exemption is a bad idea. 'Higher-risk mortgages' refers to what were once called subprime mortgages -- loans made at higher than prime market rate that generally also include high-risk features such as high upfront fees, balloon payments, interest-only loans, negative amortization, or other risky features. Various types of fraud and predatory lending connected to the origination of subprime mortgages were a major cause of the 2008 financial crisis. Describing the situation, the Financial Crisis Inquiry Commission stated[9]:

> "mortgage fraud... flourished in an environment of collapsing lending standards and lax regulation....One study places the losses resulting from fraud on mortgage loans made between 2005 and 2007 at $112 billion....Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities."

In response to this experience, oversight of the mortgage market has been increased in several ways. New rules are designed to encourage mortgage loans that are properly aligned with the payment ability of the borrower and with the value of the underlying housing collateral. One such rule is the addition of a new requirement that lender obtain a written appraisal of any property used as collateral for a higher-risk mortgage, based on a physical visit to the property by

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[7] *Oversight of Financial Stability and Data Security, Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs,* 113th Congress, February 6, 2014, Testimony of Mary Jo White.
[8] Americans for Financial Reform, "AFR Briefing Paper: Costs of the Crisis", Washington, DC, May 2013; General Accounting Office, "Financial Crisis Losses and Potential Impacts of the Dodd Frank Act", GAO 13-180, January, 2013.
[9] Page xxii, Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report", January, 2011.

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an independent and certified appraiser. This new requirement is intended to ensure that mortgage loans are properly collateralized. This protects both the lender, through adequate collateral for their loan, and the borrower, by preventing them from borrowing more than their home is worth.

By exempting mortgages of up to $250,000 from appraisal requirements, this legislation would significantly undermine this important new regulatory protection. The $250,000 exemption in this bill would include almost half of all new homes sold in the United States, and likely well over half of subprime or higher-risk mortgage loans.[10] The requirement that a lender retain the loan on their balance sheet for at least three years does provide some additional protection. But data on subprime loan defaults shows significant increases in default past the 36 month point.[11]

HR 4042

AFR does not have a position on HR 4042 at this time. The capital rule targeted for further study by HR 4042 would restrict mortgage servicing assets to at most 10 percent of common equity tier 1 capital. This is a significant change compared to the previous treatment of mortgage servicing rights. But it does not appear inconsistent with the rest of the regulatory capital framework given that the inclusion of most other types of intangible assets in common equity capital was eliminated completely in Basel III.

AFR feels that excessive leverage was a major contributor to the global financial crisis. By delaying the application of new capital treatment of mortgage servicing assets into 2016, HR 4042 would at least temporarily permit additional leverage in the banking system.

Some industry observers have pointed to new capital rules on mortgage servicing as a significant driver of migration of servicing rights from prudentially regulated banks to non-bank servicers. However, other market analysts disagree with this assessment, pointing to other constraints.[12] It is also worth noting that after the Dodd-Frank Act non-bank servicers are now regulated for consumer protection by the Consumer Financial Protection Bureau, and also that bank servicers did not perform well during and after the financial crisis.

We would also point out that prudential regulators carefully considered thousands of comments on their proposed rule regarding the U.S. implementation of new Basel III capital requirements. As a result of this examination, regulators chose to significantly ease capital requirements in many areas of the final rule, including the treatment of residential mortgages. But they did not modify the ceiling on mortgage servicing assets as a proportion of total capital. It is possible that

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[10] $250,000 exceeds the average value of subprime mortgages in every year from 2001 to 2007. See Table 1 in Demyanyk, Yuliya S. and Van Hemert, Otto, "Understanding the Subprime Mortgage Crisis", December 5, 2008.
[11] See Figure 1 in Palmer, Christopher, "Why Did So Many Subprime Borrowers Default During the Crisis: Loose Credit or Plummeting Prices?", Massachusetts Institute of Technology, November, 2013.
[12] E.g. Boltansky, Isaac and Kevin Barker, "Initial Basel III Reaction: Win For Mortgage Industry", Compass Point Research and Trading, LLC. July 2, 2013. The report states, "we believe the vast majority of servicing that has traded over the past few years was primarily due to operational and regulatory constraints, not capital constraints. Thus, in our opinion, the finalized rules will have little impact on whether MSRs will trade or not".

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much of the information requested in this bill has already been gathered by regulators as part of their previous consideration and could be made available without legislation and without a delay in the application of capital rules.

Finally, we would like to note our concern with the distinction between 'systemic' and 'non-systemic' banks advanced in HR 4042. The legislation limits the 'systemic' label to the eight U.S. G-SIFIs designated by international regulators. But these are hardly the only banks that could have a significant effect on the U.S. financial system, or present significant exposure to U.S. taxpayers through deposit insurance. As Federal Reserve Governor Tarullo pointed out in a recent speech, mid-size banks that are not G-SIFIs but hold more than $10 billion in assets own more than one-third of U.S. commercial banking assets.[13] As Governor Tarullo stated:

> "If a number of these [mid-size] banks simultaneously came under pressure or failed, a harmful contraction of credit availability in significant regions or sectors of the economy could ensue, even if there were little chance of a financial crisis. Thus, particularly to the degree that there are correlations in the risks associated with loans held across such institutions, there should be a macroprudential objective in the regulation of at least some of these firms."

Other Legislation Being Considered By The Committee Today

AFR does not have a position on HR 3240, HR 3374, HR 4626, or HR 5062.

Thank you for the opportunity to testify. Should you have further questions, I can be contacted at marcus@ourfinancialsecurity.org or (202) 466-3672.

[13] Tarullo, Daniel, "Rethinking The Aims of Prudential Regulation", Speech Delivered At the Federal Reserve Bank of Chicago Bank Structure Conference, May 8, 2014.

Testimony of

Samuel A. Vallandingham
President and CEO, The First State Bank
Barboursville, West Virginia

On behalf of the
Independent Community Bankers of America

Before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"Examining Regulatory Relief Proposals for Community Financial Institutions, Part II"

July 15, 2014
Washington, D.C.

Opening

Chairman Capito, Ranking Member Meeks, and members of the Subcommittee, I am Samuel Vallandingham, President and Chief Executive Officer of First State Bank, a $270 million community bank in Barboursville, West Virginia. I am pleased to be here today on behalf of the Independent Community Bankers of America and the nearly 6,500 community banks we represent. Thank you for convening this hearing titled: "Examining Regulatory Relief Proposals for Community Financial Institutions."

Community banks play a crucial role in the economic life of rural areas and small communities passed over by larger banks. The credit and other financial services we provide in these communities will help advance and sustain the economic recovery and ensure that it reaches every corner of the country. Community banks are responsible for 60 percent of all small business loans under $1 million. As the economic recovery strengthens, small businesses will lead the way in job creation with the help of community bank credit. I am proud to note that First State Bank was awarded SBA Lender of the Year in 2001 and SBA Community Bank of the Year in four consecutive years: 2005, 2006, 2007, and 2008.

The role of community banks in advancing and sustaining the recovery is jeopardized by the increasing expense and distraction of regulation drastically out of proportion to any risk we pose. Community banks didn't cause the recent financial crisis, and we should not bear the weight of new, overreaching regulation intended to address it. I would like to thank this committee for passing a number of important regulatory relief bills this Congress, many of which reflect ICBA's Plan for Prosperity. We strongly encourage this committee to build on your strong record of regulatory relief by advancing legislation I will discuss today.

I will focus my testimony on three bills before this committee that are of particular interest to community bankers: the "Community Bank Mortgage Servicing Asset Capital Requirements Study Act of 2014" (H.R. 4042); the "End Operation Choke Point Act of 2014" (H.R. 4986); and the discussion draft titled the "Access to Affordable Mortgages Act of 2014." The common theme of these bills is government overreach whether it's in the form of arbitrary capital requirements, law enforcement abuse and examination practices designed to deter or discourage banking services to legal and legitimate customers, or rigid and expensive appraisal requirements that unnecessarily escalate the cost of mortgage credit. ICBA supports each of these bills for reasons I will discuss below.

The Community Bank Mortgage Servicing Asset Capital Requirements Study Act of 2014 (H.R. 4042)

ICBA believes it is critical to retain and promote the role of community banks in mortgage servicing and adopt policies that will deter further consolidation of that industry. Community banks, which thrive on their reputation for customer focus and local commitment, promote a competitive mortgage servicing industry and deter future

abuses and avoidable foreclosures such as those that have impeded the housing recovery and led to the national mortgage settlement.

ICBA is seriously concerned about the punitive capital treatment of mortgage servicing assets under Basel III. Combined with prescriptive new servicing standards published by the CFPB, this capital treatment has the potential to drive community banks out of the servicing business, drive further industry consolidation into the largest banks and, increasingly, nonbank servicers which are beyond the reach of the bank regulators. This would result in a bad outcome for consumers and the fragile housing recovery. For this reason, ICBA strongly supports H.R. 4042, introduced by Rep. Blaine Luetkemeyer, which requires the banking regulators to "stop and study" ill conceived rules with the potential to permanently change an industry that plays an outsized role in the economy. With the Basel III MSA provisions scheduled to begin to take effect in less than six months, we urge this committee to take up H.R. 4042 expeditiously.

Servicing is Key to Relationship Banking and Helps Community Banks Remain Competitive

Residential mortgage lending has been an important component of First State Bank's business since its founding and has grown more important over the years. In 2013, we originated over $200 million in mortgages. In 1982, we first began to sell mortgages into the secondary market in order to access additional funding. Today, we have a $600 million servicing portfolio consisting of approximately 5700 loans. Most of those loans were sold to Freddie Mac, and a smaller number were sold to Fannie Mae.

Over the years, we have discovered that mortgage lending is a great way to cement long-term relations with customers and win the opportunity to serve their additional banking needs. But in order to sustain customer relations we need to service these loans, whether they are subsequently sold or held in portfolio. We also discovered that customers do care about who services their loans. They value, and even seek out, local servicing. If they have a question, they want to be able to pick up the phone or visit a branch and sit down with a banker in their community. Servicing is key to the marketing of mortgage originations, and together, origination and servicing are integral to our relationship-banking business model.

First State Bank's experience is typical of community banks. Servicing helps community banks remain competitive in the mortgage origination business. Today, community banks represent approximately 20 percent of the mortgage market, but more importantly, community bank mortgage lending is often concentrated in the rural areas and small towns of this country, which are not effectively served by large banks. For many rural and small town borrowers, a community bank loan is the only mortgage option. Any broad based recovery of the housing market must involve community bank mortgage lending.

Community bank servicing is based on close ties to customers and communities. Because First State Bank's servicing team consists of only eight people, customers always know who is on the other end of a telephone or across the desk. Most importantly, we intervene early to keep mortgages out of default. We know, for example, when an employer closes in our community and how that closure impacts the income of our borrowers. A servicer based thousands of miles away won't have such knowledge. Smaller servicing portfolios and better control of mortgage documents also provide an advantage over the large servicers. For these reasons, community banks have generally been able to identify repayment problems at the first signs of distress.

Community Bank Servicing Improves Loan Performance

This personalized approach to servicing is a natural complement to conservative, commonsense underwriting. We make sure loans are affordable for our customers and they have the ability to repay. Loans are underwritten based on personal knowledge of the borrower and their circumstances – not solely based on statistical modeling done in another part of the country. We don't underwrite option arm loans or other exotic credit products. This combination of quality, personalized underwriting and servicing yields results. Our delinquency rate is just 1.4 percent, a very low rate which is typical of community bank mortgage lenders. Community bank originated and serviced mortgages perform better in all market conditions.

Basel III

Community bank mortgage servicing is under threat from the punitive new capital provisions of Basel III. Basel III provides that the value of mortgage servicing assets (MSAs) that exceed 10 percent of a bank's common equity tier 1 capital must be deducted directly from its regulatory capital.[1] In addition, MSAs that are below the 10 percent threshold must be risk weighted at 250 percent once Basel III is fully phased in. Expressed in terms of capital ratios, MSAs will shrink the numerator (when they exceed the 10 percent threshold) and inflate the denominator, resulting in a lower regulatory capital ratio. My bank would lose over $1.6 million in common equity tier 1 capital, reducing our tier 1 ratio by 50 basis points. The capital reduction combined with higher risk weighting of MSAs would reduce our risk based capital ratio by 95 basis points. The Basel III MSA provision would have a significant impact on key measures of our regulatory capital adequacy. As if this were not enough, there's a third limitation on MSAs: When MSAs combined with deferred tax assets and investments in the common stock of unconsolidated financial institutions exceed 15 percent of common equity tier 1 capital, the excess must also be directly deducted from regulatory capital. Many banks that do not exceed that 10 percent MSA threshold will be caught by the 15 percent combined threshold. This backup provision shows regulators' unrelenting determination to curtail bank servicing.

[1] MSAs represent the future value of servicing mortgage loans owned by third parties.

Banks that have strong capital ratios today and that have serviced mortgages for decades without problems, would have starkly lower capital ratios under the new rule, or be forced to raise new capital, a significant challenge for community banks in the current environment. This is a gratuitous and punitive double hit on a community bank servicer's capital ratio, just as Basel III sets out a narrower definition of regulatory capital and higher target ratios. It effectively bans the holding of MSAs above the 10 percent threshold (or the 15 percent combined threshold) as though they were a toxic asset and imposes an exorbitant capital charge on MSAs below the threshold. In addition, the calculations are so complex that many community banks will not realize that they have a capital problem until next year when the provisions begin to take effect.

The Basel III rule is a drastic change from the current rule which allows a bank to hold MSAs up to 100 percent of tier 1 capital (and broader measure of capital) and risk weight MSAs at 100 percent. Any change in policy with such a broad adverse impact should be clearly supported by data and analysis. But regulators have offered no data or empirical analysis whatsoever to suggest that MSAs destabilized banks during the recent financial crisis.

A Rule Based on Flawed Reasoning

MSAs are intangible assets. When a mortgage prepays either because the home is sold or the owner refinances, the value of that particular servicing agreement ceases. Regulators have used the intangibility of MSAs to justify their concerns. However, MSAs are held in a diverse portfolio, which significantly lowers their risk. In addition, they are counter cyclical. When interest rates rise, creating interest rate risk in loan portfolios, pre-payment risk goes down because fewer people sell their homes or refinance. This makes MSAs more secure and therefore more valuable. Falling interest rates have the opposite effect. For community banks, which cannot afford to hedge with derivatives, MSAs provide a feasible alternative.

Unintended Consequences: Heightened Systemic Risk

Today, even before the Basel III rule has gone into effect, a high volume of MSAs is shifting from regulated bank servicers to non-bank servicers in the shadow banking system in anticipation of the new capital rules. Non-bank servicers are not subject to prudential standards such as capital, liquidity, or risk management oversight.

The Financial Stability Oversight Council (FSOC) highlighted this trend in its annual report for 2014 and noted the "potential implications for financial stability."[2] The value of MSAs held by banks has dropped by $758 billion since 2012, while the value of MSAs held by nonbanks has increased by $806 billion during the same period and now total $1.7 trillion.[3] Comptroller Thomas Curry carried the implications of this trend further, noting in a recent speech that "the shift of financial assets into the shadow banking

[2] 2014 Annual Report, Financial Stability Oversight Council. Page 10.
[3] Ibid. Page 54.

system could carry with it the seeds of the next financial crisis if we do not act quickly and effectively."[4]

Unless the Basel III MSA provisions are repealed or amended, this transfer will only accelerate. The logic of the market dictates that MSAs will be acquired and held by entities that can hold them for the least cost, whether or not this is the best outcome for preserving market stability or for consumers. As noted above, consumers seek out personalized, local servicing because they want to interact with bankers who know their community. Moreover, community bankers are better positioned to anticipate servicing challenges and have a strong incentive to help the borrower work through difficulties. Basel III will push borrower-servicer relationships out of the community and into the shadow banking system.

While ICBA supports better prudential and consumer supervision of the shadow banking system, the best solution is to preserve and strengthen incentives for community banks to retain servicing. Community banks are best qualified to service the loans they originate and have done so without problems for decades.

H.R. 4042 Will Provide Needed Relief

ICBA is grateful to Rep. Luetkemeyer for introducing H.R. 4042, which would delay the effective date of the Basel III rule with respect to MSAs for nonsystemic banking institutions and require the banking agencies to conduct a joint study of the appropriate capital treatment of MSAs. The study would address many critical questions regarding the impact of the Basel III rule and whether MSAs have ever been associated with the failure or destabilization of an insured depository institution. This information, which is critical for the design of an appropriate rule, does not currently exist. The agencies would report the results of their study to Congress no later than one year from the date of enactment. Any subsequent rule would be subject to a six month delay following the report to Congress. The eventual rule would hopefully be informed by findings of the report.

ICBA strongly supports H.R. 4042 and urges expeditious consideration by this committee.

The End Operation Choke Point Act of 2014 (H.R. 4986)

ICBA strongly supports H.R. 4986, introduced by Rep. Luetkemeyer, which would help preserve the ability of banks to serve legal and legitimate business customers without undue pressure from law enforcement or examiners.

"Operation Choke Point," a Justice Department initiative intended to address consumer fraud by "choking off" access to fraudsters' banking services, is a grave concern to community bankers. Community banks currently dedicate significant energy and resources to monitoring, detection and reporting of fraud and other financial crimes in

[4] Thomas J. Curry speech before Conference of State Bank Supervisors. May 14, 2014. Page 8.

compliance with the Bank Secrecy Act. Last year alone, depository institutions filed over 600,000 suspicious activity reports to assist federal and local law enforcement in the fight against financial crime.

However, ICBA strongly believes that Operation Choke Point is sweeping in its scope and overly aggressive in its tactics. In the last two years, Choke Point has targeted more than 50 banks and payment processors with subpoenas issued under a very aggressive reading of its authority under FIRREA. Reputation in their communities is the stock-in-trade of community banks. The mere prospect of enforcement action is daunting enough to lead risk adverse community banks to shut off access to their payment systems to all but the most established, low risk businesses.

All legal forms of business should be allowed to operate freely with access to essential banking services, subject to the discretion of banks, and without excessive pressure or intimidation from law enforcement. Law enforcement should focus on law breakers directly, without forcing banks to act as police, and their efforts should be narrowly targeted. ICBA is encouraged that members of Congress on both sides of the aisle have been critical of the aggressive tactics and troubling impact of Operation Choke Point.

At the same time, bank regulators have begun applying unwarranted scrutiny to bank relationships with categories of businesses deemed "high risk" or that supposedly create "reputational risk." These businesses include internet-based businesses, short term lenders, telemarketers, debt collectors, and other lawful businesses. Regulators have questioned long-standing relationships with businesses that have been properly screened by the bank's own risk controls. It is beyond the scope of the supervisory process to assess a bank's reputational risk or to prohibit or discourage community banks from providing these services. Community banks are the best judge of their own reputation risk and have every incentive to safeguard their own reputations through proper screening of customers. We conduct due diligence to assess the level of risk of each customer relationship and ensure that controls are in place to identify and monitor these relationships on an ongoing basis. ICBA is grateful to Chairman Hensarling for his May 22 letter to the bank regulators questioning their use of reputational risk in prudential supervision. We fully endorse the Chairman's comments in that letter.

H.R. 4986 Will Rein in Operation Choke Point, Promote Bank-Law Enforcement Cooperation, and Provide a Safe Harbor for Legal Customer Relationships

ICBA thanks Rep. Luetkemeyer for his leadership in addressing these concerns and specifically for introducing H.R. 4986. This legislation would promote cooperation between banks and law enforcement to enable law enforcement to exercise its responsibility to prosecute illegal wrongdoing directly against the perpetrators of that wrongdoing, instead of taking action that results in cutting off banking services to legal businesses. In addition, H.R. 4986 would rein in DOJ's abusive use of subpoena authority and create a safe harbor for banks serving businesses that meet specific criteria. ICBA fully supports H.R. 4986 as a response to Operation Choke Point and examiners' recent assessment of "reputational risk."

ICBA fully supports H.R. 4986 as a response to Operation Choke Point and examiners' recent assessment of "reputational risk."

The Access to Affordable Mortgages Act of 2014

Appraisal standards have changed significantly over the past few years. New standards are often well intentioned, having been designed to prevent abuses by unregulated mortgage brokers that contributed to the collapse of the housing market. However, they have made it nearly impossible for my bank and community banks nationwide to use local appraisers. Using an appraisal management company has become the only practical option for a community bank mortgage lender. This expense, coupled with new appraisal requirements, has increased the cost of an appraisal for our customers by 25 to 50 percent, an experience that is typical of other community banks. Passed on to the borrower, these costs increase the cost of credit. What's more, because the appraisal management companies frequently use appraisers from outside the area, they produce lower quality appraisals.

Under the Dodd-Frank Act, "higher risk mortgages" must have an independent, written appraisal by a certified or licensed appraiser which includes physical inspection of the interior of the home. As defined by the Act, "higher risk mortgages" are non-qualified mortgages under the CFPB's ability-to-repay rule with an APR that exceeds the average prime rate offer by at least 1.5 percent for most mortgages. In today's low rate environment, a 30-year loan with a rate as low as 5.5 percent would meet this definition. Such appraisals typically cost around $400 depending on the location of the property. On a low dollar loan, which more easily triggers the "higher risk" definition, this is a significant expense. Low dollar loans are common in many parts of the country for purchase or refinance.

ICBA strongly supports Rep. Luetkemeyer's discussion draft, the Access to Affordable Mortgages Act, which would create an exemption from the higher risk mortgage appraisal requirements for loans of $250,000 or less provided they are held in portfolio by the originator for a period of at least three years. When a lender holds a loan in portfolio, it bears the full risk of default and has every incentive to ensure the collateral is accurately appraised. In house appraisers are not only more cost effective, they have superior knowledge of local markets and provide more accurate property valuations. The discussion draft will increase the flow of mortgage credit for moderate income borrowers and strengthen the housing recovery.

Closing

Thank you again for the opportunity to testify today. We appreciate the role of this committee in putting a check on regulatory overreach and rolling back unwarranted regulation that is reducing credit and promoting industry consolidation. This committee has already passed critical regulatory relief legislation. The bills I've discussed today would build on your previous efforts by addressing critical threats to community banking. We look forward to working with this committee to advance them into law.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions
and Consumer Credit

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Hearing:

"Examining Regulatory Relief Proposals for Community Financial Institutions, Part II"

Tuesday, July 15, 2014

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Statement of the
American Financial Services Association

Re: H.R. 5062, the "Examination and Supervisory Privilege Parity Act"

About AFSA

Founded in 1916, the American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Our 350 members include consumer and commercial finance companies, auto finance and leasing companies, credit card issuers, industrial banks and industry suppliers. Prior to enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010, AFSA members were always responsible for adhering to the federal consumer statutes and regulations, but most were exclusively licensed and examined by the states in which they conducted business. Today, as covered persons pursuant to the Dodd-Frank Act, they are subject to the full jurisdiction of the Consumer Financial Protection Bureau (CFPB or Bureau).

Statement of Interest

AFSA represents banks as well as captive finance companies, sales finance companies and retail installment sales finance companies. These consumer finance companies – many of which are small local or regional businesses – are licensed and supervised by state banking agencies or consumer credit authorities. Unlike banks or credit unions, their extensions of credit are funded by placing their own capital at risk, rather than through insured deposits.

This statement will focus on the matter of supervisory privilege, and specifically the "Examination and Supervisory Privilege Parity Act" (H.R. 5062), introduced on July 10, 2014, by Reps. Perlmutter and Barr.

Consumer Finance Companies and the CFPB

The Dodd-Frank Act of 2010 established the CFPB to regulate and supervise both banks and nonbank financial institutions engaged in the offering of consumer financial products or services. As a result, consumer finance companies find themselves subject to a new layer of federal supervision and enforcement for the first time. In general, AFSA urges Congress and the CFPB to seek a balance between consumer protections and the desire to maintain access to and the affordability of credit for consumers. One key way to promote this balance is by protecting the privilege and confidentiality of any nonpublic, proprietary information disclosed to the CFPB and other regulators by or about the financial institutions under their jurisdiction.

Background on Supervisory Privilege

A strong supervisory privilege plays an important role in supporting an effective and open examination process. Straightforward communications between regulators and the regulated entities are critical, and are made possible by the maintenance of privilege. There is precedent for this degree of protection in the longtime practice by bank regulators of asserting the confidentiality of records related to entities under their supervision. When challenged, the courts have upheld this confidence. In 1992, the U.S. Court of Appeals for the D.C. Circuit sustained the assertion of privilege by the Federal Reserve Board and Office of the Comptroller of the Currency in denying the discovery of confidential supervisory information related to a national

bank. In its opinion, the court discussed the justification for bank examination privilege as follows:[1]

> Bank safety and soundness supervision is an iterative process of comment by the regulators and response by the bank. The success of the supervision therefore depends vitally upon the quality of communication between the regulated banking firm and the bank regulatory agency. This relationship is both extensive and informal. It is extensive in that bank examiners concern themselves with all manner of a bank's affairs... Because bank supervision is relatively informal and more or less continuous, so too must be the flow of communication between the bank and the regulatory agency. Bank management must be open and forthcoming in response to the inquiries of bank examiners, and the examiners must in turn be frank in expressing their concerns about the bank. ***These conditions simply could not be met as well if communications between the bank and its regulators were not privileged.*** (emphasis added)

CFPB Seeks Access to Confidential Information

During testimony before the Financial Services Committee on July 19, 2012, CFPB Deputy Director Raj Date stated, "Supervision depends on confidential information being shared with regulators, full stop. You cannot create a supervisory relationship that is going to be meaningful additive to the system unless institutions can count on that..." He asserted that access to confidential information is important to enabling an effective supervisory regime, and that the CFPB would therefore insist that confidential information be shared by institutions under its jurisdiction. Mr. Date acknowledged that to the extent any doubt remains about whether surrendering such information could waive any attorney-client privilege, "then statutory remedy is something, as Director Cordray has pointed out, something that we would welcome."[2]

Status of the Nonpublic, Proprietary Information of Nonbanks

In establishing the CFPB, Congress neglected to extend bank supervisors' historical protections over privileged information to either the CFPB or the state regulators of nonbanks, with whom the Bureau is expected to share information and coordinate examinations. Therefore, the proprietary information of nonbank consumer finance companies does not enjoy the same legal protections as that of banks when disclosed during the course of supervision or other regulatory processes.

Recognizing the importance of promoting effective supervision, Congress enacted H.R. 4014 in December 2012 to protect privileged information disclosed to the CFPB by covered persons. H.R. 4014 amended the Federal Deposit Insurance Act (FDI Act) to add the CFPB to the list of federal regulators with whom no applicable privilege is waived when disclosing privileged information by or about a company under supervision. The FDI Act also permits enumerated agencies to share such privileged information with "state bank supervisors" without waiving the privilege. However, in the case of a nonbank institution, federal law currently provides

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[1] In re Subpoena Served upon Comptroller of Currency, 967 F.2d 630, 633–34 (D.C. Cir. 1992)

[2] Hearing on "The Impact of Dodd-Frank on Consumer Choice and Access to Credit." U.S. House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. 19 July 2012.

comprehensive protection of existing privilege *if and only if* the company does business exclusively in states where it is regulated by state bank supervisors, per se.

Current Law Provides Uneven Protections for Nonbanks

Across the country, nonbank consumer finance companies do not always fall under the jurisdiction of state bank supervisors. This exposes such entities to significant legal risk, given the uncertainty surrounding whether privilege will withstand the transfer of information by the Bureau to, and among, state agencies not specifically referenced in federal law. Such uncertainty will necessarily chill communications between the CFPB and the companies it supervises, undermining the agency's effectiveness.

According to an informal survey conducted by AFSA, there are at least 15 states where an agency other than the state bank supervisor currently has either partial or full jurisdiction over nonbanks offering consumer credit in that state. For example, the Office of the Consumer Credit Commissioner in Texas and Colorado's Attorney General each oversee nonbank consumer finance companies in their respective states. Furthermore, state governments periodically reorganize their regulatory regimes – raising the issue of whether a nonbank currently under a given state's banking agency would be protected if that state alters its regulatory jurisdiction in the future.

With the CFPB conducting examinations of state-regulated nondepository financial institutions, it is imperative for Congress to extend all applicable privileges to the range of institutions subject to supervision by the Bureau. Congress should ensure that the same protections apply to all consumer creditors to ensure an effective and equitable examination and investigatory process.

AFSA Supports H.R. 5062

The "Examination and Supervisory Privilege Parity Act" (H.R. 5062) would amend the Consumer Financial Protection Act of 2010 to specify that privilege is maintained when information is shared by certain nondepository covered persons with federal and state financial regulators. AFSA believes this bill will achieve parity in the statutory treatment of nonpublic, proprietary information disclosed by nondepository financial institutions with that of their depository peers, and will thereby promote greater candor with regulators and more efficient regulation. As some state laws and regulations use the terms "privileged" and "confidential" interchangeably with regard to the treatment of nonpublic, proprietary information, Congress may wish to consider broadening the scope of this bill to reflect that fact. In any case, AFSA urges Congress to advance this legislation at the soonest possible opportunity, as covered persons face greater risk to the sanctity of their proprietary information as they disclose more documents to the CFPB with each passing day.

*

AFSA thanks the Financial Services Committee for the opportunity to provide a statement on this issue. If you have any questions, please contact AFSA's Executive Vice President, Bill Himpler, at 202-466-8616 or bhimpler@afsamail.org.

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July 11, 2014

The Honorable Shelley Moore Capito
Chairwoman
Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Gregory W. Meeks
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Capito and Ranking Member Meeks:

On behalf of the 22,000 designated members, candidates and affiliates of the Appraisal Institute, I am writing to express our support for H.R. 4626, the SAFE Act Confidentiality and Privilege Enhancement Act. This bill would broaden the privilege and confidentiality protections for information in the Nationwide Mortgage Licensing System and Registry (NMLS), increasing uniformity, reducing regulatory burden, and enhancing consumer protection.

The NMLS was developed by the states in 2006 as a single system for the licensing and registration of the nation's mortgage industry. The NMLS allows the states to track mortgage loan originators (MLOs) from state-to-state on a nationwide basis while keeping licensing and oversight at the state level. Congress endorsed the NMLS in 2008 with the passage of the Secure and Fair Enforcement of Mortgage Licensing Act of 2008 (the "SAFE Act") and required all MLOs to be licensed or registered through the NMLS.

Building on the success of the NMLS as a mortgage licensing and registration database, state regulators in 2010 made the decision to expand the NMLS so that the System could serve as a licensing system for other state-licensed, non-bank financial services providers. Section 1512 of the SAFE Act provides that information in the NMLS retains any privilege or confidentiality granted by the originating state if it is shared with other federal or state mortgage regulators through the NMLS. To address expanded use of the NMLS, H.R. 4626 enhances the privilege and confidentiality provisions of the SAFE Act to ensure that information shared with and among a broad range of state financial regulators – including state regulators responsible for appraiser oversight – retains its privilege and confidentiality. Since most state agencies that regulate appraisers typically do not have authority over mortgages, passage of H.R. 4626 is critical to the modernization of the appraisal regulatory structure.

Within the realm of real estate appraisal, H.R. 4626 is critical to the modernization efforts of the appraisal regulatory structure, as the current system is overly complicated, cumbersome and expensive for state regulators and practitioners. We testified before the Subcommittee on Insurance, Housing and Community Opportunity on this subject in 2012, outlining flaws with the current system

and citing the need for a NMLS-like structure for the appraisal profession[1]. All of those concerns remain and, in many cases, the issues have become worse or are more confusing.

This legislation would enable state appraiser regulatory agencies to use the NMLS as a licensing platform and it would set the stage for broader reforms that are overdue. This would result in significant efficiencies for state appraiser regulatory agencies. It also would benefit appraisal practitioners, appraisal firms, appraisal management companies and users of appraisal services, as the NMLS's common application protocol, which may be accessed by all participating state licensing authorities, would significantly reduce the burden on appraisers who operate in multiple states.

Please contact Bill Garber, Director of Government and External Relations, at 202-298-5586, bgarber@appraisalinstitute.org or Brian Rodgers, Manager of Federal Affairs, 202-298-5597, brodgers@appraisalinstitute.org if you have any questions or require additional information.

Sincerely,

Ken P. Wilson, MAI, SRA
2014 President

[1] From Testimony of Ms. Sara Stephens, MAI, 2012 President of the Appraisal Institute, pgs. 26-27, June 28, 2012, available at http://financialservices.house.gov/uploadedfiles/112-140.pdf

FINANCIAL SERVICES ROUNDTABLE

July 15, 2014

The Honorable Shelley Capito
Chairwoman
Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Gregory Meeks
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
B301C Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Capito and Ranking Member Meeks,

The Financial Services Roundtable (FSR) commends you and the subcommittee for holding a hearing to examine legislation designed to create efficient regulatory compliance and reduce regulatory burdens for financial institutions, ensuring consumers have access to quality financial products they want and need.

We are pleased that HR 5062, the "Examination and Supervisory Privilege Parity Act of 2014" introduced by Reps. Perlmutter and Barr is included in the discussion. The legislation provides assurance for financial institutions that privileged information shared between federal banking regulators and state regulatory agencies will be protected and remain confidential. While the Consumer Financial Protection Bureau (CFPB) has acted to protect confidential information obtained through the supervisory process, this legislation provides additional assurance that when the CFPB shares supervisory information with federal and state regulators—including any state agency that licenses, supervises or examines the offering of consumer financial products or services,- that the confidential nature of the information will be protected.

We appreciate the subcommittee's consideration of HR 5062 in the broader discussion of ways to streamline regulatory compliance and reduce regulatory burden. We encourage the full committee's consideration and passage of this legislation.

If you need additional information, please feel free to contact me or Georgette Sierra at 202-289-4322.

Best,

Francis Creighton

Executive Vice President, Government Affairs
Financial Services Roundtable

NASCUS

Submission for the Record
From Mary Martha Fortney, NASCUS President and CEO
To Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives Committee on Financial Services
Hearing Examining Regulatory Relief Proposals for Community Financial Institutions, Part II
July 15, 2014

Chairman Capito, Ranking Member Meeks, and distinguished Members of the Committee:

The National Association of State Credit Union Supervisors (NASCUS) appreciates the opportunity to provide a statement for the record of the July 15, 2014 hearing of the Subcommittee on Financial Institutions and Consumer Credit. As the professional association of the nation's state credit union regulatory agencies, NASCUS values the committee's dedication to reducing regulatory burden and streamlining regulatory compliance for community financial institutions.

Streamlined, efficient regulation not only allows financial institutions to provide needed financial services to consumers, it also helps regulators to identify emerging risks more quickly. The SAFE Act Confidentiality and Privilege Enhancement Act (H.R.4626), which eliminates unnecessary impediments to information sharing between federal and state regulators, would accomplish both of these objectives.

This legislation will allow state regulators' to leverage the Nationwide Mortgage Licensing System and Registry (NMLS) to license, track, and share information on a variety of financial services entities while ensuring the protection of privileged and confidential information.

Under current law, state regulators are limited in their use of this technology, which is cost and time-saving to both industry and regulators, because of a limitation in the confidentiality protection of the original statute. NASCUS encourages the members of the Subcommittee to enhance the ability of state and federal regulators to coordinate and share information by supporting this legislation.

NASCUS and its state regulator members are available to answer any questions that the Subcommittee may have regarding the significant efficiencies that could be accomplished through this proposed reform. We thank the Subcommittee for the opportunity to submit written comments and appreciate your attention to this important matter.

National Association of State Credit Union Supervisors (NASCUS)
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(703) 528-8351 • (703) 528-3248 Fax
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TOYOTA

TOYOTA MOTOR NORTH AMERICA, INC.

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July 14, 2014

The Honorable Shelley Moore Capito
2366 Rayburn House Office Building
Washington, D.C. 20525

The Honorable Gregory Meeks
2234 Rayburn House Office Building
Washington, D.C. 20525

Dear Representatives Capito and Meeks:

On behalf of the over 30,000 Toyota Team members in the U.S., thank you for holding a hearing on H.R. 5062, the Examination and Supervisory Privilege Parity Act of 2014. We appreciate your commitment to common sense regulatory reform.

Consumer access to finance is the life blood of new car sales. To maintain competitiveness, automobile manufacturers must have a strong vehicle finance division. These "captive finance companies", like Toyota Financial Services, provide tailored financing options to our customers, whether they be individual consumers or franchised dealers. As a captive, Toyota Financial Services exist solely to support the auto manufacturer in selling vehicles and are designed to maintain a long-term, positive, customer relationship with the consumer.

As you know, the Dodd-Frank Act placed captive finance companies under the jurisdiction of the newly created Consumer Financial Protection Bureau (CFPB). However, in a technical oversight, the Act did not extend the traditional protections of privilege over nonpublic, proprietary information – often disclosed in the course of supervision – to either the CFPB or the state agencies that jointly oversee captive finance companies under the CFPB's jurisdiction.

A strong supervisory privilege plays an important role in supporting an effective and open examination process. Straightforward communications between regulators and the regulated entities are critical, and are made possible by the extension of privilege. Once lost, privilege cannot be restored.

H.R. 5062 corrects this oversight by simply guaranteeing that when captive finance companies produce information to the CFPB, the privileged status of that information is preserved when the CFPB shares the information with state regulation agencies.

At Toyota, we support H.R. 5062 and appreciate your taking the time to learn about this issue.

Sincerely,

Stephen Ciccone
Group Vice President, Government Affairs

Statement for the Record

Rep. Derek Kilmer (WA-06)
Member of Congress

House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

H.R. 3374, the American Savings Promotion Act.

July 15, 2014

Thank you, Chairman Capito and Ranking Member Meeks for providing me with the opportunity to submit testimony today in support of H.R. 3374, the American Savings Promotion Act.

The American Savings Promotion Act is legislation that would remove federal barriers that today prevent certain financial institutions from being able to offer prize-linked savings products. These safe, innovative financial products are designed to make savings fun—the more you save, the more chances you have to win. As a Dire Straits fan, I called this idea the "Money for Nothing" concept. If you make deposits, you get more chances to win. And even if you don't win, you get to keep the money that you saved.

Let me step back and talk about why I think this is so important. Many families understand that the importance of saving money to help them manage unexpected costs that they might face – whether it's a trip to the emergency room or repairing their car. But we know too many Americans struggle to set aside a little bit of cash every month. Nearly a quarter of Americans report that they wouldn't be able to come up with at least $2,000 in 30 days—another 19% said they could but they'd have to begin pawning or selling their possessions or taking out payday loans. So the need here is profound.

The idea behind prize-linked savings accounts is based on the recognition that people are significantly motivated by rewards. And when it comes to saving money, the idea of earning pennies on the dollar just isn't all that attractive to a lot of folks—particularly those who don't have a lot to save in the first place. Prize-linked savings accounts seek to step into that gap and provide savers with a product that keeps folks excited about saving by offering large prizes.

And the research shows that prize-linked savings accounts are actually working to boost savings. The National Bureau of Economic Research recently published an analysis of these accounts, finding that the data "demonstrate clearly" that individuals save at a higher rate when they are offered the use of prize-linked savings accounts.

The challenge is that the reach of these products is limited by federal law. Even if a state decides that it wants to go ahead and authorize financial institutions to offer prize-linked savings products, federal law limits banks and thrifts from participating.

My legislation, which I'm proud to have worked on with Representative Tom Cotton, alongside Senators Jerry Moran and Sherrod Brown, would clear away the federal obstacles so that more financial institutions can offer these products. It accomplishes this without establishing a new government program, spending scarce federal dollars, or pre-empting state laws.

In my home state, 834 credit union members have opened these accounts, holding deposits of nearly $785,000. Even if those members don't win a big cash prize, they are strengthening their financial cushion to withstand whatever life throws at them while developing a habit of saving. I am hopeful that Congress will take this opportunity to help making this innovative savings tool available to more people.

Thank you, Chairman Capito and Ranking Member Meeks, for the opportunity to submit this testimony in support of H.R. 3374, the American Savings Promotion Act.

Written Statement for the Record

The Electronic Transactions Association

For the

House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing entitled "Examining Regulatory Relief Proposals for Community Financial Institutions, Part II"

July 15, 2014

Chairman Capito, Ranking Member Meeks and Members of the Subcommittee, the Electronic Transactions Association (ETA) appreciates the opportunity to submit this written statement for the record for the House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit's hearing, "Examining Regulatory Relief Proposals for Community Financial Institutions, Part II", in support of H.R. 4986, the "End Operation Choke Point Act of 2014".

ETA is an international trade association representing companies that offer electronic transaction processing products and services related to debt, credit, and prepaid cards. The purpose of ETA is to grow the payments industry by providing leadership through education, advocacy, and the exchange of information. ETA's membership spans the breadth of the payments industry, from financial institutions to transaction processors to independent sales organizations to equipment suppliers. More than 500 companies worldwide are members of ETA.

For the reasons set forth below, ETA supports H.R. 4986. H.R. 4986 would create a safe-harbor for insured depository institutions to provide financial products and services for any merchant engaged in a legal business. The legislation also seeks to prevent misuse of the Department of Justice's (DOJ) subpoena authority the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 by requiring the DOJ to obtain court order to issue a subpoena.

Keeping Fraud Off Payment Systems

ETA strongly supports the vigorous enforcement of existing laws and regulations to prevent fraud. Consumers in the United States choose electronic payments over cash and checks because they have zero liability for fraud, making electronic payments the safest and most reliable way to pay. As a result, payment companies are generally responsible for paying for fraud involving payment systems under Federal law and payment network rules, and thus our members have a strong interest in making sure fraudulent actors do not gain access to payment systems. With the benefit of decades of payment system expertise, ETA members have developed effective due diligence programs to prevent fraudulent actors from accessing payment systems and to terminate access for network participants that engage in fraud. These programs have helped to keep the rate of fraud on payment systems at remarkably low levels. In 2012, there was more than $4.6 trillion in debit, credit and prepaid card transactions in the United States, but there was only $5.5 billion in credit card fraud. In addition, a recent survey of ETA members indicates that more than 10,000 merchants were discharged last year for fraud. These actions demonstrate the commitment of ETA members to keeping fraudulent actors off payment systems.

Despite this strong record, however, payment processors can never take the place of regulators and law enforcement in protecting consumers. Because regulators and law enforcement can issue subpoenas, conduct investigations, and have far great resources, personnel, and legal authorities, they will always be in a far better position to combat fraud. Yet, payments companies are committed to doing their part.

ETA therefore believes we must be constantly vigilant on continuing to update our processes. The growth of internet commerce has created remarkable new opportunities for business and benefits for consumers, but unfortunately also has created new opportunities for fraud. For example, because websites can change in the blink of an eye, they can be difficult to monitor and easy for fraudsters to exploit. Hence, ETA welcomes further Federal efforts to combat fraudulent activity by unscrupulous merchants that operate on the internet.

In an effort to further strengthen payment systems, ETA has recently published new industry guidelines for merchant due diligence and monitoring that provide more than 100 pages of methods and practices to detect and halt fraudulent actors. The ETA Guidelines were developed by ETA's member companies after months of discussions and sharing of techniques to prevent fraud. During this process, ETA even shared the preliminary draft guidelines with, and sought comments from, the Federal Trade Commission (FTC), which had strongly encouraged the industry to strengthen its anti-fraud efforts. Now, ETA is actively encouraging its members and companies across the payments ecosystem to make use of the guidelines, especially smaller companies that may not have the resources to develop such advanced practices on their own.

The ETA Guidelines provide a practical and targeted approach to combating fraud on payment systems. ETA members already have a strong commitment to, and financial interest in, keeping fraudulent actors off payment systems, but the targeted nature of the ETA Guidelines gives them enhanced tools to improve their effectiveness and help ensure that law-abiding merchants do not unfairly lose access to payment systems due to overly broad anti-fraud protections.

Another benefit of the ETA Guidelines is that they provide a basis for payments companies to work cooperatively with Federal regulators and law enforcement toward their common goal of stopping fraud. ETA strongly believes that such a collaborative approach is good public policy. It would encourage companies to cooperate with law enforcement by fostering an environment of open communications between government agencies and payments companies. As a result, such a cooperative approach would be more effective at protecting consumers from fraud.

Concerns About Operation Choke Point

Unfortunately, the Department of Justice (DOJ) and other Federal regulators have begun pursuing a more confrontational approach to addressing fraud on payment systems. On March 20, 2013, the Financial Fraud Enforcement Taskforce publicly announced a new initiative by its Consumer Protection Working Group (which is co-chaired by representatives from the DOJ, the FTC, and the Consumer Financial Protection Bureau) to address mass consumer frauds by holding banks and payment processors liable for the acts of certain merchants.[1] This initiative, named "Operation Choke Point" by the DOJ, aims to "close the access to the banking system that mass marketing fraudsters enjoy – effectively putting a chokehold on it."[2]

Although ETA strongly supports increased law enforcement aimed at preventing mass frauds, it has serious concerns about the Operation Choke Point approach. In ETA's view, Operation Choke Point employs the wrong legal tools, is unnecessarily confrontational, and creates serious risks to law abiding processors and merchants without producing any benefits to consumers beyond those which could be obtained with a more focused and collaborative approach.

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[1] http://www.justice.gov/iso/opa/doj/speeches/2013/opa-speech-130320.html.
[2] *Id.*

The DOJ has sought to implement Operation Choke Point by initiating investigations and civil suits under the Financial Institutions Reform, Recovery, and Enforcement Act, 12 U.S.C. § 1833a (FIRREA). Under FIRREA, the DOJ can initiative investigations and bring civil suits for alleged violations of 14 predicate criminal offenses, including wire fraud "affecting a federally-insured financial institution."[3] Several courts have recently held that FIRREA suits can be brought against not only third parties whose violations "[affect] a federally-insured financial institution," but also against the banks whose violations affect themselves.[4] This broad reading of FIRREA has given DOJ a very powerful tool because under FIRREA the statute of limitations is 10 years and cases only need to be proven by "preponderance of the evidence," rather than the "beyond a reasonable doubt" standard required in criminal prosecution.[5] In addition, FIRREA provides for penalties of up to $5 million for each violation or, if greater, the amount of any pecuniary gain derived by the violation or of any losses inflicted on another person.[6] These provisions significantly tilt the litigation playing field in favor of the DOJ and make FIRREA cases very costly for companies to defend against and risky to litigate.

Although no court has yet issued a final decision in a FIRREA case involving payment processing, DOJ has recently settled two FIRREA cases involving payment processing and issued scores of subpoenas to financial institutions as part of Operation Choke Point. These settlements, combined with recently released DOJ memoranda detailing the agency's plans for

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[3] 12 U.S.C. § 1833a(c)(2).
[4] United States v. Bank of New York Mellon, 941 F. Supp. 2d 438 (S.D.N.Y. 2013); United States v. Countrywide Fin. Corp., 961 F. Supp. 2d 598 (S.D.N.Y. 2013); United States v. Wells Fargo Bank, N.A., 972 F. Supp. 2d 593 (S.D.N.Y. 2013).
[5] 12 U.S.C. § 1833a(f), (h).
[6] 12 U.S.C. § 1833a(b).

Operation Choke Point, have raised concerns among ETA's members that Operation Choke Point will result in the government seeking to broaden the scope of processor liability for the acts of merchants.[7] There is also concern that Operation Choke Point will be used to impose penalties on financial institutions for processing transactions of certain categories of legal but disfavored businesses.

Impact of Operation Choke Point on Processors, Entrepreneurs, and Consumers

From a public policy perspective, Operation Choke Point and similar efforts by other regulators to impose enhanced liability on payment processing will likely have adverse consequences for not only merchants and entrepreneurs, but also the very consumers Operation Choke Point purports to protect. In addition, Operation Choke Point sets a troubling precedent of government agencies using the payment systems to achieve objectives unrelated to preventing financial fraud.

First, if payment companies' liability for the actions for merchants increases, processors may very well have little choice but to increase the prices of payment services for merchants and/or restrict access to their payment systems to manage their new liability exposure. Invariably, the brunt of these burdens will fall on small, new and innovative businesses because they pose the highest potential risks. For example, start-up internet businesses with liberal return policies present high risks to financial institutions because they have no transaction history, rely on card-not-present transactions and have (by design) high return rates. Federal regulators view high return rates as strong evidence of fraud. Due to the risks these new businesses present, banks and payment processors may very well decide that the increased liability risks outweigh the

[7] The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?, U.S. House of Representatives, Committee on Oversight and Government Reform, Staff Report (May 29, 2014), Appendix 1.

benefits of having them as customers. Because in today's marketplace consumers expect merchants to accept debit, credit, and prepaid cards, the inability of a merchant to access the payment systems could effectively be the death knell for its business. New restrictions on access to payment systems, or even higher costs to access payment systems, could therefore become an impediment to job creation and innovation, especially in the critical high-tech start-ups and internet commerce segments of the economy.

Second, increasing liability on payment processing, especially processing of debit, credit, and prepaid cards, does not necessarily benefit consumers. It is consumers who will ultimately pay for the higher costs arising from increased liability. They also will be harmed by the inconvenience of not being able to use their preferred methods of payment (credit, debit, and prepaid cards) with some merchants due to more restrictive access to payment systems. Similarly, they would be harmed if new liability on processors impedes continued innovations in electronic payments. Over the last twenty years, electronic transactions have grown rapidly to become the dominant method of payment for consumer transactions due to their convenience, security (especially when compared to cash), and customer service. Therefore, to the extent that new liability risks impede the evolution of electronic transactions, consumers will have less access to the payment methods they prefer and beneficial developments in electronic payments.

Third, there is a real risk that a confrontational approach, like Operation Choke Point, will alter payments companies' natural incentive to cooperative with law enforcement and regulatory authorities if they believe that such cooperation will only result in enforcement actions against them. Thus, a far better approach would be to establish a reasonable safe harbor that would

allow payments companies, which were not directly involved in the fraudulent activities of a merchant, to work with regulators without any risk of triggering an enforcement action. ETA believes that such cooperation between payments companies and regulators is likely to be more effective because it recognizes and further strengthens the strong incentives such companies already have to prevent fraudulent actors from accessing payment systems.

Finally, enforcement actions against payment systems are an inappropriate tool for regulators to use to limit the ability of consumers to access legal but currently disfavored industries. There has been much debate about the attempts by Operation Choke Point and similar regulatory efforts to compel payments companies to sever relationships with a variety of legal but disfavored industries, ranging from coin dealers and short-term lenders, to home-based charities and pharmaceutical sales.[8] ETA believes that such efforts unfairly expose institutions to regulatory actions merely for engaging in lawful commerce. Moreover, if the precedent is set that regulators can unilaterally intervene to keep certain lawful industries off payment systems, payments companies will be subject to shifting regulatory exposure as the disfavored industries of regulators shifts with changes in administrations and agency personnel. If regulators have concerns about a particular industry, the appropriate forums for addressing those concerns are formal rulemakings, Congress, or state legislatures. To be clear, ETA takes no position on which types of industries should be legal and its members are fully committed to preventing any businesses engaged in activities prohibited by statute or regulation from accessing payment systems. ETA merely seeks to ensure that payments companies can freely process transactions for any law-abiding merchant.

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[8] *See* The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses?, U.S. House of Representatives, Committee on Oversight and Government Reform, Staff Report (May 29, 2014), p. 8.

Conclusion

Operation Choke Point is premised on the flawed assumption that increasing liability on lawful payments companies for the actions of fraudulent merchants will yield only benefits to consumers. In practice, however, imposing new liability standards on such institutions is likely to have serious adverse consequences for not only law-abiding merchants, but also consumers generally. There needs to be a careful balancing of the need to limit access to payment systems to prevent fraud and the need to ensure that all law-abiding businesses can access the payment systems consumers want to use. A cooperative approach to combating fraud by financial institutions and Federal regulators is far more likely to strike the right balance than blunt enforcement actions. Accordingly, ETA stands ready to work with federal regulators to work cooperatively toward our common goal of preventing fraud.

Board of Governors of the Federal Reserve System
Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation

September 13, 2013

The Honorable Ed Perlmutter
House of Representatives
Washington, D.C. 20515

Dear Congressman Perlmutter:

Thank you for your letter dated June 28, 2013, expressing concern about the application of the proposed regulatory capital rules to banking organizations of all sizes and, in particular, the proposed rule's treatment of mortgage servicing assets (MSAs). Your letter raises concerns that the proposed rule would make it difficult for small and mid-size banks to compete with the largest banking organizations involved in the mortgage servicing business. The agencies considered in excess of 2,500 comments in finalizing the capital rules, including comments addressing many of the issues raised in your letter.

Consistent with the treatment of intangible assets generally, the inclusion of MSAs in regulatory capital has long been subject to strict limitations in the United States because of the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions. After carefully considering comments received on this issue, in the revised regulatory capital rules approved by the agencies in July (the capital rules),[1] the agencies decided to remove the current rule's 90 percent fair value limitation on inclusion of MSAs in regulatory capital, (as the capital treatment of MSAs in the capital rules is more conservative than the current rules) but otherwise adopted the treatment of MSAs the agencies proposed in 2012.

Before adopting the capital rules, the agencies conducted a pro forma analysis that indicated the vast majority of banking organizations, including those with less than $10 billion in total assets, could already meet the 7 percent threshold composed of the minimum common equity tier 1 capital ratio plus the capital conservation buffer. With respect to the small number of banking organizations that currently have concentrations in MSAs that exceed the limits in the capital rules, we note the capital rules provide lengthy transition periods that should allow these firms sufficient time to modify their capital structure or adjust their business models to conform to the capital rules. The capital rules also provide for a lower risk-weighting of MSAs that are not deducted from regulatory capital during the transition period.

[1] The Board of Governors of the Federal Reserve System (FRB) and the Office of the Comptroller of the Currency (OCC) have approved the regulatory capital requirements as a final rule [http://www.federalreserve.gov/bcreg20130702a.pdf (FRB); http://www.occ.gov/news-issuances/news-releases/2013/2013-110a.pdf (OCC)]. The Federal Deposit Insurance Corporation (FDIC) has approved the regulatory capital requirements as an interim final rule [http://www.fdic.gov/news/board/2013/2013-07-09_notice_dis_a_res.pdf].

Several significant aspects of the capital rules apply only to large, internationally active banks or those with significant trading activity. These include the supplementary leverage ratio, countercyclical capital buffer, mandatory recognition of accumulated other comprehensive income in regulatory capital, advanced approaches for calculating risk-weighted assets, and the approach for calculating market risk-weighted assets.

The agencies believe that the revised capital rules will permit small and mid-sized banks to maintain a competitive position as compared to the largest banking organizations. Furthermore, the capital rules increase the resiliency of the overall banking sector by strengthening the quantity and quality of capital held by all banking organizations, with a special emphasis on increasing capital at large, systemically important organizations.

Sincerely,

Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System

Thomas J. Curry
Comptroller
Comptroller of the Currency

Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

January 27, 2014

The Honorable Ed Perlmutter
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Thank you for your letter dated October 30, 2013, regarding the agencies' treatment of mortgage servicing assets (MSAs) in the new capital rule adopted earlier this year.[3] In your letter, you express concern that the new capital rule would impose higher capital requirements with respect to MSAs and thereby make it difficult for small and mid-sized banks to maintain the capital necessary to compete with the largest banking organizations in the mortgage servicing business. Your letter also asks the agencies to examine the possibility of using alternative assessments with respect to MSAs in the capital rule and expresses concern that the agencies did not give consideration to alternatives during the course of the rulemaking.

The regulatory capital rule was designed to increase the resiliency of the overall banking sector by strengthening the quantity and quality of capital held by all banking organizations. Before taking this action, the agencies carefully considered comments received on the proposal that addressed many of the issues raised in your letter.

As discussed in the Federal Register notice implementing the new rule, the agencies have long excluded MSAs and other intangible assets from regulatory capital either fully or partially due to the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions.[4] Furthermore, the FDIC, as receiver of failed institutions, has experience with mortgage servicing assets. In many cases, the FDIC has found mortgage servicing assets to be unmarketable for a variety of reasons related to portfolio size and contingent liabilities arising from selling representations and warranties associated with MSAs. Accordingly, the requirements in the new capital rule reflect the agencies'

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[3] See 78 FR 62018 (October 11, 2013). See 78 FR 55340 (September 10, 2013) for FDIC's interim final capital rule.

[4] See 78 FR 62018, 62070 (October 11, 2013). See 78 FR 55374, 55389 (September 10, 2013).

observations and concerns about the uncertainty associated with the ability of MSAs to absorb losses.

Prior to issuing the new regulatory capital rule, the agencies conducted a pro-forma impact analysis that indicated the new rule would not require most small and mid-sized banking organizations (those with less than $10 billion in total assets) to raise additional capital to meet the required minimum common equity tier 1 capital ratio plus capital conservation buffer. Moreover, for the few small and mid-sized banking organizations whose current holdings of MSAs exceed the rule's limits, the new application date (January 2015) and lengthy transition period should allow such firms sufficient time to modify their capital structure or adjust their business models to conform to the capital rules.

Sincerely,

Pots of marijuana cash cause security concerns

Trevor Hughes, USATODAY *12:50 p.m. EDT July 13, 2014*

(Photo: Matthew Staver for USA TODAY)

DENVER — The unmarked armored truck rumbles to a stop in a narrow alley, and former L Karr slides out, one hand holding a folder, the other hovering near the pistol holstered at his

With efficient motions he retrieves a locked, leather-bound satchel from a safe set into the t presses a buzzer outside the door. It swings open to reveal a cavernous warehouse filled w safe stuffed with cash.

Welcome to the rear guard of Colorado's rapidly expanding legal marijuana industry, where millions of dollars — most of it in small bills — into buying pot, hashish, and marijuana-infus drinks. All that cash adds up, and there are few places to put it: Federal regulations, which s an illegal drug, make it difficult for marijuana producers to deposit their profits into traditional bank accounts.

And those cash-heavy small businesses make awfully attractive — and vulnerable — targets for criminals.

That's where Karr and the company he works for come in.

Heading through the warehouse where workers tend young marijuana plants, Karr greets a young woman, and the two empty a safe of dollars in cash neatly packed in plastic envelopes. Like every room in this combined marijuana store and grow house, the smell of p the air. Karr double-checks the ledger, locks his satchel and hustles outside, where former cop Phil Baca waits at the wheel of the arm

Karr opens the truck's safe, pitches the satchel inside and climbs back into the passenger seat, an AR-15 rifle stashed behind him. It's out six times in three hours. Their take for the day: somewhere close to $100,000 in cash.

"For the first three months, people were just keeping the money everywhere — in the walls, in mattresses, at home," says Sean Camp Line Protection Group, which provides marijuana security services, including Karr, Baca and the armored car. "And banks don't even v You have a quarter-of-a-million dollars in cash show up all at once. The counting time alone is going to take an hour."

The unusual problem of having too much cash is forcing business owners to hire security firms like Campbell's, especially after Denve June of a credible threat against marijuana stores and couriers.

Marijuana-store owners have suffered some smash-and-grab robberies over the last several years but surveillance systems and close have solved many of them. Experts say those robberies were largely committed by amateurs, rather than sophisticated crime rings.

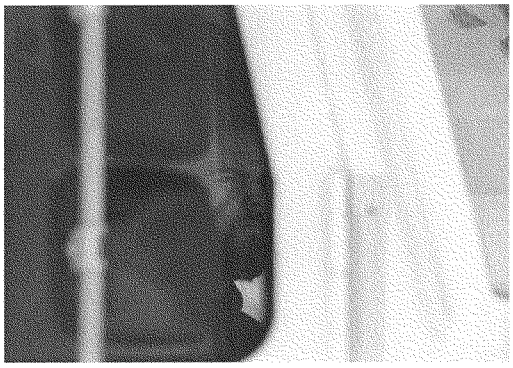
Campbell said he believes it will take a serious high-dollar heist to force smaller marijuana stores to take their security more seriously.

State law requires marijuana businesses to have security cameras and systems on the premises, and many have armed guards, but t targets. The stores and grow operations often are in remote industrial areas, in warehouses that have not been hardened against a de Many stores have large amounts of pot sitting around in rooms secured only by flimsy wooden doors.

Options are limited, however. Unlike most other businesses, marijuana-store owners can't easily open bank accounts for fear of runnii law. Despite Washington state joining Colorado last week in legalizing sales of marijuana for recreational purposes and 23 states plus Columbia permitting medical pot, the federal government still classifies the plant as an illegal drug more dangerous than cocaine or m

By opening a bank account, pot growers and shop owners run the risk of being charged with money laundering, because federal bank regulations are deliberately aimed at tracking large flows of cash like those generated by both legal and illegal drug sales. A single su

decades in prison, and most banks and pot-shop owners don't want to run that risk.



Matt Karr waits in the armored car as Philip Baca (not pictured) makes a delivery. *(Photo: Matthew Staver for USA TODAY)*

"When you go into the business, and you know it's federally illegal, you're taking your chances," said Tom Gorman, who runs the fede Mountain High Intensity Drug Trafficking Area task force. "That's the problem when the state legalizes something that remains illegal a

While declining to be quoted by name, many marijuana store owners interviewed by USA TODAY shared tales of playing cat-and-mou managing to keep accounts open for only a few months at a time before getting shut down.

U.S. Treasury officials require banks to file what are known as "suspicious activity reports" whenever they suspect someone is trying t Anyone bringing in a pile of cash sets off internal alarms for bank workers, pot-shop workers say. Federal financial-crimes investigator to report suspected marijuana transactions because pot remains illegal at the federal level.

"Our goal is to promote financial transparency and make sure law enforcement receives the reporting from financial institutions that it activity and to make it less likely that this financial activity will run underground and be much harder to track," said Steve Hudak, a spo Treasury Department's Financial Crimes Enforcement Network.

Tax-and-marijuana attorney Rachel Gillette said she's seen banks' concerns firsthand — several banks she deals with said they would account, even though both the federal and state government are allowed to deposit tax payments from pot sellers. Gillette said federa say it's just easier for them not to risk getting their hands tainted by pot.

"They literally told me they would not take my account because I do business with the marijuana industry," Gillette said. "That seems l — the state is taking that money and putting it in the bank; the IRS is taking that money and putting it in the bank."

Pots of marijuana cash cause security concerns

Philip Baca checks off each smaller bag of marijuana from an inventory list. *(Photo: Matthew Staver for USA TODAY)*

Gillette is suing the IRS on behalf of one of her clients who has been paying federal payroll tax bills with cash. The IRS calls for electr adds a 10% surcharge for cash payments, she said. With some marijuana businesses paying payroll taxes of $100,000 a quarter, tho substantial.

Colorado has tried to solve the problem with a new state law permitting creation of marijuana banking cooperatives, which would have accept deposits, lend money and make electronic payments. But that system likely won't begin operating for at least another year, sai Hickenlooper, and even then federal officials would need to bless the plan.

The amount of cash already flowing through the fast-growing system has forced state tax officials to change how they accommodate p Colorado allows businesses to pay their taxes in cash, most pay electronically. Marijuana businesses, however, must trek to a central in hand, where they're met at the curb by armed guards and escorted inside.

"Some people walk in with shoe boxes. Some people have it in locked briefcases. We've had people bring it in buckets," said Natriece spokeswoman for the Colorado Department of Revenue.

Campbell, who runs the armored-car company, said the vast cash flows are a clear come-on for criminals. He said he's working with t alternatives for marijuana businesses, including vault services. For many in the marijuana industry, the scene from the Emmy-winning *Breaking Bad* of a storage unit filled with drug cash hits uncomfortably close to reality.

Says Campbell, "You're effectively creating a magnet for crime."

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B. Dan Berger
President & Chief Executive Officer

July 16, 2014

The Honorable Ed Royce
U.S. House of Representatives
2185 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Royce:

On behalf of the National Association of Federal Credit Unions, the only credit union trade association exclusively representing the interests of our nation's federal credit unions, I write today to thank you for raising the issue of the National Credit Union Administration's (NCUA) proposed risk-based capital rule for credit unions at yesterday's Subcommittee on Financial Institutions and Consumer Credit hearing on regulatory relief. In response to your question, we want to share with you language (attached) that would require NCUA to "stop and study" this issue further and report back to Congress before proceeding.

This approach would help ensure that the agency, credit unions, Congress and others fully understand and comprehend the impacts of this proposal before moving forward. Furthermore, the additional time provided by the study could help ensure that things are done right in any final proposal. As we testified at the hearing, we would urge the Committee to move forward with this approach, either as a stand-alone bill, or packaged as an amendment to other legislation. We would welcome the opportunity to work with you in this regard.

In addition to the "stop and study" approach, NAFCU also supports broader capital reform for credit unions as outlined in our Five-Point Plan for credit union regulatory relief that was highlighted in our testimony. This includes improvements to prompt corrective action standards to help foster an effective risk-based capital regime for credit unions and authorizing NCUA to allow all credit unions to have access to supplemental forms of capital.

Thank you again for your leadership on this issue and your support of credit unions. If I or my staff can be of assistance to you, please do not hesitate to contact myself or NAFCU's Vice President of Legislative Affairs, Brad Thaler, at (703) 842-2204.

Sincerely,

Thanks for all you do!

B. Dan Berger

cc: Members of the House Financial Services Committee

Attachment

Attachment

Section 1. SHORT TITLE

This Act may be cited as the 'Stop and Study Risk-Based Capital for Credit Unions Act of 2014'.

Section 2. DEFINITIONS.—

For Purposes of this Act:

(1) CREDIT UNION – the term "credit union" shall have the same meaning as the term "insured credit union" as defined by the Federal Credit Union Act (12 U.S.C 1752(7));

(2) ADMINISTRATION - the term "Administration" shall have the same meaning as the definition prescribed by the Federal Credit Union Act (12 U.S.C 1752(3));

(3) BOARD - the term "Board" shall have the same meaning as the definition prescribed by the Federal Credit Union Act (12 U.S.C 1752(4)); and

(4) PROPOSED RULE – the term "Proposed Rule" means the rule proposed by the National Credit Union Administration on Risk-Based Capital, RIN 3133-AD77.

Section 3. NATIONAL CREDIT UNION ADMINISTRATION STUDY ON PROMPT CORRECTIVE ACTION.—

(a) In General- The Board shall conduct a study on any new regulations proposed pursuant to the requirements of the Federal Credit Union Act, 12 U.S.C. 1790d(d). In carrying out such study, the Board shall consult with qualified industry and Administration representatives.

(b) Issues To Be Studied- The study required by this section shall include--

(1) analysis of the appropriate risk-weights for capital requirements at credit unions pursuant to the requirements of 12 U.S.C. 1790d;

(2) justification and clarification as to why the risk weights in the Proposed Rule differ from those applied to other community financial institutions;

(3) determination of the actual risk attributable to assets held by credit unions;

(4) analysis and review of the cost and burden of implementing new risk-based net worth requirements beyond the current leverage ratio requirements;

(5) the historical success or failure of credit unions relative to capital levels, particularly in the period of the financial crisis;

(6) an analysis of what impact the Proposed Rule would have on mortgage, automotive, business and other lending at credit unions if the rule were fully implemented as proposed; and

(7) an examination of secondary capital for credit unions.

(c) Report to Congress- Not later than the end of the 1-year period beginning on the date of the enactment of this Act, the Administration shall issue a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives containing—

(1) all findings and determinations made in carrying out the study required under subsections (a) and (b), including a record of all Board and Administration staff communications used to complete the study under subsections (a) and (b);

(2) specific legislative recommendations recommended by the Board, an analysis of the specific differences between those recommendations and the Proposed Rule, and the reasons for such revisions;

DELAY OF RULEMAKING.—

(a) New Rules on Risk-Based Net Worth- Notwithstanding any other provision of law, no new regulation to implement risk-based net worth rules promulgated pursuant to 12 U.S.C. 1790d(b)(1) shall be proposed before the end of the 18-month period beginning on the date the report is issued under section 3(c) of this Act, so that Congress has ample time to review the findings of the study and consider the Board's legislative recommendations.

(b) No regulation to implement risk-based net worth rules promulgated pursuant to 12 U.S.C. 1790d(b)(1) proposed by the Board after January 1, 2014, and before enactment of this act shall be finalized before the end of the 18-month period beginning on the date the report is issued under section 3(c) of this Act.

(c) Final Rule Requirements-

(1) Before any final rule is issued, the Administration shall issue a new proposed rule for public comment to last at least 90 days; and

(2) Upon issuance of a final rule, there shall be at least 36 months for implementation of the new rule.

Question from Mr. Royce

The National Credit Union Administration has proposed a new risk-based capital rule for credit unions. The proposal has drawn significant criticism from the credit union sector, where many are concerned that it would adversely affect credit unions' ability to serve their members. Among the several concerns that have been raised is the concern that the proposed rule includes risk-weights which are in some cases more stringent than those to which similarly sized banks are subject.

What specific next steps would you like this Committee to take as it relates to NCUA's risk-based capital proposal?

Response from Mr. Fecher

We encourage the Committee to exercise fully its oversight responsibilities over the National Credit Union Administration to ensure that the proposal is substantially modified and implemented consistent with the Federal Credit Union Act. The Committee should also help ensure the rule is in the best interests of the credit unions and their members, as well as the National Credit Union Share Insurance Fund. In terms of specific steps, we urge the Committee to:

1. Continue to urge NCUA to make the modifications that NCUA Board members have publicly indicated would be made;
2. Focus renewed Congressional oversight on questions related to whether the proposed rule is consistent with the authorities Congress conveyed to the agency under the Federal Credit Union Act; and,
3. Urge NCUA to submit the revised rule for public comment before proceeding to finalize the rule.

Continued Focus on Areas in which NCUA Has Indicated It Would Make Changes
Stakeholders, including a very large number of Members of Congress, have expressed significant concerns regarding the risk-weights proposed by NCUA, the authority of examiners to set individual capital requirements on credit unions, and the period of time NCUA has proposed to implement the rule. In response, NCUA has indicated it would make changes in these areas, including a recalibration of several of the risk weights, clarification that examiners generally do not have the authority to set individual capital requirements on credit unions, and consideration of an extended implementation period. We welcome the NCUA's willingness to make modifications in these areas, and we urge the Committee to continue to raise these issues with NCUA to ensure that the modifications are satisfactory to address the concerns raised by stakeholders.

Ensuring the Rule is Implemented Consistently with the Federal Credit Union Act
In addition, we strongly urge the Committee to take a very close look at whether NCUA has the authority under the Federal Credit Union Act to impose a risk-based capital requirement for the **well**-capitalized credit unions that is higher than the RBC requirement for adequately capitalized

credit unions. The law limits NCUA's authority in this area to establishing one risk-based capital requirement that is the same for adequately and well-capitalized credit unions.

> The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be **adequately** capitalized may not provide adequate protection.[1]

Because the RBC requirement for a well-capitalized credit union is higher than for an adequately capitalized credit union, the proposed rule exceeds NCUA's statutory authority. This is a matter that we urge the Committee to take very seriously. If NCUA feels that it needs the authority to implement a higher risk-based capital requirement for a credit union to be well-capitalized, it should ask Congress to amend the Federal Credit Union Act to provide such authority. Congress should not permit the NCUA to implement a rule in violation of the law. If NCUA proceeds with this requirement as proposed in the final rule, we urge Congress to step in to stop the implementation of the rule.

Urge NCUA to Submit the Revised Rule to Stakeholders for an Additional Comment Period
The level of stakeholder interest in this rule, measured by the volume of comments submitted to the NCUA, is unprecedented for an NCUA rulemaking procedure. Given the level of stakeholder concern and the public comments made by NCUA Board members and staff in recent months, it is highly unlikely that the Board will proceed to finalize the proposed rule without making significant changes. Whether these changes are significant enough to require NCUA, under the Administrative Procedures Act, to resubmit the proposal for comment will be a question that NCUA will have the authority to decide. We believe that the NCUA should put the modified rule out for comment regardless of whether it determines the law requires them to do so, and we urge the Committee to intervene to encourage NCUA to give stakeholders the opportunity to comment on the modified proposal prior to proceeding to finalizing the rule.

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[1] 12 USC 1790d(d)(2)